

# **NLV Financial Corporation and Subsidiaries**

**Financial Statements  
December 31, 2008 and 2007**

# NLV FINANCIAL CORPORATION AND SUBSIDIARIES

## Index

December 31, 2008 and 2007

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	<b>Page(s)</b>
<b>Report of Independent Auditors</b> .....	1
<b>Consolidated Financial Statements</b>	
Consolidated Balance Sheets .....	2
Consolidated Statements of Operations .....	3
Consolidated Statements of Changes in Stockholder's Equity .....	4
Consolidated Statements of Cash Flows .....	5
Notes to Consolidated Financial Statements .....	6 - 47

**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, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 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 fair value measurement on January 1, 2008. Additionally, 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 and changed its method of accounting for uncertainty in income taxes on January 1, 2007.

*PricewaterhouseCoopers LLP*

February 26, 2009

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

December 31,

(In Thousands)

	2008	2007
<b>Assets:</b>		
Cash and investments:		
Available-for-sale debt securities	\$ 9,036,202	\$ 9,330,759
Available-for-sale debt securities on loan	119,254	265,784
Total available-for-sale debt securities	9,155,456	9,596,543
Available-for-sale equity securities	86,908	152,870
Trading equity securities	15,714	23,456
Mortgage loans on real estate	1,676,877	1,659,951
Policy loans	719,251	706,278
Real estate investments	15,653	19,112
Securities lending invested collateral	81,440	234,691
Other invested assets	367,900	358,757
Cash and cash equivalents	147,987	179,405
Total cash and investments	12,267,186	12,931,063
Deferred policy acquisition costs	1,414,078	969,875
Accrued investment income	147,640	139,898
Premiums and fees receivable	23,774	21,158
Deferred income taxes	229,216	2,786
Amounts recoverable from reinsurers	142,775	135,874
Present value of future profits of insurance acquired	37,775	42,749
Property and equipment, net	50,912	46,829
Federal income tax recoverable	31,324	1,647
Other assets	199,715	195,273
Goodwill and intangibles	56,178	31,532
Separate account assets	609,236	983,815
<b>Total assets</b>	<b>\$ 15,209,809</b>	<b>\$15,502,499</b>
<b>Liabilities:</b>		
Policy liabilities:		
Policy benefit liabilities	\$ 4,670,993	\$ 4,648,082
Policyholder account liabilities	7,817,806	7,153,888
Policyholders' deposits	65,321	55,599
Policy claims payable	47,269	42,339
Policyholders' dividends	51,352	128,333
Total policy liabilities	12,652,741	12,028,241
Amounts payable to reinsurers	17,419	21,957
Securities lending payable	121,695	269,927
Other liabilities and accrued expenses	236,002	247,077
Pension and other post-retirement benefit obligations	217,421	168,451
Debt	294,747	294,713
Separate account liabilities	609,236	983,815
<b>Total liabilities</b>	<b>14,149,261</b>	<b>14,014,181</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	1,483,880	1,470,504
Accumulated other comprehensive income	(423,332)	17,814
<b>Total stockholder's equity</b>	<b>1,060,548</b>	<b>1,488,318</b>
<b>Total liabilities and stockholder's equity</b>	<b>\$ 15,209,809</b>	<b>\$15,502,499</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,

<i>(In Thousands)</i>	2008	2007	2006
<b>Revenues:</b>			
Insurance premiums	\$ 322,470	\$ 322,328	\$ 336,007
Policy and contract charges	210,113	178,770	156,950
Net investment income	575,766	758,058	797,462
Net realized investment (losses) gains	(105,994)	(4,953)	1,122
Change in value of trading equity securities	(7,650)	847	1,538
Mutual fund commissions and fee income	98,837	104,017	105,919
Other income	19,659	21,800	18,563
<b>Total revenues</b>	<b>1,113,201</b>	<b>1,380,867</b>	<b>1,417,561</b>
<b>Benefits and Expenses:</b>			
Increase in policy liabilities	45,105	29,717	81,783
Policy benefits	406,068	411,267	349,718
Policyholders' dividends and dividend obligations	113,798	111,097	122,308
Interest credited to policyholder account liabilities	108,679	274,928	327,445
Operating expenses	168,655	169,600	174,797
Interest expense on debt	21,666	21,944	21,975
Policy acquisition expenses and amortization of present value of future profits, net	241,710	198,994	179,242
<b>Total benefits and expenses</b>	<b>1,105,681</b>	<b>1,217,547</b>	<b>1,257,268</b>
<b>Income before income taxes and minority interest</b>	<b>7,520</b>	<b>163,320</b>	<b>160,293</b>
Income tax (benefit) expense	(7,840)	48,101	43,566
<b>Income before minority interest</b>	<b>15,360</b>	<b>115,219</b>	<b>116,727</b>
Minority interest in consolidated subsidiaries	-	-	(103)
<b>Net Income</b>	<b>\$ 15,360</b>	<b>\$ 115,219</b>	<b>\$ 116,830</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, 2006	\$-	\$-	\$-	\$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
December 31, 2007	-	-	-	1,470,504	17,814	1,488,318
Cumulative effect of FAS 158 measurement date adjustment	-	-	-	(1,984)	-	(1,984)
Comprehensive income:						
Net income	-	-	-	15,360	-	15,360
Change in unrealized gains on available- for-sale securities, net	-	-	-	-	(404,865)	(404,865)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in FAS 158 liability, net	-	-	-	-	(36,315)	(36,315)
Total comprehensive income						(425,786)
<b>December 31, 2008</b>	<b>\$-</b>	<b>\$-</b>	<b>\$-</b>	<b>\$ 1,483,880</b>	<b>\$ (423,332)</b>	<b>\$ 1,060,548</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,

<i>(In Thousands)</i>	2008	2007	2006
<b>Cash Flows from Operating Activities:</b>			
Net income	\$ 15,360	\$ 115,219	\$ 116,830
Adjustments to reconcile net income to net cash provided by operating activities:			
Changes in assets and liabilities:			
Accrued investment income	(7,742)	(9,187)	(3,364)
Policy acquisition costs	(75,430)	(66,360)	(83,564)
Policy benefit liabilities	24,872	35,585	43,992
Other assets and liabilities	64,658	22,025	36,319
Provision for deferred income taxes	12,193	6,411	26,917
Interest credited to policyholder account liabilities	108,679	274,928	327,445
Policy and contract charges	(210,113)	(178,770)	(156,950)
Net realized investment losses (gains)	105,994	4,953	(1,122)
Net option losses (gains)	197,184	(1,959)	(77,348)
Market value change on corporate owned life insurance policies	(3,388)	(5,706)	(4,037)
Change in present value of future profits of insurance acquired	4,974	6,172	8,176
Depreciation	7,867	6,941	8,276
Other	(22,674)	10,755	12,052
Net cash provided by operating activities	222,434	221,007	253,622
<b>Cash Flows from Investing Activities:</b>			
Proceeds from sales, maturities and repayments of investments	1,917,642	2,261,479	2,906,885
Cost of investments acquired	(2,833,440)	(3,030,297)	(3,438,464)
Change in policy loans	(12,973)	(10,155)	(4,476)
Change in securities lending invested collateral	153,251	23,512	(99,321)
Other	(43,345)	(16,895)	(10,316)
Net cash used by investing activities	(818,865)	(772,356)	(645,692)
<b>Cash Flows from Financing Activities:</b>			
Policyholders' deposits	1,548,519	1,125,012	1,047,595
Policyholders' withdrawals	(835,274)	(737,843)	(576,402)
Change in securities lending payable	(148,232)	(116,118)	18,659
Net cash provided by financing activities	565,013	271,051	489,852
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(31,418)</b>	<b>(280,298)</b>	<b>97,782</b>
<b>Cash and Short-term investments:</b>			
Beginning of year	179,405	459,703	361,921
End of year	\$ 147,987	\$ 179,405	\$ 459,703

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

**NLV FINANCIAL CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2008 and 2007**

**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-two 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 530,000 policyholders and is licensed to do business in all 50 states and the District of Columbia through its affiliates. About 27% 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’ \$4.0 billion of net assets represent sixteen mutual funds managed on behalf of about 252,000 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 Company’s consolidated financial statements have been prepared on the basis of United States generally accepted accounting principals (“U.S. GAAP”). Preparing financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

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

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

**Cash and Cash Equivalents**

Cash and cash equivalents is made up of unrestricted cash and restricted cash components. The restricted cash was \$32.6 million and \$65.9 million for the years ended December 31, 2008 and 2007, respectively. This included \$23.1 million and \$34.0 million associated with securities lending collateral and \$9.5 million and \$31.9 million associated with collateral assigned to purchased options for the years ended December 31, 2008 and 2007, respectively.

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

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

**Investments**

Available-for-sale debt and equity securities are reported at estimated fair value. When determining estimated fair value, the Company utilizes observable market inputs and considers available data from third party pricing agencies, independent brokers and pricing matrices. Publicly available prices are used whenever possible. In the event that publicly available pricing is not available, the securities are submitted to independent brokers for pricing, or they are valued using a pricing matrix that maximizes the use of observable inputs that include, but are not limited to reported trades, benchmark yields, issuer spreads, bids, offers and or estimated cash flows. The Company performs a monthly analysis on prices received from third parties to ensure that the price represents a reasonable estimate of fair value. This process includes quantitative and qualitative analysis and is performed by the Company's investment professionals.

At the balance sheet date, the Company evaluates its security holdings that are in an unrealized loss position. When the Company's intention is to dispose of securities before they recover to their cost basis, the Company deems that decline to be other than temporary, and the decline is recorded as a realized loss at the balance sheet date. If a loss is recognized from a sale subsequent to a balance sheet date pursuant to a change in circumstances, the loss is recognized in the period in which the intent to hold the securities until recovery no longer existed.

Certain investments with a beneficial interest in securitized financial assets with contractual cash flows, including asset-backed securities are carried at estimated fair value which is determined by a pricing model that generates the predicted cash flows based on observable inputs such as market spreads and trades of similar securities. Emerging Issues Task Force (EITF) 99-20, "*Recognition of Interest Income and Impairment on Purchased Beneficial Interest that Continued to be Held by a Transferor in Securitized Assets ("EITF 99-20")*" requires periodic updates of the Company's best estimate of cash flows over the life of the security. If the fair value of an investment with a beneficial interest in a securitized financial asset is less than its amortized cost, and there has been a decrease in estimated cash flows since the last revised estimate, then considering both the timing and the amount of the decrease, an other than temporary impairment ("OTTI") is recognized.

Trading equity securities are reported at estimated fair value. Realized and unrealized (losses) gains 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 (losses) gains.

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 independent broker pricing quotes when data is not publicly available. Changes in fair value are reflected in the statements of operations as a component of net realized investment (losses) gains.

