

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

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FINANCIAL STATEMENTS

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DECEMBER 31, 2005 and 2004

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, comprehensive income, changes in 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, 2005 and 2004, and the results of their operations and their cash flows for the three years ended December 31, 2005 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 15 to the consolidated financial statements, the Company changed its method of accounting for interests in certain entities effective January 1, 2005.

As discussed in note 16 to the consolidated financial statements, the Company changed its method of accounting for certain non-traditional insurance contracts effective January 1, 2004.

PricewaterhouseCoopers LLP

Boston, Massachusetts
February 23, 2006

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31,

(In Thousands)

| | 2005 | 2004 |
|---|---------------|---------------|
| Assets: | | |
| Cash and investments: | | |
| Available-for-sale debt securities | \$ 8,216,767 | \$ 8,040,229 |
| Available-for-sale debt securities on loan | 361,748 | 20,283 |
| Total available-for-sale debt securities | 8,578,515 | 8,060,512 |
| Available-for-sale equity securities | 202,444 | 212,293 |
| Trading equity securities | 23,129 | 25,308 |
| Mortgage loans on real estate | 1,510,512 | 1,440,639 |
| Policy loans | 691,705 | 697,011 |
| Real estate investments | 51,767 | 34,406 |
| Other invested assets | 248,780 | 225,364 |
| Cash and cash equivalents | 519,947 | 141,555 |
| Total cash and investments | 11,826,799 | 10,837,088 |
| Deferred policy acquisition costs | 799,755 | 680,755 |
| Accrued investment income | 127,346 | 122,306 |
| Premiums and fees receivable | 21,774 | 21,418 |
| Deferred income taxes | 35,269 | 4,857 |
| Amounts recoverable from reinsurers | 80,929 | 73,292 |
| Present value of future profits of insurance acquired | 54,532 | 59,300 |
| Property and equipment, net | 40,793 | 41,601 |
| Federal income tax recoverable | 1,381 | 5,592 |
| Other assets | 206,213 | 170,593 |
| Separate account assets | 840,125 | 779,591 |
| Total assets | \$ 14,034,916 | \$ 12,796,393 |
| Liabilities: | | |
| Policy liabilities: | | |
| Policy benefit liabilities | \$ 4,582,240 | \$ 4,525,196 |
| Policyholder account liabilities | 5,989,251 | 5,352,824 |
| Policyholders' deposits | 56,672 | 65,119 |
| Policy claims payable | 39,724 | 39,754 |
| Policyholders' dividends | 155,712 | 223,245 |
| Total policy liabilities | 10,823,599 | 10,206,138 |
| Amounts payable to reinsurers | 18,480 | 19,909 |
| Collateral held on loaned securities | 367,386 | 21,297 |
| Other liabilities and accrued expenses | 178,073 | 143,906 |
| Pension and other post-retirement benefit obligations | 186,895 | 173,449 |
| Debt | 362,145 | 219,623 |
| Separate account liabilities | 840,125 | 779,591 |
| Total liabilities | 12,776,703 | 11,563,913 |
| Minority Interest in Consolidated Subsidiaries | 241 | 5,416 |
| Equity: | | |
| Retained earnings | 1,228,285 | 1,130,826 |
| Accumulated other comprehensive income | 29,687 | 96,238 |
| Total equity | 1,257,972 | 1,227,064 |
| Total liabilities, minority interest, and equity | \$ 14,034,916 | \$ 12,796,393 |

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)

| | 2005 | 2004 | 2003 |
|---|------------------|------------------|------------------|
| Revenues: | | | |
| Insurance premiums | \$ 354,556 | \$ 378,093 | \$ 411,226 |
| Policy and contract charges | 137,740 | 123,115 | 103,106 |
| Net investment income | 675,687 | 682,856 | 667,057 |
| Net realized investment gains (losses) | 2,146 | 8,419 | (5,282) |
| Change in value of trading equity securities | 155 | 1,134 | 4,187 |
| Mutual fund commissions and fee income | 100,475 | 95,431 | 71,853 |
| Other income | 23,017 | 18,745 | 28,629 |
| Total revenues | 1,293,776 | 1,307,793 | 1,280,776 |
| Benefits and Expenses: | | | |
| Increase in policy liabilities | 84,467 | 63,590 | 168,105 |
| Policy benefits | 363,414 | 416,125 | 329,674 |
| Policyholders' dividends and dividend obligations | 116,103 | 115,008 | 126,774 |
| Interest credited to policyholder account liabilities | 230,819 | 256,892 | 244,551 |
| Operating expenses | 177,230 | 173,914 | 173,827 |
| Interest expense on debt | 20,465 | 17,148 | 12,134 |
| Change in sales practice remediation provision | - | (2,367) | (2,384) |
| Early retirement of surplus notes and other financing | 974 | 3,354 | 405 |
| Policy acquisition expenses and amortization of present value of future profits, net | 166,774 | 147,816 | 142,916 |
| Total benefits and expenses | 1,160,246 | 1,191,480 | 1,196,002 |
| Income before income taxes, minority interest, and cumulative effect of accounting change | 133,530 | 116,313 | 84,774 |
| Income tax expense | 34,834 | 27,995 | 6,619 |
| Income before minority interest and cumulative effect of accounting change | 98,696 | 88,318 | 78,155 |
| Minority interest in consolidated subsidiaries | 1,237 | 944 | 769 |
| Income before cumulative effect of accounting change | 97,459 | 87,374 | 77,386 |
| Cumulative effect of accounting change, net | - | (1,350) | - |
| Net Income | \$ 97,459 | \$ 86,024 | \$ 77,386 |

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended December 31,

| <i>(In Thousands)</i> | 2005 | 2004 | 2003 |
|--|-------------|-------------|-------------|
| Net income | \$ 97,459 | \$ 86,024 | \$ 77,386 |
| Other Comprehensive Income: | | | |
| Change in unrealized gains on available-for-sale securities, net | (57,111) | 19,476 | 32,603 |
| Change in cash flow hedge on debt issuance, net | 34 | 34 | (998) |
| Change in additional minimum pension liability, net | (9,474) | (612) | (320) |
| Total comprehensive income | \$ 30,908 | \$ 104,922 | \$ 108,671 |

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the years ended December 31,

| <i>(In Thousands)</i> | 2005 | 2004 | 2003 |
|--|--------------|--------------|--------------|
| Retained Earnings: | | | |
| Balance at January 1 | \$ 1,130,826 | \$ 1,044,802 | \$ 967,416 |
| Net income | 97,459 | 86,024 | 77,386 |
| Balance at December 31 | 1,228,285 | 1,130,826 | 1,044,802 |
| Accumulated Other Comprehensive Income: | | | |
| Balance at January 1 | 96,238 | 77,340 | 46,055 |
| Change in unrealized gains on available-for-sale securities, net | (57,111) | 19,476 | 32,603 |
| Change in cash flow hedge on debt issuance, net | 34 | 34 | (998) |
| Change in additional minimum pension liability, net | (9,474) | (612) | (320) |
| Balance at December 31 | 29,687 | 96,238 | 77,340 |
| Total Equity: | | | |
| Balance at December 31 | \$ 1,257,972 | \$ 1,227,064 | \$ 1,122,142 |

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)

| | 2005 | 2004 | 2003 |
|---|----------------|-----------------|----------------|
| Cash Flows from Operating Activities: | | | |
| Net income | \$ 97,459 | \$ 86,024 | \$ 77,386 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Change in: | | | |
| Accrued investment income | (5,040) | (2,174) | (1,094) |
| Policy acquisition costs | (48,268) | (69,710) | (52,816) |
| Policy benefit liabilities | 39,457 | 26,561 | 138,434 |
| Amendment of modco reinsurance agreement with UNUM | - | - | 286,161 |
| Interest credited to policyholder account liabilities | 230,819 | 256,892 | 244,551 |
| Policy and contract charges | (137,740) | (123,115) | (103,106) |
| Other liabilities | 10,572 | (3,756) | 1,859 |
| Provision for deferred income taxes | 5,419 | 11,750 | (1,726) |
| Net realized investment (gains) losses | (2,146) | (8,419) | 5,282 |
| Net options losses (gains) | 26,199 | 10,090 | (68,317) |
| Change in present value of future profits of insurance acquired | 8,796 | 8,356 | 7,225 |
| Depreciation | 2,868 | 2,939 | 5,698 |
| Other | 28,356 | 445 | 49,412 |
| Net cash provided by operating activities | 256,751 | 195,883 | 588,949 |
| Cash Flows from Investing Activities: | | | |
| Proceeds from sales, maturities and repayments of investments | 3,313,772 | 3,758,680 | 3,193,815 |
| Cost of investments acquired | (4,143,967) | (4,457,479) | (4,327,245) |
| Change in policy loans | 5,306 | 24,960 | 15,807 |
| Other | (26,463) | (16,400) | (16,892) |
| Net cash used by investing activities | (851,352) | (690,239) | (1,134,515) |
| Cash Flows from Financing Activities: | | | |
| Policyholders' deposits | 909,404 | 819,336 | 665,658 |
| Policyholders' withdrawals | (366,056) | (304,239) | (258,273) |
| Net change in collateral held on loaned securities | 346,089 | (18,538) | 22,072 |
| Issuance of senior notes and other debt | 146,705 | - | 219,609 |
| Retirement of surplus notes and other debt | (44,853) | (63,199) | (7,000) |
| Other | (18,296) | (13,705) | 13,844 |
| Net cash provided by financing activities | 972,993 | 419,655 | 655,910 |
| Net Increase (Decrease) in Cash and Cash Equivalents | 378,392 | (74,701) | 110,344 |
| Cash and Cash Equivalents: | | | |
| Beginning of year | 141,555 | 216,256 | 105,912 |
| End of year | \$ 519,947 | \$ 141,555 | \$ 216,256 |

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, and is also known by its registered trade name “National Life of Vermont.” The Company employs approximately 870 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. See Note 11 for more information. Concurrent with the conversion to a stock life insurance company, National Life created a closed block of insurance and annuity policies (the “Closed Block”). See Note 10 for more information. The Company also maintains an inforce block of disability income insurance contracts.

The insurance operations within the Company 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. 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 brokers throughout the United States of America. The Company has in excess of 485,000 policyholders and is licensed to do business in all 50 states and the District of Columbia through its member companies. About 29% 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”) (formerly NL Capital Management, Inc.) and its subsidiaries and affiliates, the Company also distributes and provides investment advisory and administrative services to the Sentinel Group Funds, Inc. The Sentinel Funds’ \$4.1 billion of net assets represent fourteen mutual funds managed on behalf of about 231,000 individual, corporate, and institutional shareholders worldwide.

During late 2005, the Company completed a series of transactions whereby SAMI and its affiliates became direct subsidiaries of NLVF, and several companies were merged into other companies within the Company. There were no dividends or capital transactions with entities outside of the Company as a result of these transactions. These transactions had no impact on consolidated net income or total equity.

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. On January 1, 2005, pursuant to the Company’s adoption of FASB revised Interpretation No. 46 (“FIN 46R”), the Company deconsolidated NL Group Statutory Trust I and consolidated Lake Carlton Arms. See Note 15. 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.

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)

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. Market values for loan-backed securities are based on Interactive Data pricing obtained through HUB Data, Inc.

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.

Options and futures contracts are included in other invested assets 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.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments (continued)

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.

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.

Deferred policy acquisition costs assets are regularly evaluated for recoverability from product margins. 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.

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.

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 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 7.75% in 2005. In 2004, the rate of investment return was assumed to be 7% in 2005, and 8% thereafter.

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. See Note 12 for additional information.

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 \$4.8 million and \$3.8 million at December 31, 2005 and 2004, respectively, and was included in other assets. Total other intangible assets were \$15.3 million and \$11.5 million at December 31, 2005 and 2004, respectively, and were included in other assets. There were no reductions in goodwill or other intangible assets due to impairment during 2005, 2004, or 2003. The increase in goodwill and other intangible assets in 2005 is due to the Company's purchase of minority interests held by outside investors.

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 \$95.7 million and \$92.8 million at December 31, 2005 and 2004, respectively, and is included in other assets. At December 31, 2005 and 2004, 76% of the total COLI cash surrender value was held at declared interest, with the remainder held in segregated variable separate account funds.

COLI income includes the net change in cash surrender value and any benefits received. COLI income was \$7.0 million, \$4.0 million, and \$10.0 million in 2005, 2004, and 2003, respectively, and is included in other income.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 universal life insurance and non-equity indexed investment-type annuities represent amounts that inure to the benefit of the policyholders before surrender charges. Policyholder account balances for equity indexed 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 Index. 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 Index. See Note 3 for additional disclosure on derivatives associated with equity indexed annuities.

The guaranteed minimum interest rates for the Company's fixed interest rate annuities range from 1.5% to 4.5%. In 2003, the Company made application with various states to sell annuity products with a minimum guaranteed rate of 1.5%. As of December 31, 2005 and 2004, 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.

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, 2005 was fifty-five. 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, subject to state approval. Policyholder partial withdrawals to date have not

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

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 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 \$3.6 and \$2.8 million and recorded net amortization of \$2.1 and \$1.7 million during 2005 and 2004, respectively. Sales inducement assets were \$9.0 and \$7.5 million at December 31, 2005 and 2004, respectively. See Note 16.

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 and \$1.1 million and recorded net increases for amortization and unlocking of \$1.2 and \$0.2 million during 2005 and 2004, respectively. Sales inducement liabilities were \$6.3 and \$4.9 million at December 31, 2005 and 2004, 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. See Note 10 for additional information on dividend obligations within the Closed Block.

Policyholder Deposits

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition of Insurance Income 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, 2005. 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 represent minority partners' interests in entities within the Company. Minority interests attributable to common stockholders are carried on the equity method. In late 2005, the Company purchased most of the remaining minority interests held by outside investors. Those attributable to preferred stockholders are carried on the cost method, with dividends paid reflected as minority interests expense within the consolidated financial statements. 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.

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

NOTE 3 – 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):

| 2005 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|--------------------|---------------------------------------|--|---------------------------------|
| AFS debt and equity securities: | | | | |
| U.S. government obligations | \$ 85,395 | \$ 371 | \$ 376 | \$ 85,390 |
| Government agencies, authorities and subdivisions | 178,666 | 3,044 | 1,564 | 180,146 |
| Corporate: | | | | |
| Communications | 558,956 | 33,975 | 3,918 | 589,013 |
| Consumer & retail | 609,849 | 18,784 | 11,744 | 616,889 |
| Financial institutions | 1,328,897 | 52,632 | 9,741 | 1,371,788 |
| Industrial and chemicals | 389,005 | 20,640 | 5,931 | 403,714 |
| Other corporate | 94,552 | 13,319 | 2 | 107,869 |
| REITS | 167,960 | 3,935 | 1,384 | 170,511 |
| Transportation | 138,249 | 7,669 | 1,518 | 144,400 |
| Utilities | 1,111,678 | 63,276 | 6,372 | 1,168,582 |
| Total corporate | 4,399,146 | 214,230 | 40,610 | 4,572,766 |
| Private placements | 726,368 | 33,529 | 4,276 | 755,621 |
| Mortgage-backed securities | 3,020,347 | 18,706 | 54,461 | 2,984,592 |
| Total AFS debt securities | 8,409,922 | 269,880 | 101,287 | 8,578,515 |
| Preferred stocks | 141,765 | 6,288 | 634 | 147,419 |
| Common stocks | 46,065 | 9,379 | 419 | 55,025 |
| Total AFS equity securities | 187,830 | 15,667 | 1,053 | 202,444 |
| Total AFS debt and equity securities | \$8,597,752 | \$285,547 | \$102,340 | \$8,780,959 |

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

NOTE 3 – INVESTMENTS (continued)

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

| 2004 | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|-------------|---------------------------------------|--|---------------------------------|
| AFS debt and equity securities: | | | | |
| U.S. government obligations | \$ 16,069 | \$ 592 | \$ 53 | \$ 16,608 |
| Government agencies, authorities and subdivisions | 169,939 | 5,571 | – | 175,510 |
| Corporate: | | | | |
| Communications | 520,062 | 55,664 | 310 | 575,416 |
| Consumer & retail | 474,879 | 31,907 | 767 | 506,019 |
| Financial institutions | 1,222,978 | 70,982 | 4,657 | 1,289,303 |
| Industrial and chemicals | 329,616 | 29,528 | 921 | 358,223 |
| Other corporate | 95,472 | 15,235 | 4 | 110,703 |
| REITS | 173,973 | 7,930 | 39 | 181,864 |
| Transportation | 103,524 | 8,466 | 379 | 111,611 |
| Utilities | 1,065,934 | 93,725 | 1,318 | 1,158,341 |
| Total corporate | 3,986,438 | 313,437 | 8,395 | 4,291,480 |
| Private placements | 661,669 | 47,084 | 2,795 | 705,958 |
| Mortgage-backed securities | 2,835,674 | 45,545 | 10,263 | 2,870,956 |
| Total AFS debt securities | 7,669,789 | 412,229 | 21,506 | 8,060,512 |
| Preferred stocks | 115,580 | 10,694 | 215 | 126,059 |
| Common stocks | 75,104 | 11,450 | 320 | 86,234 |
| Total AFS equity securities | 190,684 | 22,144 | 535 | 212,293 |
| Total AFS debt and equity securities | \$7,860,473 | \$434,373 | \$22,041 | \$8,272,805 |

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):

| | 2005 | 2004 | 2003 |
|--|--------------------|-------------|-------------|
| Net unrealized gains (losses) on available-for-sale securities | \$(229,125) | \$ 31,471 | \$ 84,769 |
| Net unrealized gains on separate accounts | 178 | 168 | 586 |
| Net unrealized gains on other invested assets | 3,889 | 4,118 | 877 |
| Related deferred policy acquisition costs | 70,732 | 3,006 | (28,179) |
| Related present value of future profits of insurance acquired | 4,028 | 4,825 | (687) |
| Related deferred income taxes | 30,752 | (10,487) | (17,526) |
| Related policyholder dividend obligation | 62,435 | (13,625) | (7,237) |
| (Decrease) increase in net unrealized gains | (57,111) | 19,476 | 32,603 |
| Balance, beginning of year | 112,904 | 93,428 | 60,825 |
| Balance, end of year | \$ 55,793 | \$112,904 | \$ 93,428 |

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

NOTE 3 – INVESTMENTS (continued)

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

| | 2005 | 2004 |
|---|------------------|-------------------|
| Balance, end of year includes: | | |
| Net unrealized gains on available-for-sale securities | \$183,207 | \$ 412,332 |
| Net unrealized gains on separate accounts | 2,947 | 2,769 |
| Net unrealized gains on other invested assets | 8,884 | 4,995 |
| Related deferred policy acquisition costs | (13,982) | (84,714) |
| Related present value of future profits of insurance acquired | (2,627) | (6,655) |
| Related deferred income taxes | (30,042) | (60,794) |
| Related policyholder dividend obligation | (92,594) | (155,029) |
| Balance, end of year | <u>\$ 55,793</u> | <u>\$ 112,904</u> |

Net other comprehensive income (loss) related to unrealized gains and losses on available-for-sale securities for 2005, 2004, and 2003 of \$(57.1) million, \$19.5 million, and \$32.6 million is presented net of reclassifications to net income for net realized gains (losses) during the period of \$17.4 million, \$7.1 million, and \$(2.9) million and net of tax and deferred acquisition cost offsets of \$11.3 million, \$4.8 million, and \$(2.0) million, respectively.

The amortized cost and estimated fair values of debt securities by contractual maturity at December 31, 2005, 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 | \$ 217,297 | \$ 219,465 |
| Due after one year through five years | 1,178,346 | 1,213,759 |
| Due after five years through ten years | 2,631,801 | 2,686,924 |
| Due after ten years | 1,362,131 | 1,473,775 |
| Mortgage-backed securities | 3,020,347 | 2,984,592 |
| Total | <u>\$8,409,922</u> | <u>\$8,578,515</u> |

Proceeds from sales of available-for-sale debt and equity securities for the years ended December 31, 2005, 2004, and 2003 were \$2,240.0 million, \$2,979.1 million, and \$2,445.4 million, respectively. Gross realized gains on sales of available-for-sale debt securities for the years ended December 31, 2005, 2004, and 2003 were \$13.0 million, \$33.8 million, and \$37.1 million, respectively. Gross realized losses on sales of available-for-sale debt securities for the years ended December 31, 2005, 2004, and 2003 were \$11.8 million, \$23.6 million, and \$31.3 million, respectively. Gross realized gains on available-for-sale equity securities for the years ended December 31, 2005, 2004, and 2003 were \$5.8 million, \$3.5 million, and \$4.2 million, respectively. Gross realized losses on available-for-sale equity securities for the years ended December 31, 2005, 2004, and 2003 were \$0.2 million, \$1.6 million, and \$1.1 million, respectively.

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

NOTE 3 – INVESTMENTS (continued)

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

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, 2005 and 2004, were as follows (in thousands):

| 2005 | Less than 12 months | | 12 months or more | | Total | |
|---|----------------------|-------------------|----------------------|-------------------|----------------------|-------------------|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Description of Securities | | | | | | |
| U.S. government obligations | \$ 71,955 | \$ 355 | \$ 700 | \$ 21 | \$ 72,655 | \$ 376 |
| Government agencies, authorities and subdivisions | 127,340 | 1,564 | – | – | 127,340 | 1,564 |
| Corporate: | | | | | | |
| Communications | 136,220 | 3,756 | 9,819 | 162 | 146,039 | 3,918 |
| Consumer & retail | 179,105 | 4,290 | 37,665 | 7,454 | 216,770 | 11,744 |
| Financial institutions | 366,214 | 5,903 | 107,612 | 3,838 | 473,826 | 9,741 |
| Industrial and chemicals | 123,758 | 4,252 | 27,450 | 1,679 | 151,208 | 5,931 |
| Other corporate | 5,000 | 2 | – | – | 5,000 | 2 |
| REITS | 44,561 | 876 | 15,976 | 508 | 60,537 | 1,384 |
| Transportation | 57,767 | 1,518 | – | – | 57,767 | 1,518 |
| Utilities | 269,484 | 5,218 | 35,925 | 1,154 | 305,409 | 6,372 |
| Total corporate | 1,182,109 | 25,815 | 234,447 | 14,795 | 1,416,556 | 40,610 |
| Private placements | 180,289 | 2,060 | 45,694 | 2,216 | 225,983 | 4,276 |
| Mortgage-backed securities | 2,214,790 | 53,988 | 15,635 | 473 | 2,230,425 | 54,461 |
| Subtotal debt securities | 3,776,483 | 83,782 | 296,476 | 17,505 | 4,072,959 | 101,287 |
| Preferred stock | 19,977 | 254 | 18,264 | 380 | 38,241 | 634 |
| Common stock | 14,280 | 220 | 1,652 | 199 | 15,932 | 419 |
| Total securities | \$3,810,740 | \$ 84,256 | \$ 316,392 | \$ 18,084 | \$4,127,132 | \$ 102,340 |

| 2004 | Less than 12 months | | 12 months or more | | Total | |
|----------------------------------|----------------------|-------------------|----------------------|-------------------|----------------------|-------------------|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Description of Securities | | | | | | |
| U.S. government obligations | \$ 1,379 | \$ 13 | \$ 3,532 | \$ 40 | \$ 4,911 | \$ 53 |
| Corporate: | | | | | | |
| Communications | 21,050 | 251 | 4,475 | 59 | 25,525 | 310 |
| Consumer & retail | 102,010 | 1,670 | – | – | 102,010 | 1,670 |
| Financial institutions | 206,913 | 3,242 | 55,528 | 2,279 | 262,441 | 5,521 |
| Industrial and chemicals | 30,984 | 923 | 10,363 | 390 | 41,347 | 1,313 |
| Other corporate | – | – | 5,004 | 4 | 5,004 | 4 |
| REITS | 17,471 | 50 | – | – | 17,471 | 50 |
| Transportation | 5,376 | 32 | 8,127 | 815 | 13,503 | 847 |
| Utilities | 100,737 | 771 | 21,494 | 704 | 122,231 | 1,475 |
| Total corporate | 484,541 | 6,939 | 104,991 | 4,251 | 589,532 | 11,190 |
| Mortgage-backed securities | 979,235 | 8,410 | 89,465 | 1,853 | 1,068,700 | 10,263 |
| Subtotal debt securities | 1,465,155 | 15,362 | 197,988 | 6,144 | 1,663,143 | 21,506 |
| Preferred stock | 8,000 | 209 | 384 | 6 | 8,384 | 215 |
| Common stock | 12,707 | 279 | 91 | 41 | 12,798 | 320 |
| Total securities | \$1,485,862 | \$ 15,850 | \$ 198,463 | \$ 6,191 | \$1,684,325 | \$ 22,041 |

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – INVESTMENTS (continued)

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

Of the \$83.8 million total unrealized losses on debt securities in the less than 12 months category, \$54.0 million was in the mortgage backed securities portfolio. Unrealized losses on mortgage backed securities purchased in 2005 was \$30.8 million. All of these securities were rated AAA at acquisition and maintained that rating at December 31, 2005. These unrealized losses are due to the higher level of market interest rates at December 31, 2005, compared to those at the time of purchase. The remaining \$23.2 million unrealized loss relates to mortgage backed securities that were generally purchased in the low interest rate environment experienced during recent years. The \$54.0 million of unrealized losses on mortgage backed securities represents 2.4% of the aggregate fair value of the \$2.2 billion in mortgage backed securities with unrealized losses at December 31, 2005. Many of the positions in this category have fair values only marginally below their respective carrying values.

The \$25.8 million unrealized losses in the corporate bond portfolio in the less than 12 months category are concentrated in the financial institution, consumer and retail, industrial and chemical, and utility sectors. Many of these bonds were purchased during the aforementioned low interest rate environment in early 2003. The majority of the unrealized losses on these bonds are interest rate related, not credit related. The majority of the corporate bonds purchased in 2005 were investment grade at the time of purchase, and none have been subsequently downgraded to non-investment grade since purchase.

The \$14.8 million unrealized losses on the corporate bond portfolio in the more than 12 month category are concentrated in the financial institution, consumer and retail, and industrial and chemicals sectors. Virtually all of these securities trade at tighter spreads than when they were purchased, but have unrealized losses due to an increase in interest rates since purchase.

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, 2005 are temporary.

The Company periodically lends certain U.S. government or corporate bonds to approved counterparties to enhance the yield of its bond portfolio. In 2005, the Company substantially modified its securities lending program as a result of entering into a new agreement with its securities lending agent. The Company receives cash collateral 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. The carrying values of securities loaned are unaffected by the transaction. Collateral held (included in cash and cash equivalents) and the corresponding liability for collateral held were \$367.4 million and \$21.3 million at December 31, 2005 and 2004, respectively. The fair value of the loaned securities was \$361.7 million and \$20.3 million at December 31, 2005 and 2004, respectively. The Company's earnings with respect to its modified securities lending program were \$0.4 million less expenses of \$0.1 million in 2005. Under the prior program, securities lending related expenses were \$0.3 and \$0.2 million at December 31, 2005 and 2004, respectively.

Trading Equity Securities

For the years ended December 31, 2005, 2004, and 2003 the equity securities held in the trading category recorded \$1.1 million, \$1.2 million, and \$0.9 million of net investment income. The cost of trading securities held at December 31, 2005 and 2004 was \$22.9 million and \$24.9 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 the deferred compensation liabilities is included in operating expenses.

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

NOTE 3 – INVESTMENTS (continued)

Mortgage Loans and Real Estate

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

| | 2005 | 2004 |
|--|--------------------|-------------|
| <u>Geographic Region</u> | | |
| New England | 2.7% | 3.0% |
| Middle Atlantic | 6.0 | 7.0 |
| East North Central | 13.1 | 10.7 |
| West North Central | 7.8 | 7.7 |
| South Atlantic | 25.6 | 28.1 |
| East South Central | 2.3 | 2.3 |
| West South Central | 11.2 | 11.9 |
| Mountain | 13.6 | 13.9 |
| Pacific | 17.7 | 15.4 |
| <hr/> | | |
| Total | 100.0% | 100.0% |
| <hr/> | | |
| <u>Property Type</u> | | |
| Apartment | 18.8% | 23.7% |
| Retail | 8.9 | 7.7 |
| Office Building | 42.1 | 40.5 |
| Industrial | 27.0 | 25.1 |
| Hotel/Motel | 1.0 | 1.1 |
| Other Commercial | 2.2 | 1.9 |
| <hr/> | | |
| Total | 100.0% | 100.0% |
| <hr/> | | |
| Total mortgage loans and real estate (in thousands) | \$1,562,279 | \$1,475,045 |

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

| | 2005 | 2004 |
|---|--------------------|-------------|
| Unimpaired loans | \$1,505,705 | \$1,435,810 |
| Impaired loans without valuation allowances | 7 | 29 |
| Subtotal | 1,505,712 | 1,435,839 |
| Impaired loans with valuation allowances | 5,660 | 5,660 |
| Related valuation allowances | (860) | (860) |
| Subtotal | 4,800 | 4,800 |
| Total | \$1,510,512 | \$1,440,639 |

| | 2005 | 2004 | 2003 |
|----------------------------|----------------|-------------|-------------|
| Impaired loans: | | | |
| Average total investment | \$5,678 | \$8,047 | \$8,947 |
| Interest income recognized | \$ 341 | \$ 287 | \$ 930 |
| Interest received | \$ 369 | \$ 286 | \$ 722 |

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

NOTE 3 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

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):

| | 2005 | 2004 | 2003 |
|---|--------------|-------------|-------------|
| Additions for impaired loans charged to realized losses | \$ – | \$ – | \$1,744 |
| Changes to previously established valuation allowances | – | (1,344) | – |
| (Decrease) increase in valuation allowances | – | (1,344) | 1,744 |
| Balance, beginning of year | 860 | 2,204 | 460 |
| Balance, end of year | \$860 | \$ 860 | \$2,204 |

Net Investment Income

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

| | 2005 | 2004 | 2003 |
|-----------------------------|------------------|-------------|-------------|
| Debt securities interest | \$500,470 | \$467,134 | \$442,190 |
| Equity securities dividends | 12,430 | 13,749 | 11,117 |
| Mortgage loan interest | 111,837 | 119,159 | 104,611 |
| Policy loan interest | 40,154 | 42,224 | 45,502 |
| Real estate income | 21,250 | 3,777 | 3,889 |
| Options | 3,438 | 43,993 | 69,880 |
| Other investment income | 20,706 | 9,836 | 5,243 |
| Gross investment income | 710,285 | 699,872 | 682,432 |
| Less: investment expenses | 34,598 | 17,016 | 15,375 |
| Net investment income | \$675,687 | \$682,856 | \$667,057 |

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. See Note 15.

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

NOTE 3 – INVESTMENTS (continued)

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):

| | 2005 | 2004 | 2003 |
|-------------------------|----------------|-------------|-------------|
| Debt securities | \$ 954 | \$8,742 | \$(8,288) |
| Equity securities | 6,630 | 1,669 | 2,739 |
| Mortgage loans | – | (106) | (1,744) |
| Real estate investments | (1,069) | 31 | 2,550 |
| Other invested assets | (4,369) | (1,917) | (539) |
| Total | \$2,146 | \$8,419 | \$(5,282) |

Derivatives

The Company purchases over-the-counter options and exchange-traded futures on the S&P 500 Index to hedge obligations relating to equity indexed products. These instruments and their related equity 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.

Equity indexed annuity 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 Index. 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 Index. At December 31, 2005, total equity indexed annuity liabilities of \$2,351.5 million were comprised of \$1,906.3 million of host contract and \$445.2 million of embedded derivative value. At December 31, 2004, total equity indexed annuity liabilities of \$1,804.6 million were comprised of \$1,419.7 million of host contract and \$384.9 million of embedded derivative value. Policyholder account liabilities at December 31, 2005 and 2004 were \$2,355.6 million and \$1,797.2 million, respectively.

Results of operations for 2005, 2004, and 2003 included after-tax earnings from equity indexed annuities of \$16.2 million, \$13.3 million, and \$19.2 million, respectively. The cost of options and changes in assumptions favorably impacted results of operations in 2005 and 2004.

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

During 2003, the Company entered into two interest rate swaps (receive fixed, pay variable) whereby the Company locked in the interest rate on a total of \$115 million in anticipated senior note financing. The Company's expectation was that the hedge would be 100% effective on the \$115 million (the Company did not intend to hedge the interest rate risk on the entire expected issuance of \$200 million). The Company's risk management objective in entering into the hedge transactions was to prevent any subsequent changes in market rates of interest from impacting the expected future interest payments on part of the senior note financing.

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

NOTE 3 – INVESTMENTS (continued)

Derivatives (continued)

The interest rate swaps employed covered both potential changes in underlying 30 year treasury rates and potential changes in credit spreads over those treasury rates. The swap position was closed out concurrent with the pricing of the senior notes through an offsetting interest rate swap (receive variable, pay fixed), for a net pre-tax loss of \$1.5 million. As the transaction qualifies for cash flow hedge treatment, the loss has been recorded in other comprehensive income, net of related taxes, and will be reflected in earnings as interest payments are made on the senior notes.

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):

| | 2005 | 2004 |
|-------------------|-----------------|-------------|
| Notional amounts: | | |
| Futures | \$19,967 | \$26,044 |

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

| | 2005 | 2004 |
|---|------------------|-------------|
| Carrying values: | | |
| Options purchased (included in other invested assets) | \$109,209 | \$114,599 |
| Options written (included in other liabilities) | (22,088) | (26,242) |
| Futures purchased (included in other invested assets) | 3,583 | 4,312 |
| Net carrying value | \$ 90,704 | \$ 92,669 |

Fair Value of Financial Instruments

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

| | 2005 | | 2004 | |
|--------------------------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Cash and cash equivalents | \$ 519,947 | \$ 519,947 | \$ 141,555 | \$ 141,555 |
| Available-for-sale debt securities | 8,578,515 | 8,578,515 | 8,060,512 | 8,060,512 |
| Available-for-sale equity securities | 202,444 | 202,444 | 212,293 | 212,293 |
| Trading equity securities | 23,129 | 23,129 | 25,308 | 25,308 |
| Mortgage loans | 1,510,512 | 1,552,845 | 1,440,639 | 1,536,823 |
| Policy loans | 691,705 | 685,052 | 697,011 | 683,226 |
| Derivatives | 90,704 | 90,704 | 92,669 | 92,669 |
| Investment product liabilities | 5,212,435 | 5,226,350 | 4,613,758 | 4,653,242 |
| Debt | 362,145 | 382,099 | 219,623 | 234,282 |

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.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 3 – INVESTMENTS (continued)

Fair Value of Financial Instruments (continued)

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.

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.

NOTE 4 – INSURANCE IN-FORCE AND 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.

Other income on the statements of operations includes income of \$7.6 million, \$8.7 million, and \$11.6 million for 2005, 2004, and 2003, respectively, related to the Company's disability income reinsurance. 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, 2005 and 2004 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 4 – INSURANCE IN-FORCE AND REINSURANCE (continued)

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, 2005 and 2004 was \$52.9 billion and \$51.1 billion, respectively.

Transactions between the Closed Block (see Note 10) and non-Closed Block operations have been excluded from the following schedule.

The effects of reinsurance for the years ended December 31 were as follows (in thousands):

| | 2005 | 2004 | 2003 |
|--------------------------------------|------------------|------------------|------------------|
| Insurance premiums: | | | |
| Direct | \$422,671 | \$439,145 | \$472,873 |
| Reinsurance assumed | 1,407 | 1,198 | 1,326 |
| Reinsurance ceded | (69,522) | (62,250) | (62,973) |
| Total insurance premiums | \$354,556 | \$378,093 | \$411,226 |
| Increase in policy liabilities: | | | |
| Direct | \$66,810 | \$35,463 | \$154,387 |
| Reinsurance ceded | 17,657 | 28,127 | 13,718 |
| Total increase in policy liabilities | \$84,467 | \$63,590 | \$168,105 |
| Policy benefits: | | | |
| Direct | \$441,818 | \$497,893 | \$405,077 |
| Reinsurance assumed | 1,729 | 41 | 2,958 |
| Reinsurance ceded | (80,133) | (81,809) | (78,361) |
| Total policy benefits | \$363,414 | \$416,125 | \$329,674 |
| Policyholders' dividends: | | | |
| Direct | \$119,006 | \$118,227 | \$130,275 |
| Reinsurance ceded | (2,903) | (3,219) | (3,501) |
| Total policyholders' dividends | \$116,103 | \$115,008 | \$126,774 |

NOTE 5 – DEFERRED POLICY ACQUISITION COSTS

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

| | 2005 | 2004 | 2003 |
|--|------------------|------------------|------------------|
| Balance, beginning of year | \$680,755 | \$606,144 | \$580,144 |
| Acquisition costs deferred during the year | 156,047 | 159,544 | 139,768 |
| Amortization during the year | (96,779) | (87,939) | (85,589) |
| Amortization of remaining deferred acquisition costs on disability income contracts (See Note 2) | (11,000) | – | – |
| Adjustment through other comprehensive income during the year | 70,732 | 3,006 | (28,179) |
| Balance, end of year | \$799,755 | \$680,755 | \$606,144 |

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

NOTE 6 – FEDERAL INCOME TAXES

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):

| | 2005 | | 2004 | | 2003 | |
|-----------------------------------|-----------------|--------------|-----------------|--------------|-----------------|-------------|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| Current | \$29,415 | | \$16,245 | | \$ 8,345 | |
| Deferred | 5,419 | | 11,750 | | (1,726) | |
| Total income tax expense | <u>\$34,834</u> | | <u>\$27,995</u> | | <u>\$ 6,619</u> | |
| Expected income taxes | \$46,736 | 35.0% | \$40,710 | 35.0% | \$29,671 | 35.0% |
| Dividends received deduction | (2,725) | (2.0) | (2,306) | (2.0) | (1,226) | (1.4) |
| Affordable housing tax credit | (7,292) | (5.5) | (7,394) | (6.4) | (7,518) | (8.9) |
| Audit settlements | – | – | – | – | (10,508) | (12.4) |
| Corporate owned life insurance | (2,660) | (2.0) | (1,705) | (1.5) | (3,879) | (4.6) |
| Other, net | 775 | 0.6 | (1,310) | (1.1) | 79 | 0.1 |
| Total income tax expense | <u>\$34,834</u> | | <u>\$27,995</u> | | <u>\$ 6,619</u> | |
| Effective federal income tax rate | | <u>26.1%</u> | | <u>24.0%</u> | | <u>7.8%</u> |

The Company paid \$25.2 million, paid \$24.6 million, and received \$1.8 million in federal income taxes during 2005, 2004, and 2003, respectively.

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

| | 2005 | 2004 |
|---|------------------|-----------------|
| Deferred income tax assets: | | |
| Pension and other post retirement liabilities | \$ 66,232 | \$ 70,162 |
| Policy liabilities | 215,881 | 197,414 |
| Other liabilities and accrued expenses | 35,757 | 22,306 |
| Affordable housing tax credit carryforwards | 2,367 | 10,514 |
| Other | 507 | 519 |
| Total deferred income tax assets | <u>320,744</u> | <u>300,915</u> |
| Deferred income tax liabilities: | | |
| Debt and equity securities | 5,374 | 342 |
| Net unrealized gain on available-for-sale securities | 30,042 | 60,794 |
| Deferred policy acquisition costs | 215,095 | 199,223 |
| Present value of future profits of insurance acquired | 20,006 | 23,084 |
| Property and investments | 5,452 | 5,781 |
| Other | 9,506 | 6,834 |
| Total deferred income tax liabilities | <u>285,475</u> | <u>296,058</u> |
| Total net deferred income tax assets | <u>\$ 35,269</u> | <u>\$ 4,857</u> |

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, 2005.

The Company has affordable housing tax credit carryforwards of \$2.4 million that begin to expire in 2025.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 6 – FEDERAL INCOME TAXES (continued)

The Company's federal income tax returns are currently being audited by the Internal Revenue Service for the years 2002 and 2003. In management's opinion adequate tax liabilities have been established for all open years.

Settlements between the Company and the IRS during 2003 resulted in a reduction in tax expense of \$10.5 million. In 2003 the Company formally elected to participate in, and was admitted to, a settlement program with the IRS related to a transaction entered into in 1998. The settlement reduced 2003 tax expense by \$6.3 million. The IRS also completed the audit of the Company's tax return for 1999. As a result of the audit settlement and other actions, the Company reduced 2003 tax expense by \$4.2 million.

NOTE 7 – 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.

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 subsequent to June 30, 2001 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 began service prior to June 1, 2000, 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.

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.

The measurement date for all the plans was October 1 preceding the date of the statement of financial position.

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

NOTE 7 – BENEFIT PLANS (continued)

The status of the defined benefit plans at December 31 was as follows (in thousands):

| | Pension Benefits | | | Other Benefits | | |
|--|------------------|------------------|------------------|-----------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Change in benefit obligation: | | | | | | |
| Benefit obligation, beginning of year | \$229,866 | \$217,945 | \$197,439 | \$30,736 | \$31,911 | \$28,464 |
| Service cost for benefits earned during the period | 5,058 | 5,004 | 4,837 | 1,019 | 963 | 1,094 |
| Interest cost on benefit obligation | 13,675 | 13,340 | 13,127 | 1,843 | 1,978 | 1,898 |
| Actuarial losses | 17,741 | 12,068 | 13,655 | 4,760 | 2,057 | 5,656 |
| Decrease in benefits due to plan amendments | – | – | – | – | – | (3,407) |
| Adoption of FSP 106-2 – Medicare Part D | – | – | – | – | (4,000) | – |
| Curtailment | (929) | (4,298) | – | – | (275) | – |
| Benefits paid | (14,057) | (14,193) | (11,113) | (2,090) | (1,898) | (1,794) |
| Benefit obligation, end of year | \$251,354 | \$229,866 | \$217,945 | \$36,268 | \$30,736 | \$31,911 |
| Change in plan assets: | | | | | | |
| Plan assets, beginning of year | \$ 99,147 | \$87,784 | \$79,743 | | | |
| Contributions | 7,081 | 6,728 | – | | | |
| Actual income on plan assets | 8,739 | 12,115 | 13,733 | | | |
| Benefits paid | (6,285) | (7,480) | (5,692) | | | |
| Plan assets, end of year | \$108,682 | \$99,147 | \$87,784 | | | |

| | Pension Benefits | | | Other Benefits | | |
|---|------------------|------------------|------------------|-----------------|-----------------|------------------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Funded status: | | | | | | |
| Funded plans: | | | | | | |
| Benefit obligation | \$ 157,327 | \$ 139,669 | \$ 131,497 | | | |
| Plan assets | (108,682) | (99,147) | (87,784) | | | |
| Benefit obligation greater than plan assets | 48,645 | 40,522 | 43,713 | | | |
| Benefit obligation – other plans | 94,027 | 90,197 | 86,448 | \$36,268 | \$30,736 | \$ 31,911 |
| Unrecognized actuarial losses | (54,438) | (40,257) | (38,326) | (5,185) | (197) | (3,132) |
| Unrecognized prior service (costs) benefits | (503) | (617) | (979) | 1,200 | 2,340 | 4,417 |
| Accrued benefit cost at October 1 | 87,731 | 89,845 | 90,856 | 32,283 | 32,879 | 33,196 |
| Payments subsequent to measurement date | (2,048) | (3,058) | (1,461) | – | – | – |
| Accrued benefit cost at December 31 | \$ 85,683 | \$ 86,787 | \$ 89,395 | \$32,283 | \$32,879 | \$ 33,196 |

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

| | Pension Benefits | | | Other Benefits | | |
|--|------------------|------------------|------------------|-----------------|-----------------|----------------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Service cost for benefits earned during the period | \$ 5,058 | \$ 5,004 | \$ 4,837 | \$ 1,019 | \$ 963 | \$1,094 |
| Interest cost on benefit obligation | 13,675 | 13,340 | 13,127 | 1,843 | 1,978 | 1,898 |
| Expected (income) on plan assets | (7,949) | (7,416) | (6,152) | – | – | – |
| Net amortization of unrecognized losses (gains) | 1,841 | 1,140 | 1,439 | (228) | 717 | – |
| Amortization of plan amendments for curtailment | – | 250 | – | – | (563) | – |
| Amortization of prior service costs (benefits) and plan amendments | 114 | 113 | 106 | (1,140) | (1,515) | (275) |
| Net periodic benefit cost (included in operating expenses) | \$ 12,739 | \$ 12,431 | \$ 13,357 | \$ 1,494 | \$ 1,580 | \$2,717 |

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

NOTE 7 – BENEFIT PLANS (continued)

The total accumulated benefit obligation (“ABO”) for those defined benefit pension plans that were not separately funded was \$91.4 million and \$85.9 million at the 2005 and 2004 measurement dates, respectively. The total ABO for the separately funded defined benefit pension plans was \$143.7 million and \$127.1 million at the 2005 and 2004 measurement dates, respectively.

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

| | Pension Benefits | | | Other Benefits | | |
|--|------------------|-------------|-------------|----------------|-------|-------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Discount rate | 5.50% | 6.00% | 6.25% | 5.50% | 6.00% | 6.25% |
| 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 | 8.0% | 8.0% | 8.0% | | | |

Additional minimum pension liabilities at December 31, 2005, 2004, and 2003, were \$38.7 million, \$24.2 million, and \$23.2 million, respectively, for pension benefits where the excess of the ABO liability over the plan assets exceeded the accrued benefit cost. These liabilities are included, net of income tax effects of \$13.6 million, \$8.5 million, and \$8.1 million, as a component of accumulated other comprehensive income in 2005, 2004, and 2003, respectively.

The projected health care cost trend rate (“HCCTR”) in 2005 and 2004 for the pre-65 population was eliminated due to a plan amendment and for the post-65 population was 10% and 9%, respectively. 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 \$3.8 million and increase the 2005 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 \$3.3 million and the 2005 service cost component of net periodic postretirement benefit cost by about \$0.2 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:

| Plan Asset Category | October 1, 2005 | October 1, 2004 |
|------------------------|-----------------|-----------------|
| Bonds | 36% | 33% |
| Common stocks | 60 | 63 |
| Group annuity contract | 4 | 4 |
| Total | 100% | 100% |

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

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

NOTE 7 – BENEFIT PLANS (continued)

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 8% 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, 2005, and in aggregate for the five years thereafter is as follows (in thousands):

| Year | Projected Pension Benefit Payments | Projected Other Benefit Payments | Projected Medicare Part D Reimbursements |
|-------------|---|---|---|
| 2006 | \$15,376 | \$ 2,350 | \$ 190 |
| 2007 | 15,397 | 2,500 | 211 |
| 2008 | 15,462 | 2,628 | 231 |
| 2009 | 15,649 | 2,750 | 249 |
| 2010 | 15,748 | 2,850 | 268 |
| 2011-2014 | 85,184 | 14,931 | 1,580 |

The pension benefit obligation and accumulated benefit obligation attributable to National Life employees hired after June 30, 2001 and other Company employees was \$1.6 million, \$0.9 million and \$0.6 million at December 31, 2005, 2004, and 2003, respectively. The crediting rates were 4.76%, 5.14% and 4.90% at December 31, 2005, 2004, and 2003, respectively.

The Company's expected 2006 contribution into its separately funded defined benefit pension plan is \$16.8 million. The Company may elect to make smaller or larger contributions in 2006, subject to regulatory requirements and maximum contribution limitations.

The Company modified its postretirement plans for active employees' and early retirees' medical insurance benefits during 2003 to limit the Company's exposure to future increases in medical insurance costs. Under the terms of the modification, the Company will contribute up to a fixed limit annually toward participants' medical insurance premiums. Premium costs above the fixed limit will be the responsibility of the plan participant. This change generated prior service benefits of \$3.4 million at December 31, 2003, which will be amortized over the participants' average remaining service periods.

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 SAM). Total annual contributions can not exceed certain limits which vary based on total agent compensation. No company contributions are made to the plan.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 7 – BENEFIT PLANS (continued)

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 December 2003, the Company substantially finalized agreements with Keane, Inc., an independent technology company with worldwide operations, to assume responsibility for the Company's software maintenance and development, and other technology related activities. The ten year agreement was signed in early 2004 and announced on January 14, 2004. See Note 14 for additional information.

As the outsourcing decision occurred after the 2003 measurement date for both the Company's pension and other post-employment benefit obligations, remeasurement of the plans obligations and the recording of curtailment effects were reflected in 2004's results from operations. The pension benefit obligation was reduced in 2004 by \$4.3 million, with a corresponding reduction in unrecognized losses. Projected pension service costs for 2004 were reduced due to curtailment by \$0.8 million. Prior service cost plan amendments of \$0.2 million were recognized due to the curtailment. Other post-employment benefit obligations were reduced by \$0.3 million, with a corresponding reduction in unrecognized losses. Projected service costs for 2004 were reduced due to curtailment by \$0.2 million. The curtailment reduced post-employment plan amendment benefits, resulting in a 2004 pre-tax benefit of \$0.6 million.

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. Projected 2006 service costs decreased by \$0.3 million as a result of the curtailment.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law in December 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Financial Accounting Standards Board ("FASB") subsequently issued FSP 106-2 "*Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*" ("FSP 106-2").

The Company compared its historical net benefits provided to participants against the projected net benefits that would be provided under the Act. Based on this review, and a review of the current promulgated regulations, the Company determined that the benefits provided by the Company to qualifying individuals are at least actuarially equivalent to those to be provided under the Act. Pursuant to FSP 106-2, the Company reduced its benefit obligation in 2004 by \$4.0 million, with a corresponding reduction in unrecognized losses.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8 – DEBT

Debt consists of the following (in thousands):

| | 2005 | 2004 |
|--|------------------|------------------|
| 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. | \$199,636 | \$199,623 |
| 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. | 74,390 | – |
| Trust Preferred Securities (TPS): \$20 million of TPS issued by NL Group Statutory Trust I, a previously consolidated affiliate of the Company, callable at par on May 15, 2008, and mandatorily redeemable on May 15, 2033. The TPS are unsecured and subordinate to all current and future obligations. The dividend rate floats based on LIBOR and resets quarterly. | – | 20,000 |
| 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. | 20,619 | – |
| Real Estate Investment Mortgage: \$67.5 million, maturing November 2014, interest payable monthly at a fixed rate of 4.97% thru November 2010. Beginning in December 2010, monthly principal and interest payments at a fixed rate of 4.97% are required. The mortgage note payable is secured by a deed of trust on the underlying real estate. | 67,500 | – |
| Total debt | \$362,145 | \$219,623 |

The deconsolidation of NL Group Statutory Trust I as a result of the Company's adoption of FIN 46R on January 1, 2005 resulted in the TPS obligation being deconsolidated and the inclusion of a note payable between NLVF and NL Group Statutory Trust I. In addition, the Company consolidated the real estate investment mortgage of a partnership in which the Company has a majority partnership interest in 2005, also as a result of the Company's adoption of FIN 46R. See Note 15.

Interest paid on the 7.5% senior notes was \$15.0 million, \$15.0 million, and \$0 in 2005, 2004, and 2003, respectively. Interest paid on the 6.5% senior notes was \$2.4 million, \$0, and \$0 in 2005, 2004, and 2003 respectively. Dividends paid or accrued on the TPS were \$0 million, \$1.1 million, and \$0.7 million in 2005, 2004, and 2003, respectively. Interest paid on the \$20.6 million note payable was \$1.5 million in 2005. The Company previously had an 8.25% surplus note, initially \$70 million, which was retired on March 1, 2004. Interest paid on the surplus notes was \$2.6 million in 2004 and \$5.8 million in 2003.

Interest paid or accrued on the real estate investment mortgage outstanding at December 31, 2005 and a previous note refinanced in 2005 was \$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, 2005 and 2004. 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, 2005 and 2004. Total interest on the combined lines of credit was \$4,448 for 2005, \$1,641 for 2004, and \$2,100 for 2003.

During 2004, the Company retired \$62.8 million of 8.25% Surplus Notes. As part of the retirement, original issue costs and discount totaling \$3.4 million were expensed. These costs are included in early retirement of surplus notes and other financing expense.

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

NOTE 8 – DEBT (continued)

During 2003, the Company retired \$7.0 million of 8.25% Surplus Notes. As part of the retirement, original issue costs and discount totaling \$0.1 million were expensed. A repurchase premium of \$0.3 million was also expensed. These costs are included in early retirement of surplus notes and other financing expense.

NOTE 9 – COMMITMENTS AND CONTINGENCIES

Total outstanding mortgage loan funding commitments at December 31, 2005 and 2004, were \$68.7 million and \$53.6 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. Existing provisions for this contingency were reduced in 2004 and 2003 and are included as changes in sales practice remediation provision.

The Company leases rights to the use of certain data processing hardware and software from American International Technology Enterprises, Inc., Livingston, New Jersey. The lease contains clauses and penalties for termination prior to the end of the lease term. The following is a schedule of future minimum lease payments as of December 31, 2005 (in millions):

| Year | Operating Leases |
|-------------------------------------|-----------------------------|
| 2006 | \$ 4.6 |
| 2007 | 4.6 |
| 2008 | 4.6 |
| 2009 | 3.1 |
| Total minimum lease payments | \$16.9 |

The Company has a multi year contract for information systems application and infrastructure services from Keane, Inc. of Boston, Massachusetts. The contract became effective on February 1, 2004. The Company's remaining obligation under the contract as of December 31, 2005 (in millions):

| Year | Contract Obligation |
|----------------------------------|--------------------------------|
| 2006 | \$13.0 |
| 2007 | 13.0 |
| 2008 | 13.0 |
| 2009 | 13.3 |
| 2010 | 1.1 |
| Total contract obligation | \$53.4 |

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

NOTE 10 – 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 in force 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 in force. 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.

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 \$10.9 million and \$11.3 million was required at December 31, 2005 and 2004, 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 \$92.6 million and \$155.0 million at December 31, 2005 and 2004, 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, 2005 and 2004 was \$103.5 million and \$166.3 million, respectively.

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

NOTE 10 – NATIONAL LIFE CLOSED BLOCK (continued)

Summarized financial information for the Closed Block effects included in the consolidated financial statements as of December 31, 2005 and 2004, and for the three years ended December 31, 2005, is as follows (in thousands):

| | 2005 | 2004 |
|--|---------------------|---------------------|
| Liabilities: | | |
| Policy liabilities and accruals | \$ 3,869,945 | \$ 3,932,536 |
| Other liabilities | 59,568 | 356 |
| Total liabilities | \$ 3,929,513 | \$ 3,932,892 |
| Assets: | | |
| Cash and cash equivalents | \$ 70 | \$ 9,224 |
| Available-for-sale debt and equity securities | 2,470,689 | 2,402,200 |
| Other invested assets | 7,134 | – |
| Mortgage loans | 407,429 | 432,670 |
| Policy loans | 529,526 | 547,497 |
| Accrued investment income | 45,363 | 46,561 |
| Premiums and fees receivable | 11,518 | 11,973 |
| Other assets | 110,044 | 114,863 |
| Total assets | \$ 3,581,773 | \$ 3,564,988 |
| Excess of reported closed block liabilities over closed block assets | \$ 347,740 | \$ 367,904 |
| Closed block accumulated other comprehensive gain represented above | – | – |
| Maximum future earnings to be recognized from closed block assets and liabilities | \$ 347,740 | \$ 367,904 |

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

NOTE 10 – NATIONAL LIFE CLOSED BLOCK (continued)

| | 2005 | 2004 | 2003 |
|---|-------------------|-------------------|-------------------|
| Revenues: | | | |
| Premiums and other income | \$ 240,103 | \$ 255,941 | \$ 272,103 |
| Net investment income | 210,827 | 219,248 | 222,076 |
| Net investment loss | (1,237) | (1,924) | (1,559) |
| Total revenues | 449,693 | 473,265 | 492,620 |
| Benefits and Expenses: | | | |
| Increase (decrease) in policy liabilities | 8,916 | (44,439) | 50,922 |
| Policy benefits | 271,965 | 343,187 | 250,013 |
| Policyholders' dividends | 115,773 | 115,414 | 128,096 |
| Interest credited to policyholder account liabilities | 9,095 | 11,664 | 11,099 |
| Operating expenses | 9,585 | 9,730 | 12,697 |
| Commission expenses | 3,337 | 4,015 | 3,946 |
| Total benefits and expenses | 418,671 | 439,571 | 456,773 |
| Pre-tax results of operations | 31,022 | 33,694 | 35,847 |
| Income taxes | 10,858 | 11,793 | 14,201 |
| Closed block results of operations | 20,164 | 21,901 | 21,646 |
| Other comprehensive income: | | | |
| Unrealized loss | - | - | - |
| Total closed block comprehensive income | \$ 20,164 | \$ 21,901 | \$ 21,646 |
| Excess of reported closed block liabilities over closed block assets: | | | |
| Beginning of year | \$ 367,904 | \$ 389,805 | \$ 411,451 |
| Closed block comprehensive income | 20,164 | 21,901 | 21,646 |
| End of year | \$ 347,740 | \$ 367,904 | \$ 389,805 |

Amortized cost of bonds held by the Closed Block at December 31, 2005 and 2004 were \$2,378.1 million and \$2,233.1 million, respectively. Mortgage valuation allowances on Closed Block mortgage loans were \$0.9 million at December 31, 2005 and 2004.

Participating insurance in force within the Closed Block was \$10.4 billion and \$11.1 billion at December 31, 2005 and 2004, 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 11 – 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. Prior to 2003, assets and operations had been limited to those related to investments funded by a 2002 dividend from National Life, and its ownership of National Life's outstanding stock. 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 \$617.8 million and \$542.4 million at December 31, 2005 and 2004, respectively. Statutory net gain from operations was \$125.5 million and \$62.6 million in 2005 and 2004, 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 12 – PRESENT VALUE OF FUTURE PROFITS OF INSURANCE ACQUIRED

Interest accrued on present value of future profits of insurance acquired ("PVFP") was \$3.5 million, \$4.0 million, and \$4.4 million for the years ended December 31, 2005, 2004, and 2003, 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 5.92%; the second accrues interest at 5.46%. Amortization of PVFP was \$8.8 million, \$8.4 million, and \$7.2 million for the years ended December 31, 2005, 2004, and 2003, respectively.

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

NOTE 12 – PRESENT VALUE OF FUTURE PROFITS OF INSURANCE ACQUIRED
(continued)

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

| Year | Projected Amortization |
|-------------|-----------------------------------|
| 2006 | \$6,700 |
| 2007 | 6,400 |
| 2008 | 5,900 |
| 2009 | 5,500 |
| 2010 | 5,100 |

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

NOTE 13 – PARTICIPATING LIFE INSURANCE

Participating life insurance inforce was 57.8% and 56.0% of the face value of total insurance inforce at December 31, 2005 and 2004, respectively. The premiums on participating life insurance policies were 54.2%, 55.2%, and 57.5% of total individual life insurance premiums in 2005, 2004, and 2003, respectively.

NOTE 14 – OUTSOURCING INFORMATION TECHNOLOGY ACTIVITIES

During December 2003, the Company substantially finalized agreements with Keane, Inc., an independent technology company with worldwide operations, to assume responsibility for the Company's software maintenance and development, and other technology related activities. The ten year agreement was signed in early 2004 and announced on January 14, 2004. Under the terms of the agreements, the 158 employees affected were offered positions with Keane effective February 1, 2004, and substantially all accepted. There were no termination or other special benefits provided to the affected employees by the Company, primarily due to the employee transition agreement established with Keane, and therefore no additional expenses were accrued at December 31, 2003. See Note 7 for information on pension and other defined benefit postretirement plan curtailments recorded in 2004.

NOTE 15 – ADOPTON OF FIN 46R

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 has 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.

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

NOTE 15 – ADOPTON OF FIN 46R (continued)

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.

Under the provisions of FIN 46R, the Company has not restated its prior year financial information.

NOTE 16 – ADOPTON OF SOP 03-01

In July 2003, the Accounting Standards Executive Committee issued SOP 03-01, “*Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*” (“SOP 03-1”). SOP 03-01 provides guidance on accounting and reporting by insurance enterprises for certain nontraditional long-duration contracts and for separate accounts. It also provides guidance on accounting for guaranteed minimum death benefits and for determining the classification of reinsurance contracts as either primarily investment or insurance at inception. The Company adopted SOP 03-1 effective January 1, 2004. Pursuant to the adoption of SOP 03-1, the Company recorded an after-tax cumulative effect of (\$1.4) million which consisted of \$1.9 million of sales inducement assets and \$4.0 million of sales inducement liabilities for various annuity products, offset by income tax effects of \$0.7 million. See Note 2 for additional information.

NOTE 17 – PENDING ACCOUNTING STANDARD

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 is continuing to evaluate the provisions of SOP 05-01 on the Company’s financial position, results of operations, and cash flows. Management believes adoption of SOP 05-01 will not have a material impact on the Company’s consolidated financial position, results of operations, and cash flows.