

# **NLV Financial Corporation and Subsidiaries**

**Financial Statements  
December 31, 2007 and 2006**

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**Index**  
**December 31, 2007 and 2006**

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**Report of Independent Auditors**

To the Board of Directors and Stockholder of  
NLV Financial Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in stockholder's equity and cash flows present fairly, in all material respects, the financial position of NLV Financial Corporation and its subsidiaries (the Company) at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for defined benefit pension and other postretirement plans on December 31, 2007. Additionally, as discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for interests in certain entities effective January 1, 2005.

*PricewaterhouseCoopers LLP*

February 22, 2008

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

**December 31,**

*(In Thousands)*

	2007	2006
<b>Assets:</b>		
Cash and investments:		
Available-for-sale debt securities	\$ 9,330,759	\$ 8,598,799
Available-for-sale debt securities on loan	265,784	378,925
Total available-for-sale debt securities	9,596,543	8,977,724
Available-for-sale equity securities	152,870	194,566
Trading equity securities	23,456	22,317
Mortgage loans on real estate	1,659,951	1,600,394
Policy loans	706,278	696,123
Real estate investments	19,112	20,679
Securities lending invested collateral	234,691	258,203
Other invested assets	358,757	375,809
Cash and cash equivalents	179,405	459,703
Total cash and investments	12,931,063	12,605,518
Deferred policy acquisition costs	969,875	901,214
Accrued investment income	139,898	130,711
Premiums and fees receivable	21,158	22,404
Deferred income taxes	2,786	5,796
Amounts recoverable from reinsurers	135,874	124,920
Present value of future profits of insurance acquired	42,749	47,795
Property and equipment, net	46,829	45,354
Federal income tax recoverable	1,647	5,566
Other assets	226,805	171,665
Separate account assets	983,815	941,376
<b>Total assets</b>	<b>\$15,502,499</b>	<b>\$15,002,319</b>
<b>Liabilities:</b>		
Policy liabilities:		
Policy benefit liabilities	\$ 4,648,082	\$ 4,622,595
Policyholder account liabilities	7,153,888	6,638,668
Policyholders' deposits	55,599	56,262
Policy claims payable	42,339	52,536
Policyholders' dividends	128,333	130,140
Total policy liabilities	12,028,241	11,500,201
Amounts payable to reinsurers	21,957	19,500
Securities lending payable	269,927	386,045
Other liabilities and accrued expenses	247,077	313,773
Pension and other post-retirement benefit obligations	168,451	167,192
Debt	294,713	294,679
Separate account liabilities	983,815	941,376
<b>Total liabilities</b>	<b>14,014,181</b>	<b>13,622,766</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	1,470,504	1,355,437
Accumulated other comprehensive income	17,814	24,116
<b>Total stockholder's equity</b>	<b>1,488,318</b>	<b>1,379,553</b>
<b>Total liabilities and stockholder's equity</b>	<b>\$15,502,499</b>	<b>\$15,002,319</b>

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

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

For the years ended December 31,

(In Thousands)

	2007	2006	2005
<b>Revenues:</b>			
Insurance premiums	\$ 322,328	\$ 336,007	\$ 347,547
Policy and contract charges	178,770	156,950	145,845
Net investment income	758,058	797,462	682,023
Net realized investment gains (losses)	(4,953)	1,122	2,146
Change in value of trading equity securities	847	1,538	155
Mutual fund commissions and fee income	104,017	105,919	103,100
Other income	21,800	18,563	17,596
<b>Total revenues</b>	<b>1,380,867</b>	<b>1,417,561</b>	<b>1,298,412</b>
<b>Benefits and Expenses:</b>			
Increase in policy liabilities	29,717	81,783	76,918
Policy benefits	411,267	349,718	356,332
Policyholders' dividends and dividend obligations	111,097	122,308	116,103
Interest credited to policyholder account liabilities	274,928	327,445	230,709
Operating expenses	169,600	174,797	159,180
Interest expense on debt	21,944	21,975	20,465
Early retirement of surplus notes and other financing	—	—	974
Policy acquisition expenses and amortization of present value of future profits, net	198,994	179,242	195,010
<b>Total benefits and expenses</b>	<b>1,217,547</b>	<b>1,257,268</b>	<b>1,155,691</b>
<b>Income before income taxes and minority interest</b>	<b>163,320</b>	<b>160,293</b>	<b>142,721</b>
Income tax expense	48,101	43,566	38,582
<b>Income before minority interest</b>	<b>115,219</b>	<b>116,727</b>	<b>104,139</b>
Minority interest in consolidated subsidiaries	—	(103)	1,237
<b>Net Income</b>	<b>\$ 115,219</b>	<b>\$ 116,830</b>	<b>\$ 102,902</b>

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

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY**

<i>(In Thousands)</i>	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
January 1, 2005	\$-	\$-	\$-	\$1,130,826	\$ 96,238	\$1,227,064
Opening Balance Adjustment				4,879		4,879
January 1, 2005 (Adj.) (See Note 2)				1,135,705	\$ 96,238	1,231,943
Comprehensive income:						
Net income	-	-	-	102,902	-	102,902
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(57,111)	(57,111)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net	-	-	-	-	(9,474)	(9,474)
Total comprehensive income						36,351
December 31, 2005	-	-	-	1,238,607	29,687	1,268,294
Comprehensive income:						
Net income	-	-	-	116,830	-	116,830
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(9,620)	(9,620)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net	-	-	-	-	4,015	4,015
Total comprehensive income						111,259
December 31, 2006	-	-	-	1,355,437	24,116	1,379,553
Cumulative effect of adoption of FIN 48	-	-	-	(152)	-	(152)
Comprehensive income:						
Net income	-	-	-	115,219	-	115,219
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(9,464)	(9,464)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net, prior to adoption of SFAS No. 158	-	-	-	-	11,263	11,263
Total comprehensive income						117,052
Adjustments for adoption of SFAS No. 158:						
Establishment of liability, net	-	-	-	-	(18,033)	(18,033)
Reduction of additional minimum pension liability, net	-	-	-	-	9,898	9,898
<b>December 31, 2007</b>	<b>\$-</b>	<b>\$-</b>	<b>\$-</b>	<b>\$1,470,504</b>	<b>\$ 17,814</b>	<b>\$1,488,318</b>

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

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the years ended December 31,

(In Thousands)

	2007	2006	2005
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 115,219	\$ 116,830	\$ 102,902
Adjustments to reconcile net income to net cash provided by operating activities:			
Changes in assets and liabilities:			
Accrued investment income	(9,187)	(3,364)	(5,040)
Policy acquisition costs	(66,360)	(83,564)	(48,907)
Policy benefit liabilities	35,585	43,992	39,937
Interest credited to policyholder account liabilities	274,928	327,445	230,709
Policy and contract charges	(178,770)	(156,950)	(145,845)
Other assets and liabilities	22,025	36,319	14,290
Provision for deferred income taxes	6,411	26,917	8,350
Net realized investment losses (gains)	4,953	(1,122)	(2,146)
Net options gains	(1,959)	(77,348)	(3,438)
Market value change on corporate owned life insurance policies	(5,706)	(4,037)	(2,862)
Change in present value of future profits of insurance acquired	6,172	8,176	8,796
Depreciation	6,941	8,276	10,498
Other	10,755	12,052	20,726
Net cash provided by operating activities	221,007	253,622	227,970
<b>Cash Flows from Investing Activities:</b>			
Proceeds from sales, maturities and repayments of investments	2,261,479	2,906,885	3,343,409
Cost of investments acquired	(3,030,297)	(3,438,464)	(4,143,967)
Change in policy loans	(10,155)	(4,476)	5,306
Change in securities lending invested collateral	23,512	(99,321)	(158,882)
Other	(16,895)	(10,316)	(26,463)
Net cash used by investing activities	(772,356)	(645,692)	(980,597)
<b>Cash Flows from Financing Activities:</b>			
Policyholders' deposits	1,125,012	1,047,595	909,404
Policyholders' withdrawals	(737,843)	(576,402)	(366,056)
Change in securities lending payable	(116,118)	18,659	346,089
Issuance of senior notes and other debt	-	-	146,705
Retirement of surplus notes and other debt	-	-	(44,853)
Other	-	-	(18,296)
Net cash provided by financing activities	271,051	489,852	972,993
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(280,298)</b>	<b>97,782</b>	<b>220,366</b>
<b>Cash and Cash Equivalents:</b>			
Beginning of year	459,703	361,921	141,555
End of year	\$ 179,405	\$ 459,703	\$ 361,921

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

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2007 and 2006**

**NOTE 1 – NATURE OF OPERATIONS**

NLV Financial Corporation (“NLVF”) and its subsidiaries and affiliates (the “Company”) offer a broad range of financial products and services, including life insurance, annuities, mutual funds, and investment advisory and administrative services. The flagship company of the organization, National Life Insurance Company (“National Life”), was chartered in 1848. The Company employs approximately 900 people, primarily concentrated in Montpelier, Vermont and Dallas, Texas. On January 1, 1999, pursuant to a mutual holding company reorganization, National Life converted from a mutual to a stock life insurance company. All of National Life’s outstanding shares are currently held by its parent, NLVF, which is a wholly-owned subsidiary of National Life Holding Company (“NLHC”). NLHC and its subsidiaries are collectively known as the National Life Group. Concurrent with the conversion to a stock life insurance company, National Life created a closed block of insurance and annuity policies (the “Closed Block”).

The Company’s insurance operations develop and distribute individual life insurance and annuity products. The Company markets this diverse product portfolio to small business owners, professionals, and other middle to upper income individuals. The Company provides financial solutions in the form of estate, business succession and retirement planning, deferred compensation and other key executive benefit plans, and asset management services. Insurance and annuity products are primarily distributed through twenty-one general agencies in major metropolitan areas and a system of marketing general agents and independent marketing organizations throughout the United States of America. The Company has in excess of 515,000 policyholders and is licensed to do business in all 50 states and the District of Columbia through its member companies. About 30% of the Company’s total collected premiums and deposits are from residents of the states of New York and California.

Through Sentinel Asset Management, Inc. (“SAMI”) and its subsidiaries and affiliates, the Company also distributes and provides investment advisory and administrative services to the Sentinel Group Funds, Inc. (“Sentinel Funds”). The Sentinel Funds’ \$4.7 billion of net assets represent fifteen mutual funds managed on behalf of about 206,000 individual, corporate, and institutional shareholders worldwide.

During 2006, the Company sold its subsidiary, American Guaranty and Trust Company (“AG&T”), to an unrelated party. The Company also sold its interest in a consolidated real estate partnership to an entity controlled by the minority interest partner of the partnership.

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation and Principles of Consolidation**

The accompanying consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”).

The consolidated financial statements of the Company include the accounts of NLVF and its direct and indirect subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Certain reclassifications have been made to conform prior periods to the current year’s presentation.

These financials were previously issued by the Company. Subsequent to their issuance, the Company discovered that a significant portion of the collateral held under the Company’s securities lending program was misclassified as cash and cash equivalents as of December 31, 2007, 2006, and 2005. The reissued financial statement presentation in the Company’s Consolidated Balance Sheets reflects the reclassification of \$234.7 million and \$258.2 million from cash and cash equivalents to securities lending invested collateral as of December 31, 2007 and 2006, respectively. Beginning of year and end of year cash and cash equivalents balances were adjusted on the Company’s Consolidated Statements of Cash

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Basis of Presentation and Principles of Consolidation (continued)**

Flows for the balances reported for 2007 and 2006. In addition, the December 31, 2005 cash and cash equivalent balance was adjusted to reflect the misclassification by \$158.9 million. These changes resulted in net cash used by investing activities to be increased (decreased) by \$(23.5) million, \$99.3 million, and \$158.9 million for the years ended December 31, 2007, 2006, and 2005, respectively, for changes in securities lending invested collateral. These changes also resulted in the net increase (decrease) in cash and cash equivalents line item to be increased (decreased) by \$23.5 million, \$(99.3) million, and \$(158.9) million for the years ended December 31, 2007, 2006, and 2005. The Company's disclosure about its securities lending program and its fair value of financial instruments has also been modified (See Note 4). The Company reclassified \$50.3 million and \$26.9 million from cash and cash equivalents to securities lending invested collateral as of December 31, 2007 and 2006, respectively within the Closed Block (See Note 11).

In the second quarter of 2008, subsequent to the issuance of these consolidated financial statements, the Company identified errors in its equity-indexed annuity reserve liability calculation. Based on this matter, the Company identified that these errors resulted in inaccuracies in the presentation of certain line items within the Company's consolidated balance sheets, consolidated statements of operations, and consolidated statements of changes in stockholder's equity as well as net income and certain line items as reported on the consolidated statements of cash flows for the years ended December 31, 2005, 2006 and 2007. It should be noted that although certain line items were reported inaccurately on the statements of cash flows, there is no impact to the overall cash flow of the Company in any of the noted reporting periods. The error did not result in a material impact to the net book value or the earnings of the Company in any reported period. Corrected financial statement balances and accompanying footnotes are currently reflected in this presentation. The cumulative impact of the error prior to January 1, 2005 totaled \$4.9 million and is reflected as an adjustment to opening retained earnings as of January 1, 2005 on the consolidated statements of changes in stockholder's equity.

As a result of the error, total stockholder's equity and net income have been understated for the years noted. The accumulated impact of the errors to stockholder's equity is \$22.7 million (1.6% increase) as of December 31, 2007. More specifically, on the consolidated balance sheets of the years noted, policy account liabilities and deferred income taxes were overstated and deferred policy acquisition costs were understated. On the consolidated statements of operations, interest credited to policyholder account liabilities, and policy acquisition expense and amortization of the present value of future profits, net were overstated and income tax expense was understated.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2007 and 2006**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Basis of Presentation and Principles of Consolidation (continued)**

To more thoroughly understand the impacts of the error on the financial statements, the following tables are provided to disclose the adjustments to the financial statement line items impacted.

Consolidated Balance Sheet Statement

<i>(In Thousands)</i>	<u>Year Ended December 31, 2007</u>		
	As Adjusted	As previously reported	Effect of change
	Deferred policy acquisition costs	969,875	966,238
Deferred income taxes	2,786	15,031	(12,245)
Policyholder account liabilities	7,153,888	7,185,237	(31,349)
Retained Earnings	1,470,504	1,447,763	22,741

  

<i>(In Thousands)</i>	<u>Year Ended December 31, 2006</u>		
	As Adjusted	As previously reported	Effect of change
	Deferred policy acquisition costs	901,214	899,032
Deferred income taxes	5,796	14,683	(8,887)
Policyholder account liabilities	6,638,668	6,661,878	(23,210)
Retained Earnings	1,355,437	1,338,932	16,505

Consolidated Statement of Operations

<i>(In Thousands)</i>	<u>Year Ended December 31, 2007</u>		
	As Adjusted	As previously reported	Effect of change
	Interest credited to policyholder account liabilities	274,928	283,111
Policy acquisition expenses and amortization of present value of future profits, net	198,994	200,405	(1,411)
Income tax expense	48,101	44,743	3,358
Net Income	115,219	108,983	6,236

  

<i>(In Thousands)</i>	<u>Year Ended December 31, 2006</u>		
	As Adjusted	As previously reported	Effect of change
	Interest credited to policyholder account liabilities	327,445	336,650
Policy acquisition expenses and amortization of present value of future profits, net	179,242	179,549	(307)
Income tax expense	43,566	40,237	3,329
Net Income	116,830	110,647	6,183

  

<i>(In Thousands)</i>	<u>Year Ended December 31, 2005</u>		
	As Adjusted	As previously reported	Effect of change
	Interest credited to policyholder account liabilities	230,709	238,444
Policy acquisition expenses and amortization of present value of future profits, net	195,010	195,649	(639)
Income tax expense	38,582	35,651	2,931
Net Income	102,902	97,459	5,443

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Basis of Presentation and Principles of Consolidation (continued)**

*Consolidated Statement of Cash Flow*

<i>(In Thousands)</i>	Year Ended December 31, 2007		
	As Adjusted	As previously reported	Effect of change
Net Income	115,219	108,983	6,236
Policy acquisition costs	(66,360)	(64,949)	(1,411)
Interest credited to policyholder account liabilities	274,928	283,111	(8,183)
Provision for deferred income taxes	6,411	3,053	3,358
	Year Ended December 31, 2006		
<i>(In Thousands)</i>	As Adjusted	As previously reported	Effect of change
Net Income	116,830	110,647	6,183
Policy acquisition costs	(83,564)	(83,257)	(307)
Interest credited to policyholder account liabilities	327,445	336,650	(9,205)
Provision for deferred income taxes	26,917	23,588	3,329
	Year Ended December 31, 2005		
<i>(In Thousands)</i>	As Adjusted	As previously reported	Effect of change
Net Income	102,902	97,459	5,443
Policy acquisition costs	(48,907)	(48,268)	(639)
Interest credited to policyholder account liabilities	230,709	238,444	(7,735)
Provision for deferred income taxes	8,350	5,419	2,931

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Investments**

Available-for-sale debt and equity securities are reported at estimated fair value. Available-for-sale debt and equity securities that experience declines in value are regularly evaluated for other than temporary impairments. Impairment losses for declines in value of fixed maturity investments and equity securities below cost attributable to issuer-specific events are based upon all relevant facts and circumstances for each investment and are recognized as realized losses when deemed to be other than temporary. For such securities, realized losses are recorded to reduce amortized cost to fair value. For actively traded securities, fair value is generally quoted market price.

Loan-backed securities are reported at estimated fair value. Prepayment assumptions used in the calculation of the effective yield are based on available industry sources and information provided by lenders. The retrospective adjustment methodology is used for the valuation of securities, with the amortized cost of the security adjusted in the current period for anticipated changes in future cash flows.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **Investments (continued)**

Market values for available-for-sale debt and equity securities with quoted market prices are based on Interactive Data pricing obtained through HUB Data, Inc. Market values are estimated using an internal pricing matrix using spread pricing for privately placed or other securities when quoted market prices are not available.

Beneficial interests in securitized financial assets which experience changes in expected future cash flows are written down to fair value with the resulting change included in net realized investment gains (losses).

Trading equity securities are reported at estimated fair value. Realized and unrealized gains and losses on trading equity securities are included in change in value of trading equity securities.

Mortgage loans are reported at amortized cost, less valuation allowances for the excess, if any, of the amortized cost of impaired loans over the estimated fair value of the related collateral. Changes in valuation allowances are included in net realized investment gains (losses).

Policy loans are reported at their unpaid balance and are fully collateralized by related cash surrender values.

Real estate investments held for investment purposes are reported at depreciated cost. Real estate acquired in satisfaction of debt is generally held for investment and is transferred to real estate at the lower of cost or estimated fair value. In establishing real estate reserves, the Company considers, among other things, the estimated fair value of the real estate compared to depreciated cost. Real estate held for sale is held at the lower of cost or estimated fair value less estimated selling costs.

Long options and futures contracts are included in other invested assets and carried at estimated fair value. Short options contracts are included in other liabilities and accrued expenses and carried at estimated fair value. The estimated fair values of derivatives are based on quoted values. Changes in fair value are reflected in the statements of operations as a component of net investment income.

Investments in unconsolidated partnerships are included in other invested assets and are recorded at the Company's underlying share of the partnership's equity, which approximates fair value. Impairments are recorded in net realized investment gains and losses if future earnings are projected to be less than the carrying value of the investment. Changes in the fair value of limited partnerships are included in change in unrealized gains on available-for-sale securities, net of related deferred income taxes.

Investments in affordable housing tax credit limited partnerships are accounted for using the equity method, and included in other invested assets. These investments are amortized using the effective yield method within net investment income.

Realized investment gains and losses are recognized using the specific identification method and are reported as net realized investment gains (losses). Changes in the estimated fair values of available-for-sale debt and equity securities are reflected in other comprehensive income after adjustments for related deferred policy acquisition costs, present value of future profits of insurance acquired, policyholder dividend obligations, and deferred income taxes.

Cash and cash equivalents include highly liquid debt instruments purchased with remaining maturities of three months or less.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **Policy Acquisition Expenses**

Commissions and other costs of acquiring business that vary with and are primarily attributable to the production of new business are generally deferred.

Deferred policy acquisition costs for participating life insurance, universal life insurance, and investment-type annuities are amortized in relation to estimated gross margins. Amortization is adjusted retrospectively for actual experience and when estimates of future gross margins are revised. Future gross margins may be revised due to changes in projected investment rates, mortality assumptions, expenses, contract lapses, withdrawals, and surrenders. Deferred policy acquisition costs for these products are adjusted for related unrealized gains and losses on available-for-sale debt and equity securities (after deducting any related policyholder dividend obligations) through other comprehensive income, net of related deferred income taxes.

Deferred policy acquisition costs for non-participating term life insurance and disability income insurance are amortized in relation to premium income using assumptions consistent with those used in computing policy benefit liabilities.

A significant assumption in projecting estimated gross profits for universal life and annuity contracts is the difference between the earned interest rate and the credited interest rate. Another significant assumption is the rate of investment return on the assets held in variable product separate accounts. Gross profits for the variable life and variable annuity products in these separate accounts include charges assessed based on separate account asset levels.

In 2007, the Company updated its assumptions related to the deferral of agent benefits, resulting in an additional \$2.8 million of agent benefit costs being deferred in 2007. The Company also revised its utilization rate of free partial withdrawal assumption on annuity products resulting in increased amortization of \$7.6 million in 2007. In addition, the Company revised its surrender and investment spread assumptions resulting in increased (decreased) amortization of \$1.9 million and \$(2.1) million, respectively, in 2007 on non-indexed life and annuity products.

In 2006, the Company completed a review of deferred underwriting and issuance costs resulting in the standardization of its deferral policy to provide consistency throughout the Company. As a result, an additional \$3.8 million of underwriting and issuance costs were deferred in 2006.

Deferred policy acquisition costs assets are regularly evaluated for recoverability from product margins. In 2006, the Company amortized the remaining \$1.2 million of deferred acquisition costs on its COLI line of business due to the expectation that future expenses associated with the underlying policies will exceed future profit margins.

In 2006, the Company changed its mortality assumption which increased future estimated gross profits resulting in reduced amortization of \$3.8 million. The Company also reflected the impact of revenue sharing in the separate accounts of variable products for both historical and projected expected gross profits thereby increasing future estimated gross profits. This change resulted in reduced amortization of \$1.9 million.

In 2005, the Company amortized the remaining \$11.0 million of deferred acquisition costs on disability income contracts as a result of management's evaluation of recoverability from future product margins.

In 2005, there were changes in individual assumptions used in the calculation of unamortized deferred policy acquisition costs assets. These changes collectively had no significant earnings impact in 2005.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **Policy Acquisition Expenses (continued)**

In 2005, the Company updated substantially all assumptions underlying the calculation of amortization of deferred acquisition costs associated with Closed Block policies, in conjunction with revisions to the dividend scales applying to these policies.

In 2005, the Company also changed its methodology for universal life and annuity contracts to project that its current investment income rates would remain constant in future years, but that credited interest rates would grade to those implied by product pricing margins over a five year period. Previously, the Company had assumed that the then current interest rate environment would not persist, and that new investment interest rates would increase to more typical levels of 7.0% - 7.5% by 2007.

The assumed rate of investment return on the assets held in variable product separate accounts (after deduction of fund fees and mortality and expense charges) was 8.00% in 2007 and 2006.

##### **Present Value of Future Profits of Insurance Acquired**

Present value of future profits of insurance acquired ("PVFP") is the actuarially-determined present value of future projected profits from policies in force at the date of their acquisition, and is amortized in relation to the gross profits of those policies. Amortization is adjusted retrospectively for actual experience and when estimates of future profits are revised. The PVFP asset is also adjusted for related unrealized gains and losses on available-for-sale debt and equity securities through other comprehensive income, net of related deferred income taxes.

##### **Goodwill and Other Intangible Assets**

Goodwill and other intangible assets having indefinite useful lives are tested at least annually for impairment. Intangible assets with finite useful lives are amortized over those lives. Total goodwill was \$8.2 million and \$8.5 million at December 31, 2007 and 2006, respectively, and was included in other assets. Total other intangible assets were \$23.3 million and \$16.3 million at December 31, 2007 and 2006, respectively, and were included in other assets. The net change in goodwill and other intangible assets in 2007 is due to the purchase of assets related to the investment advisory and management of mutual fund assets which were reorganized into the Sentinel Funds, offset by impairment reductions. Goodwill was reduced by \$0.4 million and other intangible assets were reduced by \$1.5 million in 2007 due to impairment. There were no reductions in goodwill or other intangible assets due to impairment during 2006 or 2005. Goodwill was reduced by \$0.4 million in 2006 resulting from the sale of AG&T.

##### **Property and Equipment**

Property and equipment is reported at depreciated cost. Real property is primarily depreciated over 39.5 years using the straight-line method. Furniture and equipment is depreciated using accelerated depreciation methods over 7 years and 5 years, respectively.

##### **Corporate Owned Life Insurance**

The Company holds life insurance contracts on certain members of management and other key individuals. The total cash surrender value of these Corporate Owned Life Insurance ("COLI") contracts was \$147.2 million and \$99.7 million at December 31, 2007 and 2006, respectively, and is included in other assets. Approximately 58% and 76% of the total COLI cash surrender value was held at declared interest, with the remainder held in segregated variable separate account funds at December 31, 2007 and 2006, respectively.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **Corporate Owned Life Insurance (continued)**

COLI income includes the net change in cash surrender value and any benefits received. COLI income was \$5.7 million, \$6.2 million, and \$7.0 million in 2007, 2006, and 2005, respectively, and is included in other income.

##### **Separate Accounts**

Separate accounts are segregated funds relating to certain variable annuity policies, variable life policies, and the Company's pension plans. Separate account assets are primarily common stocks and bonds and are carried at estimated fair value. Separate account liabilities, which reflect separate account policyholders' interests in separate account assets, reflect the actual investment performance of the respective accounts. Minimum guarantees related to separate account policies are included in policy liabilities. Separate account results relating to policyholders' interests are excluded from the Company's consolidated operations.

##### **Policy Liabilities**

Policy benefit liabilities for participating life insurance are developed using the net level premium method, with interest and mortality assumptions used in calculating policy cash surrender values. Participating life insurance terminal dividend reserves are accrued in relation to gross margins, and are included in policy benefit liabilities.

Policy benefit liabilities for non-participating life insurance, disability income insurance, and certain annuities are developed using the net level premium method with assumptions for interest, mortality, morbidity, and voluntary terminations. In addition, disability income policy benefit liabilities include provisions for future claim administration expenses.

Policyholder account liabilities for non-indexed life insurance (universal life products) and investment-type annuities represent amounts that inure to the benefit of the policyholders before surrender charges. Policyholder account balances for indexed life insurance and annuity liabilities consist of a combination of underlying host contract and embedded derivative values. The underlying host contract is primarily based on policy guarantees and its initial value is determined at the time of premium payment. Thereafter, the host contract liability increases with interest to reach the guaranteed value at projected maturity. The embedded derivative component is based on the fair value of the contract's expected participation in future increases in the S&P 500 or Russell 2000 indexes. The fair value of the embedded derivative component includes assumptions about future interest rates and interest rate structures, future costs for options used to hedge the contract obligations, and the level and limits on contract participation in any future increases in the S&P 500 or Russell 2000 indexes.

As previously mentioned, the Company revised its utilization rate of free partial withdrawal assumption on indexed annuity products resulting in a reduction of policyholder account liabilities of \$7.6 million in 2007.

The guaranteed minimum interest rates for the Company's fixed interest rate annuities range from 1.5% to 4.5%. As of December 31, 2007 and 2006, less than 2% of the contracts in force had a credited rate below 3%. The guaranteed minimum interest rates for the Company's fixed interest rate universal life insurance policies range from 3% to 4.5%. These guaranteed minimum rates are before deduction for any policy administration fees or mortality charges.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

##### **Policy Liabilities (continued)**

Reserves are established, as appropriate, for separate account product guarantees. The most significant of these relates to a guaranteed minimum death benefit on variable annuities equal to the amount of premiums paid less prior withdrawals (regardless of investment performance). In addition, a policyholder less than seventy-six years of age may elect, at issue, to purchase an enhanced death benefit rider, which pays a benefit on death equal to the sum of the highest prior anniversary value and the net of premiums received and funds withdrawn since that date. The average age of policyholders with the enhanced death benefit rider at December 31, 2007 was fifty-six. Coverage from this rider ceases at age eighty. Guaranteed death benefits are reduced dollar-for-dollar for partial withdrawals, which increases the risk profile of this benefit. Partial withdrawals from policies issued after November 1, 2003, will use the pro-rata method. Policyholder partial withdrawals to date have not been significant. Separate account product guarantee reserves are calculated as a percentage of collected mortality and expense risk and rider charges, with the current period change in reserves reflected in policyholder benefits.

The Company offers various sales incentives including bonus interest credited on its annuity products at the point of sale, as well as higher interest crediting rates in the first policy year. The Company capitalizes and amortizes these incentives to the extent they are in excess of expected policy benefits and interest credits provided in renewal years. These incentives are amortized based on the underlying gross margins of the products, with amortization adjusted periodically to reflect actual experience. The Company capitalized sales inducement costs of \$4.7 and \$5.3 million and recorded net amortization of \$2.8 and \$2.6 million during 2007 and 2006, respectively. Sales inducement assets were \$13.6 and \$11.7 million at December 31, 2007 and 2006, respectively.

The Company also offers persistency bonuses on certain products, whereby contract holders can receive additional interest credits by maintaining their policy in force for predetermined durations. These additional interest credits are accrued ratably over the bonus period and adjusted for actual persistency. The Company accrued sales inducement liabilities of \$0.2 million during 2007 and 2006 and recorded net increases for amortization and unlocking of \$0.3 and \$0.9 million during 2007 and 2006, respectively. Sales inducement liabilities were \$9.7 and \$9.2 million at December 31, 2007 and 2006, respectively.

##### **Reinsurance**

The Company reinsures certain risks assumed in the normal course of business to other companies. The Company assumes a small amount of reinsurance from other companies. These reinsurance arrangements provide for greater diversification of business, allow management to control exposure to potential losses arising from large risks, and provide additional capacity for growth.

Amounts recoverable from and payable to reinsurers are estimated in a manner consistent with the related liabilities associated with the reinsured policies. Reinsurance premiums and benefits paid or provided are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

##### **Policyholders' Dividends and Dividend Obligations**

Policyholders' dividends consist of the pro-rata amount of dividends earned that will be paid or credited at the next policy anniversary and policyholder dividend obligations arising from the Closed Block. Dividends are based on a scale that seeks to reflect the relative contribution of each group of policies to National Life's overall operating results. The dividend scale is approved annually by National Life's Board of Directors.

# NLV FINANCIAL CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

### NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Policyholder Deposits

Policyholder deposits primarily consist of death benefits held in interest-bearing accounts for life insurance contract beneficiaries.

#### Recognition of Insurance Revenues and Related Expenses

Premiums from traditional life and certain annuities are recognized as revenue when due from the policyholder. Benefits and expenses are matched with income by providing for policy benefit liabilities and the deferral and amortization of policy acquisition costs so as to recognize profits over the life of the policies.

Premiums and surrenders from universal life and investment-type annuities are reported as increases and decreases, respectively, in policyholder account liabilities. Revenues for these policies consist of mortality charges, policy administration fees, and surrender charges deducted from policyholder account liabilities. Policy benefits charged to expense include benefit claims in excess of related policyholder account liabilities. Premiums from disability income policies are recognized as revenue over the period to which the premiums relate. Benefits and expenses are matched with income by providing for policy benefit liabilities and the deferral and amortization of policy acquisition costs so as to recognize profits over the life of the policies.

#### Federal Income Taxes

NLHC will file a consolidated tax return for the tax year ended December 31, 2007. The income tax return will include NLHC and all members within the Company. Current federal income taxes are charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. Deferred income tax assets and liabilities are recognized based on temporary differences between financial statement carrying amounts and income tax bases of assets and liabilities using enacted income tax rates and laws.

#### Minority Interests

Minority interests represented minority partners' interests in entities within the Company. Minority interests attributable to common stockholders are carried on the equity method. Those attributable to preferred stockholders are carried on the cost method, with dividends paid reflected as minority interests expense within the consolidated financial statements.

During 2006, the Company sold its interests in two entities within the Company which had minority interests. There are no remaining minority interests in entities within the Company.

In late 2005, the Company purchased most of the remaining minority interests held by outside investors. On October 1, 2005, \$5 million of mandatory redeemable preferred stock issued by an affiliate of SAMI was redeemed by the Company for \$5,974,000. An early retirement premium of \$974,000 is included in early retirement of surplus notes and other financing expense.

### NOTE 3 – CHANGES IN ACCOUNTING PRINCIPLES

**Financial Accounting Standards Board Interpretation No. 48 – Accounting for Uncertainty in Income Taxes – an interpretation of Financial Accounting Standards Board Statement No. 109.** In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 requires an entity to determine whether it is

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 3 – CHANGES IN ACCOUNTING PRINCIPLES (continued)

“more likely than not” that an individual tax position will be sustained upon examination by the appropriate taxing authority prior to any part of the benefit being recognized in the financial statements. The amount recognized would be the largest amount of tax benefit that is greater than fifty percent likely of being realized upon ultimate settlement, along with any related interest and penalties (if applicable). Upon adoption of FIN 48, the guidance will be applied to all tax positions, and only those tax positions meeting the “more likely than not” threshold will be recognized or continue to be recognized in the financial statements. In addition, FIN 48 expands disclosure requirements to include additional information related to unrecognized tax benefits, including accrued interest and penalties, and uncertain tax positions where the estimate of the tax benefit may change significantly in the next twelve months. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 effective January 1, 2007 by recording an increase in the liability for unrecognized tax benefits of \$152,000 in its Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings.

**SFAS No. 155 – Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140.** In February 2006, the FASB issued SFAS No. 155, *“Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140”* (“SFAS 155”) which permits fair value remeasurement for a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Under SFAS 155, an entity may make an irrevocable election to measure a hybrid financial instrument at fair value, in its entirety, with changes in fair value recognized in earnings. SFAS 155 also: (a) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, *“Accounting for Derivative Instruments and Hedging Activities”*; (b) eliminates the interim guidance in SFAS 133 Implementation Issue No. D1, *“Application of Statement 133 to Beneficial Interests in Securitized Financial Assets,”* and establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are either freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation; (c) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (d) eliminates restrictions on a qualifying special-purpose entity’s ability to hold passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument.

In December 2006, the FASB issued Derivative Implementation Group Statement 133 Implementation Issue No. B40, *“Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets”* (“DIG B40”). Since SFAS 155 eliminated the interim guidance related to securitized financial assets, DIG B40 provides a narrow scope exception for securitized interests that contain only an embedded derivative related to prepayment risk. Under DIG B40, a securitized interest in prepayable financial assets would not be subject to bifurcation if: (a) the right to accelerate the settlement of the securitized interest cannot be controlled by the investor and (b) the securitized interest itself does not contain an embedded derivative for which bifurcation would be required other than an embedded derivative that results solely from the embedded call options in the underlying financial assets. Any other terms in the securitized financial asset that may affect cash flow in a manner similar to a derivative instrument would be subject to the requirements of paragraph 13(b) of SFAS 133. The guidance in DIG B40 is to be applied upon the adoption of SFAS 155.

The Company adopted the provisions SFAS 155 and DIG B40 on January 1, 2007. The adoption of SFAS 155 did not have a material impact on the Company’s consolidated financial condition or results of operations.

**SFAS No. 158 - Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R).** In September 2006, the FASB issued SFAS No. 158, *“Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)”* (“SFAS 158”). The guidance requires the Company to recognize on the balance sheet the funded status of its defined

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 3 – CHANGES IN ACCOUNTING PRINCIPLES (continued)

benefit postretirement plans as either an asset or liability, depending on the plans' funded status, with changes in the funded status recognized through other comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation, for pension plans, or the accumulated postretirement benefit obligation for postretirement benefit plans. Prior service costs or credits and net actuarial gains or losses which are not recognized in current net periodic benefit cost, pursuant to SFAS No. 87, "Employers' Account for Pensions" or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," must be recognized in other comprehensive income, net of tax, in the period in which they occur. As these items are recognized in net periodic benefit cost, the amounts accumulated in other comprehensive income are adjusted. Disclosure requirements have also been expanded to separately provide information on the prior service costs or credits and net gains and losses recognized in other comprehensive income and their effects on net periodic benefit costs. SFAS 158 is effective for fiscal years ending after June 15, 2007 and is applied prospectively. The Company adopted the recognition provision of SFAS 158 as of December 31, 2007. See Note 8 for more information regarding the Company's adoption of SFAS 158.

The Company will also be required to measure plan assets and benefit obligations at its fiscal year-end beginning in 2008 under SFAS 158. Net periodic benefit cost from October 1, 2007 to December 31, 2007, net of tax, will be recognized as a separate adjustment to the opening balance of retained earnings and is expected to approximate \$2.6 million.

**SOP 05-01 – Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts.** In September, 2005, the Accounting Standards Executive Committee issued SOP 05-01, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts" ("SOP 05-01"). SOP 05-01 provides guidance on internal replacement of insurance and investment contracts, whereby an existing policyholder exchanges a current contract for a new contract, and whether certain acquisition costs associated with the original contract may continue to be deferred or must be expensed immediately. Under the terms of SOP 05-01, internal replacements qualifying for continued deferral of original acquisition costs must demonstrate that the new contract is substantially unchanged from the original contract, including coverage provided, insured individual, investment returns, and any dividend participation rights. SOP 05-01 is effective for fiscal years beginning after December 15, 2006.

The Company adopted the provisions of SOP 05-01 on January 1, 2007. The adoption of SOP 05-01 did not have a material impact on the Company's consolidated financial position or results of operations.

**FSP 115-1 - The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.** In November 2005, the FASB issued FASB Staff Position ("FSP") FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP 115-1"). The guidance in FSP 115-1 nullifies the accounting and measurement provisions of Emerging Issues Task Force No. 03-1 - "The Meaning of Other Than Temporary Impairments and Its Application to Certain Investments" references existing guidance, and supersedes EITF Topic No. D-44 "Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value." FSP 115-1 was effective for reporting periods beginning after December 15, 2005, on a prospective basis. The Company's existing policy for recognizing other-than-temporary impairments is consistent with the guidance in FSP 115-1, and includes the recognition of other than temporary impairments of securities resulting from credit related issues as well as declines in fair value related to rising interest rates, where the Company does not have the intent to hold the securities until either maturity or recovery. The Company applied the principles of FSP 115-1 effective January 1, 2006. The initial application of FSP 115-1 did not have a material effect on the Company's consolidated financial condition or results of operations.

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 3 – CHANGES IN ACCOUNTING PRINCIPLES (continued)

**FIN 46R – Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51.** In December 2003, the FASB revised No. 46, "*Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51.*" Accounting Research Bulletin, No. 51, "*Consolidated Financial Statements*" ("ARB 51") states that consolidation is usually necessary when a company has a "controlling financial interest" in another company, a condition most commonly achieved through ownership of a majority voting interest. FIN 46R clarifies the application of ARB 51, to certain "variable interest entities" ("VIE") and addresses consolidation by business enterprises of VIEs where the equity investment at risk is not sufficient to permit the entity to finance its activities without additional support, where the equity investors lack one or more characteristics of a controlling financial interest, or where the equity investors have voting rights that are disproportionate to their economic interests. The Company adopted FIN 46R on January 1, 2005.

The Company had a 60% partnership interest in Lake Carlton Arms ("LCA"), a 1,812-unit apartment complex in Florida. LCA assets of \$31.1 million, liabilities of \$46.3 million, and a partnership deficit of \$15.2 million were consolidated with those of the Company on January 1, 2005 due to the Company's adoption of FIN 46R. In addition, a receivable from the minority partner of \$6.1 million was established for minority partner withdrawals in excess of accumulated earnings and is included in other assets. There was no impact on net income. The Company sold its interest in LCA in late 2006, which resulted in a gain of \$30.6 million and deconsolidation of the entity. LCA assets of \$31.6 million, liabilities of \$70.5 million, including a mortgage note of \$67.5 million, and a partnership deficit of \$38.9 million were deconsolidated upon the sale of the interest on October 29, 2006.

The Company created NL Group Statutory Trust I, a statutory trust company ("STT"), as a wholly-owned subsidiary of NLVF during 2003. Prior to the Company's adoption of FIN 46R, STT was a consolidated entity within the Company's financial statements. Under the provisions of FIN 46R, management currently believes that the primary beneficiary of STT is the special purpose pool holding STT's trust preferred capital securities. Adoption of FIN 46R therefore required deconsolidation of STT, with a corresponding increase of \$0.6 million in the Company's available-for-sale equity securities and debt outstanding on January 1, 2005.

**SFAS No. 157 – Fair Value Measurements.** In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value under current accounting pronouncements that require or permit fair value measurement and enhances disclosures about fair value instruments. SFAS 157 retains the exchange price notion, but clarifies that exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability (exit price) in the most advantageous market for that asset or liability, as opposed to the price that would be paid to acquire the asset or receive a liability (entry price). Fair value measurement is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset, or nonperformance risk which would include the reporting entity's own credit risk. SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The highest priority is given to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs in situations where there is little or no market activity for the asset or liability. In addition, SFAS 157 expands the disclosure requirements for annual and interim reporting to focus on the inputs used to measure fair value, including those measurements using significant unobservable inputs, and the effects of the measurements on earnings. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007. Retrospective application is required for certain financial instruments as a cumulative effect adjustment to the opening balance of retained earnings. The Company expects to adopt SFAS 157 effective January 1, 2008, and is currently evaluating the effects of SFAS 157 on its consolidated financial condition and results of operations.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 3 – CHANGES IN ACCOUNTING PRINCIPLES (continued)**

**SFAS No. 159 – The Fair Value Option for Financial Assets and Financial Liabilities.** In February 2007, the FASB issued SFAS No. 159, “*The Fair Value Option for Financial Assets and Financial Liabilities*” (“SFAS 159”), which allows an entity to make an irrevocable election, on specific election dates, to measure eligible items at fair value. The election to measure an item at fair value may be determined on an instrument by instrument basis, with certain exceptions. If the fair value option is elected, unrealized gains and losses will be recognized in earnings at each subsequent reporting date, and any upfront costs and fees related to the item will be recognized in earnings as incurred. In addition, the presentation and disclosure requirements of SFAS 159 are designed to assist in the comparison between entities that select different measurement attributes for similar types of assets and liabilities. SFAS 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has also elected to apply the provisions of SFAS 157. At the effective date, the fair value option may be elected for eligible items that exist on that date. The effect of the first remeasurement to fair value shall be reported as a cumulative effect adjustment to the opening balance of retained earnings. The Company expects to adopt SFAS 159 effective January 1, 2008, and is currently evaluating the items to which it may apply the fair value option and the effect on its consolidated financial condition and results of operations.

**NOTE 4 – INVESTMENTS**

**Available-for-Sale Debt and Equity Securities**

The amortized cost of available-for-sale (“AFS”) debt securities and cost for AFS equity securities and estimated fair values for both at December 31 are as follows (in thousands):

<b>2007</b>	<b>Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
AFS debt and equity securities:				
U.S. government obligations	\$ 38,768	\$ 1,449	\$ –	\$ 40,217
Government agencies, authorities and subdivisions	81,872	5,303	–	87,175
Corporate:				
Communications	654,441	26,622	6,784	674,279
Consumer & retail	880,250	17,764	17,609	880,405
Financial institutions	1,323,431	27,494	49,622	1,301,303
Industrial and chemicals	637,738	17,441	11,299	643,880
Other corporate	82,070	9,676	37	91,709
REITS	173,181	1,072	5,272	168,981
Transportation	146,921	5,523	2,074	150,370
Utilities	1,304,837	44,025	15,377	1,333,485
Total corporate	5,202,869	149,617	108,074	5,244,412
Private placements	909,762	26,403	8,704	927,461
Mortgage-backed securities	3,288,850	34,956	26,528	3,297,278
Total AFS debt securities	9,522,121	217,728	143,306	9,596,543
Preferred stocks	98,942	2,347	6,220	95,069
Common stocks	48,761	10,658	1,618	57,801
Total AFS equity securities	147,703	13,005	7,838	152,870
Total AFS debt and equity securities	\$9,669,824	\$230,733	\$151,144	\$9,749,413

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Available-for-Sale Debt and Equity Securities (continued)**

2006	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
AFS debt and equity securities:				
U.S. government obligations	\$ 65,650	\$ 129	\$ 297	\$ 65,482
Government agencies, authorities and subdivisions	235,668	2,948	2,468	236,148
Corporate:				
Communications	609,853	26,628	6,709	629,772
Consumer & retail	723,984	13,416	9,778	727,622
Financial institutions	1,230,970	32,062	13,650	1,249,382
Industrial and chemicals	560,521	18,577	6,755	572,343
Other corporate	88,808	9,351	–	98,159
REITS	159,989	2,755	1,673	161,071
Transportation	122,862	4,907	1,437	126,332
Utilities	1,072,075	40,984	12,823	1,100,236
Total corporate	4,569,062	148,680	52,825	4,664,917
Private placements	835,592	23,467	9,806	849,253
Mortgage-backed securities	3,177,448	19,791	35,315	3,161,924
Total AFS debt securities	8,883,420	195,015	100,711	8,977,724
Preferred stocks	122,979	4,207	937	126,249
Common stocks	52,253	16,231	167	68,317
Total AFS equity securities	175,232	20,438	1,104	194,566
Total AFS debt and equity securities	\$ 9,058,652	\$ 215,453	\$ 101,815	\$ 9,172,290

Unrealized gains and losses on available-for-sale debt and equity securities included as a component of accumulated other comprehensive income and changes therein for the years ended December 31 were as follows (in thousands):

	2007	2006	2005
Net unrealized gains (losses) on available-for-sale securities	<b>\$(34,049)</b>	\$(69,569)	\$(229,125)
Net unrealized gains on separate accounts	<b>256</b>	407	178
Net unrealized gains on other invested assets	<b>17,693</b>	940	3,889
Related deferred policy acquisition costs	<b>2,257</b>	16,020	70,732
Related present value of future profits of insurance acquired	<b>1,188</b>	1,439	4,028
Related deferred income taxes	<b>5,096</b>	5,180	30,752
Related policyholder dividend obligation	<b>(1,905)</b>	35,963	62,435
Decrease in net unrealized gains	<b>(9,464)</b>	(9,620)	(57,111)
Balance, beginning of year	<b>46,173</b>	55,793	112,904
Balance, end of year	<b>\$ 36,709</b>	\$ 46,173	\$ 55,793

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Available-for-Sale Debt and Equity Securities (continued)**

	2007	2006
Balance, end of year includes:		
Net unrealized gains on available-for-sale securities	\$ 79,589	\$113,638
Net unrealized gains on separate accounts	3,610	3,354
Net unrealized gains on other invested assets	27,517	9,824
Related deferred policy acquisition costs	4,295	2,038
Related present value of future profits of insurance acquired	–	(1,188)
Related deferred income taxes	(19,766)	(24,862)
Related policyholder dividend obligation	(58,536)	(56,631)
Balance, end of year	<b>\$ 36,709</b>	<b>\$ 46,173</b>

Net other comprehensive income (loss) related to unrealized gains and losses on available-for-sale securities for 2007, 2006, and 2005 of \$(9.5) million, \$(9.6) million, and \$(57.1) million is presented net of reclassifications to net income for net realized gains (losses) during the period of \$(3.7) million, \$(32.4) million, and \$17.4 million and net of tax and deferred acquisition cost offsets of \$(2.5) million, \$(21.2) million, and \$11.3 million, respectively.

The amortized cost and estimated fair values of debt securities by contractual maturity at December 31, 2007, are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 143,647	\$ 144,584
Due after one year through five years	1,329,254	1,375,974
Due after five years through ten years	3,128,055	3,103,561
Due after ten years	1,632,315	1,675,146
Mortgage-backed securities	3,288,850	3,297,278
Total	<b>\$9,522,121</b>	<b>\$9,596,543</b>

Proceeds from sales of available-for-sale debt and equity securities for the years ended December 31, 2007, 2006, and 2005 were \$1,330.2 million, \$1,936.8 million, and \$2,240.0 million, respectively. Gross realized gains on sales of available-for-sale debt securities for the years ended December 31, 2007, 2006, and 2005 were \$5.0 million, \$4.5 million, and \$13.0 million, respectively. Gross realized losses on sales of available-for-sale debt securities for the years ended December 31, 2007, 2006, and 2005 were \$15.6 million, \$48.0 million, and \$11.8 million, respectively. Gross realized gains on available-for-sale equity securities for the years ended December 31, 2007, 2006, and 2005 were \$20.0 million, \$4.1 million, and \$5.8 million, respectively. Gross realized losses on available-for-sale equity securities for the years ended December 31, 2007, 2006, and 2005 were \$0.3 million, \$0.5 million, and \$0.2 million, respectively.

The Company recognized losses of \$11.0 million, \$3.1 million, and \$1.2 million on available-for-sale debt and equity securities for the years ended December 31, 2007, 2006, and 2005, respectively, resulting from other-than-temporary declines in the fair value of individual securities held. Factors considered in determining whether declines in the fair value of securities are other-than temporary include 1) the significance of the decline, 2) the Company's ability and intent to retain the investment for a sufficient period of time for it to recover, 3) the time period during which there has been a significant decline in

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Available-for-Sale Debt and Equity Securities (continued)**

value, and 4) fundamental analysis of the liquidity, business prospects, and overall financial condition of the issuer. Based upon these factors, securities that have indications of potential impairment are subject to intensive review. Where such analysis results in a conclusion that declines in fair values are other-than-temporary, the security is written down to fair value.

Investments' gross unrealized losses and estimated fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2007 and 2006, were as follows (in thousands):

2007	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
<b>Description of Securities</b>						
U.S. government obligations						
Government agencies, authorities and subdivisions						
Corporate:						
Communications	\$ 120,842	\$ 3,164	\$ 70,531	\$ 3,620	\$ 191,373	\$ 6,784
Consumer & retail	212,015	9,194	142,164	8,415	354,179	17,609
Financial institutions	488,650	30,485	248,401	19,137	737,051	49,622
Industrial and chemicals	196,317	8,122	82,300	3,177	278,617	11,299
Other corporate	4,957	37	—	—	4,957	37
REITS	91,195	2,987	46,648	2,285	137,843	5,272
Transportation	47,071	1,506	13,193	568	60,264	2,074
Utilities	284,375	7,148	190,785	8,229	475,160	15,377
Total corporate	1,445,422	62,643	794,022	45,431	2,239,444	108,074
Private placements	283,438	5,259	84,742	3,445	368,180	8,704
Mortgage-backed securities	670,448	10,525	793,386	16,003	1,463,834	26,528
Subtotal debt securities	2,399,308	78,427	1,672,150	64,879	4,071,458	143,306
Preferred stock	26,592	5,398	7,889	822	34,481	6,220
Common stock	10,592	1,481	583	137	11,175	1,618
Total securities	\$2,436,492	\$ 85,306	\$1,680,622	\$ 65,838	\$4,117,114	\$ 151,144

2006	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
<b>Description of Securities</b>						
U.S. government obligations	\$ 50,319	\$ 218	\$ 3,064	\$ 79	\$ 53,383	\$ 297
Government agencies, authorities and subdivisions	49,015	4	126,434	2,464	175,449	2,468
Corporate:						
Communications	126,242	2,358	92,770	4,351	219,012	6,709
Consumer & retail	250,145	5,246	151,883	4,532	402,028	9,778
Financial institutions	215,798	2,691	333,024	10,959	548,822	13,650
Industrial and chemicals	146,067	2,256	93,616	4,499	239,683	6,755
REITS	28,570	330	51,093	1,343	79,663	1,673
Transportation	44,032	597	16,913	840	60,945	1,437
Utilities	176,474	2,667	228,621	10,156	405,095	12,823
Total corporate	987,328	16,145	967,920	36,680	1,955,248	52,825
Private placements	134,179	1,857	246,673	7,949	380,852	9,806
Mortgage-backed securities	778,050	6,231	1,069,247	29,084	1,847,297	35,315
Subtotal debt securities	1,998,891	24,455	2,413,338	76,256	4,412,229	100,711
Preferred stock	3,164	42	21,527	895	24,691	937
Common stock	1,188	42	1,124	125	2,312	167
Total securities	\$2,003,243	\$ 24,539	\$2,435,989	\$ 77,276	\$4,439,232	\$ 101,815

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 4 – INVESTMENTS (continued)**

##### **Available-for-Sale Debt and Equity Securities (continued)**

Of the \$78.4 million total unrealized losses on debt securities in the less than 12 months category, \$62.6 million was in the corporate bond portfolio. The unrealized losses are concentrated in the financial institution, consumer & retail, industrial and chemicals, and utility sectors. The primary cause of the unrealized losses for these bonds was the increase in spreads in the corporate bond market. The investment grade corporate index widened from approximately 91 basis points at the beginning of the year to 203 basis points at year end, while the high yield index widened from 289 basis points to 592 basis points at year end. This spread widening was caused in large part by the sub-prime mortgage crisis that infected the short term credit markets, which in turn put pressure on many financial companies such as banks, securities firms, and monoline insurers.

Of the \$64.9 million total unrealized losses on debt securities in the more than 12 months category, \$16.0 million unrealized losses is on the mortgage-backed securities portfolio. Unrealized losses on mortgage backed securities purchased in 2005 were \$9.6 million. All of these securities are agency-backed by either FHLMC, FNMA, or GNMA. During 2007, 10-year U.S. Treasury rate began the year at 4.70% and rose to a high of 5.30% by early June before declining precipitously to 3.80% in December, settling the year at 4.02%. Unrealized bond losses shrank from the previous year as a result of the lower interest rates, even though spreads in the mortgage-backed securities sectors widened by a large margin. The \$16.0 million of unrealized losses on mortgage-backed securities represents 1.09% of the aggregate fair value of the \$1.4 billion in mortgage backed securities with unrealized losses at December 31, 2007. Many of the positions in this category have fair values only marginally below their respective carrying values.

The \$45.4 million unrealized losses on the corporate bond portfolio in the more than 12 months category are concentrated in the financial institution, consumer & retail, utility, and communications sectors. As noted in the earlier comments about less 12 month category, the main reason for the unrealized losses in this group was the pervasive market spread widening caused by the sub-prime mortgage credit crunch. The typically higher yields (coupons) of these older bonds mitigated the impact of the spread widening on prices in this group.

Based on the facts and circumstances surrounding the individual securities and the Company's ability and intent to hold the individual securities to maturity or recovery, the Company believes that the unrealized losses on these bonds at December 31, 2007 are temporary.

The Company periodically lends certain U.S. government or corporate bonds to approved counterparties to enhance the yield of its bond portfolio. The Company initially receives cash collateral or U.S. government or government agency bonds for at least 102% of the market value of securities loaned. Collateral adequacy is evaluated daily and periodically adjusted for changes in the market value of securities loaned in order to ensure that the cash collateral is at least equal to 100% of the market value of securities loaned. The carrying values of securities loaned are unaffected by the transaction.

The fair value of the loaned securities was \$265.8 million and \$378.9 million at December 31, 2007 and 2006, respectively. At December 31, 2007 and 2006, the Company has recognized a liability for outstanding cash and bond collateral received (included in securities lending payable) of \$269.9 million and \$386.0 million, respectively.

The cash collateral received is generally invested in cash equivalents and short-term fixed income and other securities with debt-like characteristics and is reported at estimated fair value. The change in fair value of invested collateral is adjusted through other comprehensive income, net of related deferred

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Available-for-Sale Debt and Equity Securities (continued)**

income taxes. The invested collateral is evaluated for other-than-temporary impairment by applying the same criteria used for other investments in debt securities held by the Company. At December 31, 2007 and 2006, the fair value of invested collateral was \$234.7 million and \$258.2 million, respectively, which approximates cost.

The Company's earnings with respect to its lending program were \$1.5 million less expenses of \$0.4 million in 2007, \$0.9 million less expenses of \$0.2 million in 2006, and \$0.4 million less expenses of \$0.1 million in 2005.

**Trading Equity Securities**

For the years ended December 31, 2007, 2006, and 2005 the equity securities held in the trading category recorded \$1.6 million, \$1.3 million, and \$1.1 million of net investment income. The cost of trading securities held at December 31, 2007 and 2006 was \$22.2 million and \$21.0 million, respectively.

The total return on these equity investments is intended to offset the net appreciation or depreciation in value of certain defined contribution deferred compensation liabilities. The net change in deferred compensation liabilities is included in operating expenses.

**Mortgage Loans and Real Estate**

The distributions of mortgage loans and real estate at December 31 were as follows:

	<b>2007</b>	<b>2006</b>
<b><u>Geographic Region</u></b>		
New England	2.7%	2.1%
Middle Atlantic	4.4	5.3
East North Central	17.4	14.5
West North Central	7.1	7.0
South Atlantic	21.9	23.5
East South Central	2.7	2.2
West South Central	14.4	13.9
Mountain	11.6	13.1
Pacific	17.8	18.4
<hr/>		
Total	100.0%	100.0%
<hr/>		
<b><u>Property Type</u></b>		
Apartment	13.2%	15.4%
Retail	9.3	7.9
Office Building	45.1	45.7
Industrial	28.0	27.7
Hotel/Motel	1.0	1.0
Other Commercial	3.4	2.3
<hr/>		
Total	100.0%	100.0%
<hr/>		
Total mortgage loans and real estate (in thousands)	<b>\$1,679,063</b>	\$1,621,073

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Mortgage Loans and Real Estate (continued)**

Mortgage loans and related valuation allowances at December 31 were as follows (in thousands):

	<b>2007</b>	<b>2006</b>
Unimpaired loans	<b>\$1,659,951</b>	\$1,600,394
Impaired loans without valuation allowances	–	–
Subtotal	<b>1,659,951</b>	1,600,394
Impaired loans with valuation allowances	–	–
Related valuation allowances	–	–
Subtotal	–	–
<b>Total</b>	<b>\$1,659,951</b>	<b>\$1,600,394</b>

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Impaired loans:			
Average total investment	\$ –	\$2,834	\$5,678
Interest income recognized	–	37	341
Interest received	–	37	369

Impaired loans are mortgage loans where it is not probable that all amounts due under the contractual terms of the loan will be received. Impaired loans without valuation allowances are mortgage loans where the estimated fair value of the collateral exceeds the recorded investment in the loan. For these impaired loans, interest income is recognized on an accrual basis, subject to recoverability from the estimated fair value of the loan collateral. For impaired loans with valuation allowances, interest income is recognized on a cash basis.

Activity in the valuation allowances for impaired mortgage loans for the years ended December 31 was as follows (in thousands):

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Additions for impaired loans charged to realized losses	\$ –	\$ –	\$ –
Changes to previously established valuation allowances	–	(860)	–
Decrease in valuation allowances	–	(860)	–
Balance, beginning of year	–	860	860
<b>Balance, end of year</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$860</b>

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Net Investment Income**

The components of net investment income for the years ended December 31 were as follows (in thousands):

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Debt securities interest	<b>\$575,215</b>	\$538,839	\$502,000
Equity securities dividends	<b>11,582</b>	14,242	13,287
Mortgage loan interest	<b>115,555</b>	121,614	111,826
Policy loan interest	<b>40,647</b>	39,286	40,154
Real estate income	<b>3,391</b>	17,222	21,063
Options	<b>1,959</b>	77,348	3,438
Other investment income	<b>20,814</b>	12,056	18,326
Gross investment income	<b>769,163</b>	820,607	710,094
Less: investment expenses	<b>11,105</b>	23,145	28,071
Net investment income	<b>\$758,058</b>	\$797,462	\$682,023

Other investment income includes income distributions from unconsolidated partnership investments and the amortization of investments in affordable housing credits. Investment expenses in 2005 increased due to consolidation of a real estate partnership under FIN 46R. The Company's interest in this real estate partnership was sold in 2006.

**Net Realized Gains and Losses**

The following summarizes the components of net realized investment gains (losses), including other than temporary impairments, by investment category for the years ended December 31 (in thousands):

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Debt securities	<b>\$(21,517)</b>	\$(37,872)	\$ 954
Equity securities	<b>16,751</b>	3,457	6,630
Sale of AG&T	-	8,144	-
Real estate partnership	-	30,609	-
Mortgage loans	<b>(95)</b>	190	-
Real estate investments	<b>(692)</b>	(2,013)	(1,069)
Other invested assets	<b>600</b>	(1,393)	(4,369)
Total	<b>\$ (4,953)</b>	\$ 1,122	\$2,146

**Derivatives**

The Company purchases over-the-counter options and exchange-traded futures on the S&P 500 and Russell 2000 indexes to hedge obligations relating to indexed products. These instruments and their related indexed embedded derivative obligations do not qualify for hedge accounting and, therefore, changes in their fair value are included in the statements of operations. Call options purchased are included in other invested assets and are carried at fair value. Call options written are included in other liabilities and carried at fair value.

The Company purchases options only from highly rated counterparties. However, in the event a counterparty failed to perform, the Company's loss would be equal to the fair value of the net options held from that counterparty.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Derivatives (continued)**

Indexed annuity and life contracts are included in policyholder account liabilities and consist of a combination of underlying host contract and embedded derivative values. The embedded derivative component is based on the fair value of the contracts' expected participation in future increases in the S&P 500 or Russell 2000 indexes. The fair value of the embedded derivative component includes assumptions about future interest rates and interest rate structures, future costs for options used to hedge the contract obligations, projected withdrawal and surrender activity, and the level and limits on contract participation in any future increases in the S&P 500 or Russell 2000 indexes.

At December 31, 2007, total indexed annuity liabilities of \$3,370.6 million were comprised of \$2,705.8 million of host contract and \$664.8 million of embedded derivative value. At December 31, 2006, total indexed annuity liabilities of \$2,904.2 million were comprised of \$2,311.3 million of host contract and \$592.9 million of embedded derivative value. Policyholder account liabilities at December 31, 2007 and 2006 were \$3,408.8 million and \$2,885.3 million, respectively.

Results of operations for 2007, 2006, and 2005 included after-tax earnings from indexed annuities of \$23.4 million, \$23.6 million, and \$21.6 million, respectively. The cost of options and changes in assumptions had a neutral impact on results of operations in 2007 and favorably impacted results of operations in 2006.

At December 31, 2007, total indexed life liabilities of \$128.4 million were comprised of \$99.5 million of host contract and \$28.9 million of embedded derivative value. Policyholder account liabilities at December 31, 2007 were \$127.7 million.

Interest credited to policyholder account liabilities expense includes the interest and index related changes in the indexed annuity host contract and embedded derivative liabilities.

During 2006, the Company entered into an interest rate swap whereby the net interest paid on its \$20.6 million variable rate note payable will be fixed at 9.12% until May 15, 2008, the note's call date. The Company's expectation is that the hedge would be 100% effective. The Company's risk management objective in entering into the hedge transaction was to prevent any subsequent changes in market rates of interest from impacting the expected future interest payments on the note.

The net notional amount of options purchased, options written, and those embedded in policy liabilities, all related to equity indexed products for the current policy year, is essentially zero. The notional amounts of futures at December 31 were as follows (in thousands):

	<b>2007</b>	<b>2006</b>
Notional amounts:		
Futures	<b>\$26,598</b>	\$37,094

The carrying value of options, futures, and credit default swaps at December 31 were as follows (in thousands):

	<b>2007</b>	<b>2006</b>
Carrying values:		
Options purchased (included in other invested assets)	<b>\$144,880</b>	\$220,110
Options written (included in other liabilities)	<b>(53,477)</b>	(80,424)
Futures purchased (included in other invested assets)	<b>2,375</b>	3,380
Net carrying value	<b>\$ 93,778</b>	\$143,066

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 4 – INVESTMENTS (continued)**

**Fair Value of Financial Instruments**

The carrying values and estimated fair values of financial instruments at December 31 were as follows (in thousands):

	2007		2006	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and cash equivalents	\$ 179,405	\$ 179,405	\$ 459,703	\$ 459,703
Available-for-sale debt securities	9,596,543	9,596,543	8,977,724	8,977,724
Available-for-sale equity securities	152,870	152,870	194,566	194,566
Trading equity securities	23,456	23,456	22,317	22,317
Mortgage loans	1,659,951	1,727,322	1,600,394	1,616,210
Policy loans	706,278	708,398	696,123	695,337
Derivatives	93,778	93,778	143,066	143,066
Securities lending invested collateral	234,691	234,691	258,203	258,203
Investment product liabilities	6,224,762	6,258,286	5,806,762	5,816,380
Debt	294,713	302,774	294,679	310,939

For cash and cash equivalents carrying value approximates estimated fair value.

Debt and equity securities' estimated fair values are based on quoted values where available. Where quoted values are not available, estimated fair values are based on discounted cash flows using current interest rates of similar securities.

Mortgage loan fair values are estimated as the average of discounted cash flows under different scenarios of future mortgage interest rates (including appropriate provisions for default losses and borrower prepayments).

For variable rate policy loans the unpaid balance approximates fair value. Fixed rate policy loan fair values are estimated based on discounted cash flows using the current variable policy loan rate (including appropriate provisions for mortality and repayments).

The estimated fair values of derivatives are based on quoted values.

The estimated fair values of securities lending invested collateral is based on quoted values.

Investment product liabilities include flexible premium annuities, single premium deferred annuities, and supplementary contracts not involving life contingencies. Investment product fair values are estimated as the average of discounted cash flows under different scenarios of future interest rates of A-rated corporate bonds and related changes in premium persistency and surrenders.

Debt fair values are estimated based on discounted cash flows using current interest rates of similar securities.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 5 – REINSURANCE**

The Company reinsures certain risks assumed in the normal course of business. For individual life products sold on or after August 16, 2004, the Company generally retains no more than \$2.0 million of risk on any person (excluding accidental death benefits and dividend additions). For individual life products sold after 2001 but prior to August 16, 2004, the Company generally retains no more than \$1.0 million of risk on any person (excluding accidental death benefits and dividend additions). On individual life business issued prior to 2002, the Company generally retains no more than \$3.0 million of risk (excluding accidental death benefits and dividend additions). Reinsurance for life products is ceded under yearly renewable term, coinsurance, and modified coinsurance agreements with various reinsurers.

Disability income products are significantly reinsured under coinsurance and modified coinsurance agreements primarily with Unum Provident Corporation (“UNUM”). In February 2003, the Company executed amendments to disability income reinsurance agreements with UNUM. Under the terms of the amendments, virtually all of the existing disability income coinsurance was converted to modified coinsurance. This change resulted in \$286 million in cash and reinsurance liabilities being transferred to the Company from UNUM. The Company has agreed to pay UNUM an interest rate of 7% on the reserves held by the Company. All other rights and responsibilities outlined in the reinsurance agreements between the Company and UNUM remain in force.

In 2007, a number of assumptions used in the calculation of the Company’s disability income reserves were revised, resulting in disability income reserves being increased by \$21.2 million. This increase in reserves resulted in \$16.5 million in cash being transferred to the Company from UNUM. The impact on the Company’s operations in 2007 was an increase in policy liabilities expense of \$4.7 million.

Other income on the statements of operations includes income of \$10.8 million, \$9.0 million, and \$7.6 million for 2007, 2006, and 2005, respectively, related to the Company’s disability income reinsurance. Such income is primarily offset by expenses incurred by the Company related to this block of business. Reserve transfers and interest payments under modified coinsurance agreements are included on the statements of operations as a component of increase in policy liabilities expense.

Interest costs included in reinsurance agreements in place at December 31, 2007 and 2006 are either fixed rate, or vary based solely on the Company's net investment income earnings rate. As such, these contracts do not pass through credit experience related to underlying pools of assets, and therefore do not contain embedded derivatives.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 5 – REINSURANCE (continued)**

The effects of reinsurance for the years ended December 31 were as follows (in thousands). Transactions between the Closed Block and non-Closed Block operations have been excluded.

	2007	2006	2005
Insurance premiums:			
Direct	<b>\$390,466</b>	\$405,222	\$415,634
Reinsurance assumed	<b>412</b>	1,439	1,414
Reinsurance ceded	<b>(68,550)</b>	(70,654)	(69,501)
Total insurance premiums	<b>\$322,328</b>	\$336,007	\$347,547
Increase in policy liabilities:			
Direct	<b>\$20,854</b>	\$64,412	\$60,397
Reinsurance assumed	<b>53</b>	(35)	(14)
Reinsurance ceded	<b>8,810</b>	17,406	16,535
Total increase in policy liabilities	<b>\$29,717</b>	\$81,783	\$76,918
Policy benefits:			
Direct	<b>\$489,209</b>	\$445,087	\$431,263
Reinsurance assumed	<b>2,020</b>	540	1,962
Reinsurance ceded	<b>(79,962)</b>	(95,909)	(76,893)
Total policy benefits	<b>\$411,267</b>	\$349,718	\$356,332
Policyholders' dividends:			
Direct	<b>\$112,915</b>	\$124,462	\$118,775
Reinsurance ceded	<b>(1,818)</b>	(2,154)	(2,672)
Total policyholders' dividends	<b>\$111,097</b>	\$122,308	\$116,103

The Company remains liable in the event any reinsurer is unable to meet its assumed obligations. The Company regularly evaluates the financial condition of its reinsurers and concentrations of credit risk of reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Total life insurance inforce as of December 31, 2007 and 2006 was \$57.5 billion and \$54.9 billion, respectively.

**NOTE 6 – DEFERRED POLICY ACQUISITION COSTS**

The following reflects the changes in the deferred policy acquisition costs asset (in thousands):

	2007	2006	2005
Balance, beginning of year	<b>\$901,214</b>	\$801,557	\$681,915
Acquisition costs deferred during the year	<b>183,117</b>	171,736	156,047
Amortization during the year	<b>(116,713)</b>	(88,099)	(96,137)
Amortization of remaining deferred acquisition costs on disability income contracts	–	–	(11,000)
Adjustment through other comprehensive income during the year	<b>2,257</b>	16,020	70,732
Balance, end of year	<b>\$969,875</b>	\$901,214	\$801,557

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 7 – FEDERAL INCOME TAXES**

The Company files income tax returns in the U.S. federal jurisdiction, and various states. With few exceptions, the Company is no longer subject to U.S federal, state, and local income tax examinations by tax authorities for years prior to 2004.

The components of federal income taxes and a reconciliation of the expected and actual federal income taxes and income tax rates for the years ended December 31 were as follows (in thousands):

	2007		2006		2005	
	Amount	Rate	Amount	Rate	Amount	Rate
Current	\$41,690		\$16,649		\$30,232	
Deferred	6,411		26,917		8,350	
Total income tax expense	\$48,101		\$43,566		\$38,582	
Expected income taxes	\$57,162	35.0%	\$56,102	35.0%	\$49,952	35.0%
Dividends received deduction	(3,562)	(2.3)	(2,821)	(1.9)	(2,725)	(2.0)
Affordable housing tax credit	(4,905)	(3.2)	(6,796)	(4.5)	(7,292)	(5.5)
Audit settlements	197	0.1	(2,261)	(1.5)	–	–
Corporate owned life insurance	(2,271)	(1.5)	(2,401)	(1.6)	(2,660)	(2.0)
Other, net	1,480	1.0	1,743	1.2	1,307	1.0
Total income tax expense	\$48,101		\$43,566		\$38,582	
Effective federal income tax rate		29.1%		26.7%		26.5%

The Company paid \$37.8 million, \$20.1 million, and \$25.2 million in federal income taxes during 2007, 2006, and 2005, respectively.

During 2006 the Internal Revenue Service completed the audit of the Company's Federal Income Tax Returns for the years 2001 to 2003. A number of issues were settled resulting in a \$2.3 million dollar favorable impact to income tax expense for 2006.

As previously discussed, the Company adopted the provisions of FIN 48 on January 1, 2007. As a result, the Company recognized approximately a \$152,000 increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	2007
Balance, beginning of year	\$ 1,442
Additions based on tax positions related to the current year	13,346
Additions for tax positions of prior years	2,629
Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	(200)
Balance, end of year	\$17,217

If recognized, approximately \$1,197,000 of the total amount of unrecognized tax benefits, would affect the effective tax rate. Due to expiration of the statute of limitations, it is possible that approximately \$379,000 of an uncertain tax benefit related to the treatment of a contractual issue could be recognized within the next twelve months.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 7 – FEDERAL INCOME TAXES (continued)**

Subsequent to January 1, 2007, the IRS has completed federal exams for tax years ending prior to 2004. No changes to unrecognized tax benefits occurred due to the closing of these exams.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. During the year ended December 31, 2007, the Company recognized approximately \$253,000 in additional interest expense and penalties. The Company had approximately \$325,000 accrued for interest and penalties at December 31, 2007.

Components of net deferred income tax assets at December 31 were as follows (in thousands):

	<b>2007</b>	<b>2006</b>
Deferred income tax assets:		
Pension and other post retirement liabilities	<b>\$ 59,781</b>	\$ 59,239
Policy liabilities	<b>256,837</b>	250,139
Other liabilities and accrued expenses	<b>5,338</b>	9,714
Other	<b>465</b>	489
Total deferred income tax assets	<b>322,421</b>	319,581
Deferred income tax liabilities:		
Debt and equity securities	<b>1,836</b>	12,341
Net unrealized gain on available-for-sale securities	<b>19,766</b>	24,862
Deferred policy acquisition costs	<b>265,624</b>	244,236
Present value of future profits of insurance acquired	<b>14,962</b>	17,147
Property and investments	<b>7,510</b>	4,877
Other	<b>9,937</b>	10,322
Total deferred income tax liabilities	<b>319,635</b>	313,785
Total net deferred income tax assets	<b>\$ 2,786</b>	\$ 5,796

Management believes it is more likely than not that the Company will realize the benefit of deferred tax assets. Therefore, no valuation allowance was recorded as of December 31, 2007.

**NOTE 8 – BENEFIT PLANS**

The Company sponsors a defined benefit pension plan covering substantially all employees. The plan is administered by the Company and is non-contributory, with benefits for National Life employees hired prior to July 1, 2001, based on an employee's retirement age, years of service, and compensation near retirement. Benefits for National Life employees hired after June 30, 2001, and other Company employees are based on the amount credited to the employee's account each year, which is a factor of the employee's age, service, and compensation, increased at a specified rate of interest. This pension plan is separately funded. Plan assets are primarily bonds and common stocks held in a Company separate account and funds invested in a general account group annuity contract issued by the Company. None of the securities held in the Company separate account were issued by the Company.

The Company also sponsors other pension plans, including a non-contributory defined benefit plan for general agents that provides benefits based on years of service and sales levels, a non-contributory defined supplemental benefit plan for certain executives, and a non-contributory defined benefit plan for retired directors. These defined benefit pension plans are not separately funded.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 8 – BENEFIT PLANS (continued)**

The Company sponsors four defined benefit postretirement plans that provide medical, dental, and life insurance benefits to employees, agency staff, and agents. Substantially all employees who began service prior to July 1, 2001 may be eligible for medical, dental, and life insurance retiree benefits if they reach retirement age and meet certain minimum service requirements while working for the Company. Substantially all employees beginning service prior to December 31, 2005 may be eligible for life insurance retiree benefits if they reach retirement age and meet certain minimum service requirements while working for the Company. Substantially all agents and agency staff employees who retired prior to January 1, 2007, began service prior to June 1, 2000, and met certain minimum service requirements while working for the company may be eligible for medical, dental, and life insurance retiree benefits.

Most of the defined benefit postretirement plans are contributory, with retiree contributions adjusted annually, and contain cost sharing features such as deductibles and copayments. These postretirement plans are not separately funded, and the Company therefore pays for plan benefits from operating cash flows. The costs of providing these benefits are recognized as they are earned by employees.

Information with respect to the defined benefit plans at December 31 was as follows (in thousands):

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
<b>Change in benefit obligation:</b>						
Benefit obligation, beginning of year	\$ 249,907	\$ 251,354	\$ 229,866	\$36,510	\$ 36,268	\$ 30,736
Service cost for benefits earned during the period	4,929	5,540	5,058	1,119	1,164	1,019
Interest cost on benefit obligation	14,329	13,723	13,675	2,093	1,999	1,843
Actuarial (gains) losses	(4,433)	(5,850)	17,741	(2,075)	(755)	4,760
Curtailment	–	–	(929)	(1,971)	–	–
Benefits paid	(13,031)	(14,860)	(14,057)	(2,471)	(2,166)	(2,090)
Benefit obligation, end of year	251,701	249,907	251,354	33,205	36,510	36,268
<b>Change in plan assets:</b>						
Plan assets, beginning of year	131,705	108,682	99,147	–	–	–
Contributions	3,116	22,300	7,081	–	–	–
Actual income on plan assets	21,614	7,625	8,739	–	–	–
Benefits paid	(7,985)	(6,902)	(6,285)	–	–	–
Plan assets, end of year	148,450	131,705	108,682	–	–	–
Funded Status	(103,251)	(118,202)	(142,672)	(33,205)	(36,510)	(36,268)
Unrecognized actuarial losses	–	47,260	54,438	–	3,332	5,185
Unrecognized prior service costs (benefits)	–	382	503	–	(61)	(1,200)
Net activity subsequent to measurement date	2,057	(1,062)	2,048	–	–	–
Net amount recognized	\$(101,194)	\$ (71,622)	\$ (85,683)	\$(33,205)	\$(33,239)	\$(32,283)

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 8 – BENEFIT PLANS (continued)**

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
<b>Amounts recognized in the consolidated balance sheet:</b>						
Pension and other post-retirement benefit obligations liability		\$(104,177)	\$(124,465)		\$(33,239)	\$(32,283)
Accumulated other comprehensive income		32,555	38,782		–	–
Net amount recognized		<u>\$ (71,622)</u>	<u>\$ (85,683)</u>		<u>\$ (33,239)</u>	<u>\$ (32,283)</u>
Pension and other post-retirement benefit obligations liability		<u><b>\$(101,194)</b></u>			<u><b>\$(33,205)</b></u>	
<b>Amounts recognized in other comprehensive income consists of:</b>						
Net actuarial (gains) loss	<b>\$ 28,842</b>			<b>\$ 490</b>		
Net prior service costs (benefits)	<b>261</b>			<b>1,849</b>		
	<u><b>\$ 29,103</b></u>			<u><b>\$ (1,359)</b></u>		

The total accumulated benefit obligation (“ABO”), the accumulated benefit obligation and fair value of plan assets for the Company’s pension plans with accumulated benefit obligation in excess of plan assets, and the projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets as of the measurement date was as follows:

	2007	2006	2005
Total Accumulated Benefit Obligation	\$ 237,256	\$ 234,820	\$ 235,145
Plans with ABO in excess of plan assets:			
ABO	237,256	234,820	235,145
Fair value of plan assets	148,450	131,705	108,682
Plans with PBO in excess of plan assets:			
PBO	251,701	249,907	251,354
Fair value of plan assets	148,450	131,705	108,682

As previously discussed, the Company applied the recognition provisions of SFAS 158 as of December 31, 2007. The incremental effect of applying SFAS 158 on its Consolidated Balance Sheets at December 31, 2007 was as follows (in thousands):

	Before Application of SFAS 158	Reversal of Minimum Pension Liability	SFAS 158 Adjustment	After Application of SFAS 158
Deferred income taxes	\$ 4,798	\$ (5,329)	\$ 9,711	\$ 9,180
Total assets	15,506,725	(5,329)	9,711	15,511,107
Pension and other post-retirement benefit obligations	(155,934)	15,227	(27,744)	(168,451)
Total liabilities	(14,033,013)	15,227	(27,744)	(14,045,530)
Minimum pension liability adjustment, net of tax	9,898	(9,898)	–	–
SFAS 158 liability adjustment, net of tax	–	–	18,033	18,033
Accumulated other comprehensive income	(25,949)	(9,898)	18,033	(17,814)
Total stockholder’s equity	(1,473,712)	(9,898)	18,033	(1,465,577)

The incremental effect of applying SFAS 158, net of tax, on accumulated other comprehensive income for the Company’s pension plans and postretirement benefit plans was \$9,019,000 and \$(884,000), respectively, at December 31, 2007.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 8 – BENEFIT PLANS (continued)**

The components of net periodic benefit cost for the years ended December 31 were as follows (in thousands):

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
Service cost for benefits earned during the period	\$ 4,929	\$ 5,540	\$ 5,058	\$ 1,119	\$ 1,164	\$ 1,019
Interest cost on benefit obligation	14,329	13,723	13,675	2,093	1,999	1,843
Expected (income) on plan assets	(9,926)	(9,221)	(7,949)	–	–	–
Net amortization of actuarial losses (gains)	2,297	2,924	1,841	767	1,167	(228)
Amortization of prior service costs (benefits) and plan amendments	121	121	114	(183)	(1,139)	(1,140)
Net periodic benefit cost (included in operating expenses)	\$ 11,750	\$ 13,087	\$ 12,739	\$ 3,796	\$ 3,191	\$ 1,494

Over the next year, the estimated amount of amortization from accumulated other comprehensive income into net periodic benefit cost related to net actuarial losses and prior service benefit is \$0.7 million and \$0.1 million, respectively.

The measurement date for all the plans was October 1 preceding the date of the balance sheet. Beginning in 2008, a December 31 measurement date will be used in accordance with the provisions of SFAS 158.

The actuarial assumptions used in determining benefit obligations at the measurement dates were as follows:

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
Discount rate	6.00%	5.75%	5.50%	6.00%	5.75%	5.50%
Rate of increase in future compensation levels	3.0% - 6.5%	3.0% - 6.5%	3.0% - 6.5%			
Expected long term return on plan assets	7.75%	7.75%	8.0%			

Additional minimum pension liabilities at December 31, 2007, 2006, and 2005, prior to the adoption of SFAS 158 were \$15.2 million, \$32.6 million, and \$38.8 million, respectively, for pension benefits where the excess of the ABO liability over the plan assets exceeded the accrued benefit cost. These liabilities were included, net of income tax effects of \$5.3 million, \$11.4 million, and \$13.6 million, as a component of accumulated other comprehensive income in 2007, 2006, and 2005, respectively, prior to the adoption of SFAS 158.

Effective January 1, 2007, the Company closed its postretirement benefit plans for agents and agency staff employees to new retirees. This change generated prior service benefits of \$2.0 million and will be amortized over the remaining life expectancy of plan participants.

Included in the pension and other post-retirement benefit obligations liability as reported on the balance sheets are deferred compensation and employee disability liabilities of \$34.1 million and \$29.8 million as of December 31, 2007 and 2006, respectively.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 8 – BENEFIT PLANS (continued)**

The projected health care cost trend rate (“HCCTR”) in 2007 and 2006 for the pre-65 population was eliminated due to a plan amendment and for the post-65 population was 10%. This projected rate declines linearly to 5% in 2011 and remains level thereafter. Increasing the assumed HCCTR by one percentage point in each year would increase the accumulated postretirement benefit obligation (“APBO”) by about \$2.8 million and increase the 2007 service cost component of net periodic postretirement benefit cost by about \$0.2 million. Decreasing the assumed HCCTR by one percentage point in each year would reduce the APBO by about \$2.4 million and the 2007 service cost component of net periodic postretirement benefit cost by about \$0.1 million. The Company uses the straight-line method of amortization for prior service cost and unrecognized gains and losses.

The percentage distribution of the fair value of total plan assets held as of the measurement date is as follows:

<b>Plan Asset Category</b>	<b>October 1, 2007</b>	<b>October 1, 2006</b>
Bonds	38%	39%
Common stocks	61	58
Group annuity contract and other	1	3
Total	<b>100%</b>	<b>100%</b>

Investments are selected pursuant to investment objectives, policy, and guidelines as approved by the Chief Investment Officer of the Company and by the Committee on Finance of the Company’s Board of Directors. The primary objective is to maximize long-term total return within the investment policy and guidelines. The Company’s investment policy for the plan assets is to achieve a target allocation of approximately 50%-75% stocks and 25%-50% bonds and other fixed income instruments when measured at fair value. Investments in the obligations of any one issuer, other than the United States of America government or its agencies, shall not exceed 5% of the total investment portfolio. Further, no more than 50% of the total investment portfolio shall be invested in any major industry group (for example, public utilities, industrial, mortgage-backed or asset-backed securities, etc.), and no more than 30% shall be invested in any sub-industry (for example, oil, gas, or steel).

The Company’s expected long-term rate of return of 7.75% is based upon an expected return on stock investments of 10%-11%, and a weighted expected return of 5%-6% on fixed income investments. These projections were based on the Company’s historical and projected experience and on long term projections by investment research organizations.

Projected benefit payments for defined benefit obligations, and for projected Medicare Part D reimbursements for each of the five years following December 31, 2007, and in aggregate for the five years thereafter is as follows (in thousands):

<b>Year</b>	<b>Projected Pension Benefit Payments</b>	<b>Projected Other Benefit Payments</b>	<b>Projected Medicare Part D Reimbursements</b>
2008	\$16,918	\$ 2,646	\$ 235
2009	16,570	2,738	251
2010	16,625	2,797	267
2011	16,841	2,853	281
2012	17,740	2,884	300
2013-2017	94,467	14,685	1,706

## NLV FINANCIAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### NOTE 8 – BENEFIT PLANS (continued)

The pension benefit obligation and accumulated benefit obligation attributable to National Life employees hired after June 30, 2001 and other Company employees was \$2.9 million, \$2.2 million and \$1.6 million at December 31, 2007, 2006, and 2005, respectively. The crediting rates were 4.85%, 4.47% and 4.76% at December 31, 2007, 2006, and 2005, respectively.

The Company's general policy is to contribute the regulatory minimum required amount into its separately funded defined benefit pension plan. However, the Company may elect to make larger contributions subject to maximum contribution limitations. The Company's expected minimum required 2008 contribution is approximately \$1.8 million.

The Company provides employee thrift and 401(k) plans for its employees. For employees hired prior to July 1, 2001, up to 3% of an employee's salary may be invested by the employee in a plan and matched by funds contributed by the Company subject to applicable maximum contribution guidelines. Employees hired prior to July 1, 2001, and below specified levels of compensation also receive a foundation contribution of 1.5% of compensation. Employees beginning service after June 30, 2001 will receive a 50% match on up to 6% of an employee's salary, subject to applicable maximum contribution guidelines. Additional employee voluntary contributions may be made to the plans subject to contribution guidelines. Vesting and withdrawal privilege schedules are attached to the Company's matching contributions.

The Company also provides a 401(k) plan for its regular full-time agents whereby accumulated funds may be invested by the agent in a group annuity contract with the Company or in mutual funds (several of which are sponsored by a subsidiary of SAMI). Total annual contributions can not exceed certain limits which vary based on total agent compensation. No company contributions are made to the plan.

The Company provides non-qualified defined contribution deferred compensation plans for certain employees and agents. These plans are not separately funded. Costs associated with these plans are included in operating expenses. Liabilities for these plans are included in pension and other post-retirement benefit obligations.

During the fourth quarter of 2005, the Company announced plans to restructure a significant number of general agencies. These restructurings included the termination or redeployment of several general agent participants in a non-contributory defined benefit plan. The effect of this curtailment was to reduce the projected benefit obligation at December 31, 2005 by \$0.9 million with a corresponding reduction in unrecognized losses. There was no effect on 2005 net income.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 9 – DEBT**

Debt consists of the following (in thousands):

	<b>2007</b>	<b>2006</b>
7.5% Senior Notes: \$200 million, maturing August 2033, interest payable semiannually on February 15 and August 15. The notes are unsecured and subordinated to any existing or future indebtedness of NLVF and its subsidiaries.	<b>\$199,662</b>	\$199,649
6.5% Senior Notes: \$75 million, maturing March 2035, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of NLVF and its subsidiaries.	<b>74,432</b>	74,411
Note Payable: \$20.6 million, callable at par on May 15, 2008, and maturing on May 15, 2033. The note is unsecured and subordinate to all current and future obligations. The interest rate floats based on LIBOR and resets quarterly.	<b>20,619</b>	20,619
<b>Total debt</b>	<b>\$294,713</b>	\$294,679

Interest paid on the 7.5% senior notes was \$15.0 million in 2007, 2006, and 2005. Interest paid on the 6.5% senior notes was \$4.9 million in 2007 and 2006 and \$2.4 in 2005. Interest paid on the \$20.6 million note payable was \$1.8 million, \$1.9 million, and \$1.5 million in 2007, 2006, and 2005, respectively. Interest paid or accrued on the real estate investment mortgage was \$3.0 million in 2006 and \$2.3 million in 2005 and is included as a component of net investment income.

The Company has two lines of credit available. A \$25 million line of credit with State Street Bank, based on an adjustable rate equal to the prevailing federal funds rate plus 50 basis points. The outstanding balance was \$0 as of December 31, 2007 and 2006. The Company also has a \$20 million line of credit with Banknorth Group, based on an adjustable rate equal to LIBOR plus 37.5 basis points. The outstanding balance on the Banknorth line of credit was \$0 as of December 31, 2007 and 2006. Total interest on the combined lines of credit was approximately \$90,000 in 2007 and less than \$10,000 in 2006 and 2005.

**NOTE 10 – COMMITMENTS AND CONTINGENCIES**

Total outstanding mortgage loan funding commitments at December 31, 2007 and 2006, were \$54.8 million and \$32.3 million, respectively.

During 1997, several class action lawsuits were filed against the Company in various states related to the sale of life insurance policies during the 1980's and 1990's. The Company specifically denied any wrongdoing. The Company agreed to a settlement of these class action lawsuits in June 1998. This agreement was subsequently approved by the court in October 1998. The settlement provides class members with various policy enhancement options and new product purchase discounts. Class members could have pursued alternative dispute resolution according to predetermined guidelines. Qualifying members could also opt out of the class action and pursued litigation separately against the company. Most of the alternative dispute resolution cases had been settled by December 31, 2000. Management believes that while the ultimate cost of this litigation (including those who opted out of the class action) is still uncertain, it is unlikely to have a material adverse effect on the Company's financial position.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 10 – COMMITMENTS AND CONTINGENCIES (continued)**

The Company currently leases rights to the use of certain data processing hardware and software from Perot Systems Corporation, Plano, Texas. The following is a schedule of future minimum lease payments as of December 31, 2007 (in millions):

<b>Year</b>	<b>Operating Leases</b>
2008	\$ 4.6
2009	4.6
2010	4.6
2011	4.6
2012	4.5
Thereafter	1.9
Total minimum lease payments	<b>\$24.8</b>

The Company has a multi year contract for information systems application and infrastructure services from Keane, Inc., Boston, Massachusetts. The contract became effective on February 1, 2004. The Company's remaining obligation under the contract as of December 31, 2007 (in millions):

<b>Year</b>	<b>Contract Obligation</b>
2008	\$14.1
2009	14.1
2010	1.2
Total contract obligation	<b>\$29.4</b>

In the ordinary course of business, the nature of the Company's business subjects it to claims, law suits, regulatory examinations, and other proceedings. The results of these matters cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on the Company's results of operations in any future period and a material judgment could have a material adverse impact on the Company's financial condition and results of operations. However, it is the opinion of management, after consultation with legal counsel that, based on information currently available, the ultimate outcome of these matters will not have a material adverse impact on the business, financial condition, or operating results of the Company.

**NOTE 11 – NATIONAL LIFE CLOSED BLOCK**

The Company established and began operating the Closed Block on January 1, 1999. The Closed Block was established pursuant to regulatory requirements as part of the reorganization into a mutual holding company corporate structure. The Closed Block was established for the benefit of policyholders of participating policies inforce at December 31, 1998, and includes traditional dividend paying life insurance policies, certain participating term insurance policies, dividend paying flex premium annuities, and other related liabilities. The Closed Block's primary purpose is to protect the policy dividend expectations related to these policies. The Closed Block is expected to remain in effect until all policies within the Closed Block are no longer inforce. Assets assigned to the Closed Block at January 1, 1999, together with projected future premiums and investment returns, are reasonably expected to be sufficient to pay out all future Closed Block policy benefits, expenses, and taxes. Such benefits include dividends paid out under the current dividend scale, adjusted to reflect future changes in the underlying experience. The assets and liabilities allocated to the Closed Block are recorded in the Company's financial statements on the same basis as other similar assets and liabilities. Based on current projections, Closed Block assets are sufficient to meet all future obligations. The Company remains contingently liable for all contractual benefits and expenses of the Closed Block.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 11 – NATIONAL LIFE CLOSED BLOCK (continued)**

If actual cumulative Closed Block earnings are greater than expected cumulative earnings, only the expected earnings will be recognized in net income of the Company. Actual cumulative earnings in excess of expected earnings represent undistributed earnings attributable to Closed Block policyholders. These excess earnings are recorded as a policyholder dividend obligation (included in policyholders' dividend liability) to be paid to Closed Block policyholders unless offset by future results that are less than expected. If actual cumulative performance is less favorable than expected, only actual earnings will be recognized in income. A policyholder dividend obligation for distribution of accumulated excess earnings of \$18.3 million and \$21.7 million was required at December 31, 2007 and 2006, respectively. Similarly, unrealized gains and losses on Closed Block investments may increase (decrease) a policyholder dividend obligation liability. Unrealized gains in the Closed Block generated a policyholder dividend obligation of \$58.5 million and \$56.6 million at December 31, 2007 and 2006, respectively. These gains and their related policyholder dividend obligation and income tax offsets are included in other comprehensive income. The total policyholder dividend obligation included in policyholders' dividends liability at December 31, 2007 and 2006 was \$76.8 million and \$78.3 million, respectively.

Summarized financial information for the Closed Block effects included in the consolidated financial statements as of December 31, 2007 and 2006, and for the three years ended December 31, 2007, is as follows (in thousands):

	<b>2007</b>	<b>2006</b>
<b>Liabilities:</b>		
Policy liabilities and accruals	<b>\$3,811,175</b>	\$3,851,743
Securities lending payable	<b>56,662</b>	64,299
Other liabilities	<b>681</b>	3,485
<b>Total liabilities</b>	<b>\$3,868,518</b>	\$3,919,527
<b>Assets:</b>		
Cash and cash equivalents	<b>\$ 8,457</b>	\$ 96,693
Securities lending invested collateral	<b>50,253</b>	26,943
Available-for-sale debt and equity securities	<b>2,448,046</b>	2,347,363
Available-for-sale debt securities on loan	<b>55,579</b>	63,031
Other invested assets	<b>–</b>	1,950
Mortgage loans	<b>352,772</b>	388,330
Policy loans	<b>510,059</b>	518,115
Accrued investment income	<b>44,735</b>	45,169
Premiums and fees receivable	<b>11,279</b>	12,267
Other assets	<b>74,416</b>	90,126
<b>Total assets</b>	<b>\$3,555,596</b>	\$3,589,987
Excess of reported closed block liabilities over closed block assets	<b>\$ 312,922</b>	\$ 329,540
Closed block accumulated other comprehensive gain represented above	<b>–</b>	–
<b>Maximum future earnings to be recognized from closed block assets and liabilities</b>	<b>\$ 312,922</b>	\$ 329,540

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 11 – NATIONAL LIFE CLOSED BLOCK (continued)**

	2007	2006	2005
<b>Revenues:</b>			
Premiums and other income	<b>\$210,757</b>	\$222,437	\$240,103
Net investment income	<b>209,423</b>	211,095	210,827
Net investment loss	<b>(347)</b>	(429)	(1,237)
<b>Total revenues</b>	<b>419,833</b>	433,103	449,693
<b>Benefits and Expenses:</b>			
Increase (decrease) in policy liabilities	<b>(32,564)</b>	8,032	8,916
Policy benefits	<b>297,005</b>	252,366	271,965
Policyholders' dividends	<b>109,037</b>	120,924	115,773
Interest credited to policyholder account liabilities	<b>10,403</b>	12,130	9,095
Operating expenses	<b>8,067</b>	8,606	9,585
Commission expenses	<b>2,320</b>	3,045	3,337
<b>Total benefits and expenses</b>	<b>394,268</b>	405,103	418,671
Pre-tax results of operations	<b>25,565</b>	28,000	31,022
Income taxes	<b>8,947</b>	9,800	10,858
Closed block results of operations	<b>16,618</b>	18,200	20,164
Other comprehensive income:			
Unrealized loss	-	-	-
<b>Total closed block comprehensive income</b>	<b>\$ 16,618</b>	\$ 18,200	\$ 20,164
Excess of reported closed block liabilities over closed block assets:			
Beginning of year	<b>\$329,540</b>	\$347,740	\$367,904
Closed block comprehensive income	<b>16,618</b>	18,200	20,164
<b>End of year</b>	<b>\$312,922</b>	\$329,540	\$347,740

Amortized cost of bonds held by the Closed Block at December 31, 2007 and 2006 were \$2,435.1 million and \$2,328.9 million, respectively.

Participating insurance in force within the Closed Block was \$9.1 billion and \$9.8 billion at December 31, 2007 and 2006, respectively.

Many expenses related to Closed Block policies and operations, including amortization of policy acquisition costs, are charged to operations outside the Closed Block; accordingly, the contribution from the Closed Block presented above does not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside the Closed Block are therefore disproportionate to the actual business outside the Closed Block.

## **NLV FINANCIAL CORPORATION AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### **NOTE 12 – CORPORATE STRUCTURE**

On January 1, 1999, National Life converted from a mutual to a stock insurance company as part of a reorganization into a mutual holding company corporate structure.

Prior to the conversion, policyowners held policy contractual and membership rights from National Life. The contractual rights, as defined in the various insurance and annuity policies, remained with National Life after the conversion. Membership interests held by policyowners of National Life at December 31, 1998, were converted to membership interests in NLHC, a mutual insurance holding company created for this purpose. NLHC currently owns all the outstanding common stock class B shares of NLVF, a stock holding company created for this purpose, which in turn currently owns all the outstanding shares of National Life. NLHC's ownership of NLVF's stock consists of 100 shares with par value of \$0.01 per share. NLHC holds all of the NLVF stock currently outstanding. NLVF has a total of 1,001 shares authorized. NLHC currently has no assets, liabilities or operations other than that related to its ownership of NLVF's outstanding stock. NLVF has assets and operations primarily related to issuance of \$275 million in senior notes and \$21 million in debt related to trust preferred securities issued through a trust vehicle. See Note 8 for more information. Under the terms of the reorganization, NLHC must always hold a majority of the voting shares of NLVF.

This reorganization was approved by policyowners of National Life and was completed with the approval of the Commissioner of the Vermont Department of Banking, Insurance, Securities, and Health Care Administration (the "Commissioner").

Under the provisions of the reorganization, National Life issued 2.5 million common stock \$1 par shares to its parent, NLVF, as a transfer from retained earnings. There were no dividends paid or declared in 2004 by National Life, NLVF, or NLHC. In 2005, National Life dividended its ownership interests in SAMI and another subsidiary to NLVF. There have been no distributions to members of NLHC. Dividends declared by National Life in excess of the lesser of ten percent of statutory surplus or statutory net gain from operations require pre-approval by the Commissioner. Statutory surplus was \$826.6 million and \$708.0 million at December 31, 2007 and 2006, respectively. Statutory net income was \$64.9 million and \$79.7 million in 2007 and 2006, respectively.

The New York Insurance Department recognizes only statutory accounting practices for determining and reporting the financial condition and results of operations of an insurance company and for determining solvency under the New York Insurance Law. No consideration is given by the New York Insurance Department to financial statements prepared in accordance with GAAP in making such determinations.

#### **NOTE 13 – PRESENT VALUE OF FUTURE PROFITS OF INSURANCE ACQUIRED**

Interest accrued on present value of future profits of insurance acquired ("PVFP") was \$2.8 million, \$3.1 million, and \$3.5 million for the years ended December 31, 2007, 2006, and 2005, respectively. The Company holds PVFP attributable to two purchased blocks of insurance, the first attributed to an indirect purchase of a two-thirds ownership interest in LSW in February 1996, the second attributed to the indirect purchase of the remaining third ownership interest in July 1999. The first block accrues interest at 5.99%; the second accrues interest at 5.61%. Amortization of PVFP was \$6.2 million, \$8.2 million, and \$8.8 million for the years ended December 31, 2007, 2006, and 2005, respectively.

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**NOTE 13 – PRESENT VALUE OF FUTURE PROFITS OF INSURANCE ACQUIRED**  
**(continued)**

Projected amortization of PVFP during the next five years is as follows (in thousands):

<b>Year</b>	<b>Projected Amortization</b>
2008	<b>\$6,400</b>
2009	<b>6,300</b>
2010	<b>5,500</b>
2011	<b>4,700</b>
2012	<b>4,000</b>

Amortization is adjusted retrospectively for actual experience and when estimates of future profits are revised.

**NOTE 14 – PARTICIPATING LIFE INSURANCE**

Participating life insurance inforce was 51.5% and 55.1% of the face value of total insurance inforce at December 31, 2007 and 2006, respectively. The premiums on participating life insurance policies were 48.2%, 53.0%, and 54.2% of total individual life insurance premiums in 2007, 2006, and 2005, respectively.

**NOTE 15 – SALE OF AG&T**

On September 29, 2006, the Company sold its 95.73% interest in its consolidated subsidiary, AG&T. Prior to the sale, AG&T paid a dividend of \$2.8 million to its shareholders. The portion received by the Company was eliminated upon consolidation. The Company recognized a realized gain of \$8.1 million on the sale of its interest in AG&T. The results of operations of AG&T in all years presented are immaterial to the operations of the Company.

**NOTE 16 – PENDING TRANSACTION**

On November 13, 2007, the Company announced that SAMI had reached an agreement with Citizens Advisers, Inc. for the reorganization of eight Citizens Funds, representing assets under management of approximately \$800 million, into the Sentinel Funds. The reorganization is expected to occur in the first quarter of 2008, pending approval of the Citizens Funds shareholders and other contingencies. The cost of the transaction is expected to be capitalized by the Company as a combination of goodwill and other intangible assets.