

NLV Financial Corporation and Subsidiaries

**Financial Statements
December 31, 2006 and 2005**

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
Index
December 31, 2006 and 2005

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Report of Independent Auditors

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in stockholder's equity and cash flows present fairly, in all material respects, the financial position of NLV Financial Corporation and its subsidiaries (the Company) at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 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 14 to the consolidated financial statements, the Company changed its method of accounting for interests in certain entities effective January 1, 2005.

PricewaterhouseCoopers LLP

Hartford, Connecticut
February 23, 2007

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31,

(In Thousands)

	2006	2005
Assets:		
Cash and investments:		
Available-for-sale debt securities	\$ 8,598,799	\$ 8,216,767
Available-for-sale debt securities on loan	378,925	361,748
Total available-for-sale debt securities	8,977,724	8,578,515
Available-for-sale equity securities	194,566	202,444
Trading equity securities	22,317	23,129
Mortgage loans on real estate	1,600,394	1,510,512
Policy loans	696,123	691,647
Real estate investments	20,679	51,767
Other invested assets	375,809	253,586
Cash and cash equivalents	717,906	520,803
Total cash and investments	12,605,518	11,832,403
Deferred policy acquisition costs	899,032	799,755
Accrued investment income	130,711	127,347
Premiums and fees receivable	22,139	21,774
Deferred income taxes	14,683	35,269
Amounts recoverable from reinsurers	82,569	83,785
Present value of future profits of insurance acquired	47,795	54,532
Property and equipment, net	45,354	41,103
Federal income tax recoverable	5,566	1,381
Other assets	179,510	181,835
Separate account assets	941,376	840,125
Total assets	\$ 14,974,253	\$ 14,019,309
Liabilities:		
Policy liabilities:		
Policy benefit liabilities	\$ 4,579,889	\$ 4,571,693
Policyholder account liabilities	6,661,878	5,987,005
Policyholders' deposits	56,304	60,824
Policy claims payable	51,718	36,796
Policyholders' dividends	130,140	157,901
Total policy liabilities	11,479,929	10,814,219
Amounts payable to reinsurers	24,018	24,220
Collateral held on loaned securities	386,045	367,386
Other liabilities and accrued expenses	317,966	166,106
Pension and other post-retirement benefit obligations	167,192	186,895
Debt	294,679	362,145
Separate account liabilities	941,376	840,125
Total liabilities	13,611,205	12,761,096
Minority Interest in Consolidated Subsidiaries	–	241
Stockholder's Equity:		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	–	–
Class B common stock, par value of \$0.01, 1,001 shares authorized, 100 shares issued and outstanding	–	–
Preferred stock, 500 shares authorized, no shares issued and outstanding	–	–
Retained earnings	1,338,932	1,228,285
Accumulated other comprehensive income	24,116	29,687
Total stockholder's equity	1,363,048	1,257,972
Total liabilities, minority interest, and stockholder's equity	\$ 14,974,253	\$ 14,019,309

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)

	2006	2005	2004
Revenues:			
Insurance premiums	\$ 336,007	\$ 347,547	\$ 375,546
Policy and contract charges	156,950	145,845	131,189
Net investment income	791,015	675,893	682,871
Net realized investment gains	1,122	2,146	8,419
Change in value of trading equity securities	1,538	155	1,134
Mutual fund commissions and fee income	105,919	103,100	92,757
Other income	18,563	17,596	13,433
Total revenues	1,411,114	1,292,282	1,305,349
Benefits and Expenses:			
Increase in policy liabilities	81,783	84,465	63,588
Policy benefits	351,767	354,498	407,670
Policyholders' dividends and dividend obligations	122,308	116,103	115,008
Interest credited to policyholder account liabilities	334,600	232,731	262,801
Operating expenses	168,351	153,050	150,228
Interest expense on debt	21,975	20,465	17,148
Change in sales practice remediation provision	-	-	(2,367)
Early retirement of surplus notes and other financing	-	974	3,354
Policy acquisition expenses and amortization of present value of future profits, net	179,549	195,649	171,896
Total benefits and expenses	1,260,333	1,157,935	1,189,326
Income before income taxes, minority interest, and cumulative effect of accounting change	150,781	134,347	116,023
Income tax expense	40,237	35,651	27,705
Income before minority interest and cumulative effect of accounting change	110,544	98,696	88,318
Minority interest in consolidated subsidiaries	(103)	1,237	944
Income before cumulative effect of accounting change	110,647	97,459	87,374
Cumulative effect of accounting change, net	-	-	(1,350)
Net Income	\$ 110,647	\$ 97,459	\$ 86,024

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

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

<i>(In Thousands)</i>	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
January 1, 2004	\$-	\$-	\$-	\$1,044,802	\$77,340	\$1,122,142
Comprehensive income:						
Net income	-	-	-	86,024	-	86,024
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	19,476	19,476
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net	-	-	-	-	(612)	(612)
Total comprehensive income					(612)	104,922
December 31, 2004	-	-	-	1,130,826	96,238	1,227,064
Comprehensive income:						
Net income	-	-	-	97,459	-	97,459
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(57,111)	(57,111)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net	-	-	-	-	(9,474)	(9,474)
Total comprehensive income					(9,474)	30,908
December 31, 2005	-	-	-	1,228,285	29,687	1,257,972
Comprehensive income:						
Net income	-	-	-	110,647	-	110,647
Change in unrealized gains on available-for-sale securities, net	-	-	-	-	(9,620)	(9,620)
Change in cash flow hedge on debt issuance, net	-	-	-	-	34	34
Change in additional minimum pension liability, net	-	-	-	-	4,015	4,015
Total comprehensive income					4,015	105,076
December 31, 2006	\$-	\$-	\$-	\$1,338,932	\$24,116	\$1,363,048

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)

	2006	2005	2004
Cash Flows from Operating Activities:			
Net income	\$ 110,647	\$ 97,459	\$ 86,024
Adjustments to reconcile net income to net cash provided by operating activities:			
Changes in assets and liabilities:			
Accrued investment income	(3,364)	(5,040)	(2,174)
Policy acquisition costs	(83,257)	(48,268)	(71,605)
Policy benefit liabilities	57,350	45,650	28,726
Interest credited to policyholder account liabilities	334,600	232,731	262,801
Policy and contract charges	(156,950)	(145,845)	(131,189)
Other assets and liabilities	20,974	11,428	(3,756)
Provision for deferred income taxes	23,588	5,419	11,750
Net realized investment gains	(1,122)	(2,146)	(8,419)
Net options (gains) losses	(37,023)	26,199	10,090
Change in present value of future profits of insurance acquired	8,176	8,796	8,356
Depreciation	8,276	10,498	9,306
Other	12,052	20,726	2340
Net cash provided by operating activities	293,947	257,607	202,250
Cash Flows from Investing Activities:			
Proceeds from sales, maturities and repayments of investments	2,796,920	3,313,772	3,758,680
Cost of investments acquired	(3,368,824)	(4,143,967)	(4,457,479)
Change in policy loans	(4,476)	5,306	24,960
Other	(10,316)	(26,463)	(22,767)
Net cash used by investing activities	(586,696)	(851,352)	(696,606)
Cash Flows from Financing Activities:			
Policyholders' deposits	1,047,595	909,404	819,336
Policyholders' withdrawals	(576,402)	(366,056)	(304,239)
Net change in collateral held on loaned securities	18,659	346,089	(18,538)
Issuance of senior notes and other debt	-	146,705	-
Retirement of surplus notes and other debt	-	(44,853)	(63,199)
Other	-	(18,296)	(13,705)
Net cash provided by financing activities	489,852	972,993	419,655
Net Increase (Decrease) in Cash and Cash Equivalents	197,103	379,248	(74,701)
Cash and Cash Equivalents:			
Beginning of year	520,803	141,555	216,256
End of year	\$ 717,906	\$ 520,803	\$ 141,555

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 1 – NATURE OF OPERATIONS

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

The Company’s insurance operations develop and distribute individual life insurance and annuity products. The Company markets this diverse product portfolio to small business owners, professionals, and other middle to upper income individuals. The Company provides financial solutions in the form of estate, business succession and retirement planning, deferred compensation and other key executive benefit plans, and asset management. Insurance and annuity products are primarily distributed through twenty-one general agencies in major metropolitan areas and a system of marketing general agents and independent marketing organizations throughout the United States of America. The Company has in excess of 502,000 policyholders and is licensed to do business in all 50 states and the District of Columbia through its member companies. About 30% of the Company’s total collected premiums and deposits are from residents of the states of New York and California.

Through Sentinel Asset Management, Inc. (“SAMI”) and its subsidiaries and affiliates, the Company also distributes and provides investment advisory and administrative services to the Sentinel Group Funds, Inc. (“Sentinel Funds”). The Sentinel Funds’ \$4.1 billion of net assets represent thirteen mutual funds managed on behalf of about 226,000 individual, corporate, and institutional shareholders worldwide.

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

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 stockholder’s 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. 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

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments (continued)

in unrealized gains on available-for-sale securities, net of related deferred income taxes.

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

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

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

Policy Acquisition Expenses

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

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

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

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

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

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Acquisition Expenses (continued)

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

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

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

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

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

The assumed rate of investment return on the assets held in variable product separate accounts (after deduction of fund fees and mortality and expense charges) was 8.00% in 2006 and 7.75% in 2005.

Present Value of Future Profits of Insurance Acquired

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

Goodwill and Other Intangible Assets

Goodwill and other intangible assets having indefinite useful lives are tested at least annually for impairment. Intangible assets with finite useful lives are amortized over those lives. Total goodwill was \$8.5 million and \$4.8 million at December 31, 2006 and 2005, respectively, and was included in other assets. Total other intangible assets were \$16.3 million and \$15.3 million at December 31, 2006 and 2005, respectively, and were included in other assets. Goodwill was reduced by \$0.4 million in 2006 resulting from the sale of AG&T. There were no reductions in goodwill or other intangible assets due to impairment during 2006, 2005, or 2004. The increase in goodwill and other intangible assets in 2006 is due to the Company's purchase of net assets of an investment management company.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 \$99.7 million and \$95.7 million at December 31, 2006 and 2005, respectively, and is included in other assets. At December 31, 2006 and 2005, 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 \$6.2 million, \$7.0 million, and \$4.0 million in 2006, 2005, and 2004, respectively, and is included in other income.

Separate Accounts

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

Policy Liabilities

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

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

Policyholder account liabilities for non-indexed life insurance (universal life products) and investment-type annuities represent amounts that inure to the benefit of the policyholders before surrender charges. Policyholder account balances for indexed life insurance and annuity liabilities consist of a combination of underlying host contract and embedded derivative values. The underlying host contract is primarily based on policy guarantees and its initial value is determined at the time of premium payment. Thereafter, the host contract liability increases with interest to reach the guaranteed value at projected maturity. The embedded derivative component is based on the fair value of the contract’s expected participation in future increases in the S&P 500 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.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

The guaranteed minimum interest rates for the Company's fixed interest rate annuities range from 1.5% to 4.5%. As of December 31, 2006 and 2005, 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, 2006 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. Policyholder partial withdrawals to date have not been significant. Separate account product guarantee reserves are calculated as a percentage of collected mortality and expense risk and rider charges, with the current period change in reserves reflected in policyholder benefits.

The Company offers various sales incentives including bonus interest credited 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 \$5.3 and \$3.6 million and recorded net amortization of \$2.6 and \$2.1 million during 2006 and 2005, respectively. Sales inducement assets were \$11.7 and \$9.0 million at December 31, 2006 and 2005, respectively.

The Company also offers persistency bonuses on certain products, whereby contract holders can receive additional interest credits by maintaining their policy in force for predetermined durations. These additional interest credits are accrued ratably over the bonus period and adjusted for actual persistency. The Company accrued sales inducement liabilities of \$0.1 and \$0.2 million and recorded net increases for amortization and unlocking of \$0.9 and \$1.2 million during 2006 and 2005, respectively. Sales inducement liabilities were \$7.4 and \$6.3 million at December 31, 2006 and 2005, 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.

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Policyholder Deposits

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

Recognition of Insurance Revenues and Related Expenses

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

Premiums and surrenders from universal life and investment-type annuities are reported as increases and decreases, respectively, in policyholder account liabilities. Revenues for these policies consist of mortality charges, policy administration fees, and surrender charges deducted from policyholder account liabilities. Policy benefits charged to expense include benefit claims in excess of related policyholder account liabilities.

Premiums from disability income policies are recognized as revenue over the period to which the premiums relate. Benefits and expenses are matched with income by providing for policy benefit liabilities and the deferral and amortization of policy acquisition costs so as to recognize profits over the life of the policies.

Federal Income Taxes

NLHC will file a consolidated tax return for the tax year ended December 31, 2006. The income tax return will include NLHC and all members within the Company. Current federal income taxes are charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. Deferred income tax assets and liabilities are recognized based on temporary differences between financial statement carrying amounts and income tax bases of assets and liabilities using enacted income tax rates and laws.

Minority Interests

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

During 2006, the Company sold its interests in two entities within the Company which had minority interests. At December 31, 2006, there are no remaining minority interests in entities within the Company.

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Minority Interests (continued)

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

NOTE 3 – 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):

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

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

NOTE 3 – INVESTMENTS (continued)

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

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

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):

	2006	2005	2004
Net unrealized gains (losses) on available-for-sale securities	\$(69,569)	\$(229,125)	\$ 31,471
Net unrealized gains on separate accounts	407	178	168
Net unrealized gains on other invested assets	940	3,889	4,118
Related deferred policy acquisition costs	16,020	70,732	3,006
Related present value of future profits of insurance acquired	1,439	4,028	4,825
Related deferred income taxes	5,180	30,752	(10,487)
Related policyholder dividend obligation	35,963	62,435	(13,625)
(Decrease) increase in net unrealized gains	(9,620)	(57,111)	19,476
Balance, beginning of year	55,793	112,904	93,428
Balance, end of year	\$ 46,173	\$ 55,793	\$ 112,904

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

NOTE 3 – INVESTMENTS (continued)

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

	2006	2005
Balance, end of year includes:		
Net unrealized gains on available-for-sale securities	\$113,638	\$183,207
Net unrealized gains on separate accounts	3,354	2,947
Net unrealized gains on other invested assets	9,824	8,884
Related deferred policy acquisition costs	2,038	(13,982)
Related present value of future profits of insurance acquired	(1,188)	(2,627)
Related deferred income taxes	(24,862)	(30,042)
Related policyholder dividend obligation	(56,631)	(92,594)
Balance, end of year	\$ 46,173	\$ 55,793

Net other comprehensive income (loss) related to unrealized gains and losses on available-for-sale securities for 2006, 2005, and 2004 of \$(9.6) million, \$(57.1) million, and \$19.5 million is presented net of reclassifications to net income for net realized gains (losses) during the period of \$(32.4) million, \$17.4 million, and \$7.1 million and net of tax and deferred acquisition cost offsets of \$(21.2) million, \$11.3 million, and \$4.8 million, respectively.

The amortized cost and estimated fair values of debt securities by contractual maturity at December 31, 2006, 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	\$ 303,103	\$ 304,667
Due after one year through five years	2,714,238	1,240,417
Due after five years through ten years	1,201,014	2,715,522
Due after ten years	1,487,617	1,555,194
Mortgage-backed securities	3,177,448	3,161,924
Total	\$8,883,420	\$8,977,724

Proceeds from sales of available-for-sale debt and equity securities for the years ended December 31, 2006, 2005, and 2004 were \$1,936.8 million, \$2,240.0 million, and \$2,979.1 million, respectively. Gross realized gains on sales of available-for-sale debt securities for the years ended December 31, 2006, 2005, and 2004 were \$4.5 million, \$13.0 million, and \$33.8 million, respectively. Gross realized losses on sales of available-for-sale debt securities for the years ended December 31, 2006, 2005, and 2004 were \$48.0 million, \$11.8 million, and \$23.6 million, respectively. Gross realized gains on available-for-sale equity securities for the years ended December 31, 2006, 2005, and 2004 were \$4.1 million, \$5.8 million, and \$3.5 million, respectively. Gross realized losses on available-for-sale equity securities for the years ended December 31, 2006, 2005, and 2004 were \$0.5 million, \$0.2 million, and \$1.6 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, 2006 and 2005, were as follows (in thousands):

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

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

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 \$24.5 million total unrealized losses on debt securities in the less than 12 months category, \$16.1 million was in the corporate bond portfolio. The unrealized losses are concentrated in the consumer and retail, financial institution, utility, and communication sectors. During 2006, 10-year US Treasury rate spiked from a low of 4.33% on January 17th to a high of 5.23% on June 28th and finished the year at 4.70%. Many of the corporate bonds bought early in the year and later in the year were negatively impacted by these large moves in rates. These rate movements are the primary cause of the unrealized loss positions.

Of the \$76.3 million total unrealized losses on debt securities in the more than 12 months category, \$29.1 million was in the mortgage backed securities portfolio. Unrealized losses on mortgage backed securities purchased in 2005 was \$18.0 million. All of these securities were rated AAA at acquisition and maintained that rating at December 31, 2006. These unrealized losses are due to the higher level of market interest rates at December 31, 2006, compared to those at the time of purchase. The \$29.1 million of unrealized losses on mortgage backed securities represents 1.57% of the aggregate fair value of the \$1.8 billion in mortgage backed securities with unrealized losses at December 31, 2006. Many of the positions in this category have fair values only marginally below their respective carrying values.

The \$36.7 million unrealized losses on the corporate bond portfolio in the more than 12 month category are concentrated in the financial institution, utilities, 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, 2006 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 \$386.0 million and \$367.4 million at December 31, 2006 and 2005, respectively. The fair value of the loaned securities was \$378.9 million and \$361.7 million at December 31, 2006 and 2005, respectively. The Company's earnings with respect to its modified securities lending program were \$0.9 million less expenses of \$0.2 million in 2006 and \$0.4 million less expenses of \$0.1 million in 2005.

Trading Equity Securities

For the years ended December 31, 2006, 2005, and 2004 the equity securities held in the trading category recorded \$1.3 million, \$1.1 million, and \$1.2 million of net investment income. The cost of trading securities held at December 31, 2006 and 2005 was \$21.0 million and \$22.9 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 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:

	2006	2005
<u>Geographic Region</u>		
New England	2.1%	2.7%
Middle Atlantic	5.3	6.0
East North Central	14.5	13.1
West North Central	7.0	7.8
South Atlantic	23.5	25.6
East South Central	2.2	2.3
West South Central	13.9	11.2
Mountain	13.1	13.6
Pacific	18.4	17.7
Total	100.0%	100.0%
<u>Property Type</u>		
Apartment	15.4%	18.8%
Retail	7.9	8.9
Office Building	45.7	42.1
Industrial	27.7	27.0
Hotel/Motel	1.0	1.0
Other Commercial	2.3	2.2
Total	100.0%	100.0%
Total mortgage loans and real estate (in thousands)	\$1,621,073	\$1,562,279

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

	2006	2005
Unimpaired loans	\$1,600,394	\$1,505,705
Impaired loans without valuation allowances	–	7
Subtotal	1,600,394	1,505,712
Impaired loans with valuation allowances	–	5,660
Related valuation allowances	–	(860)
Subtotal	–	4,800
Total	\$1,600,394	\$1,510,512

	2006	2005	2004
Impaired loans:			
Average total investment	\$2,834	\$5,678	\$8,047
Interest income recognized	37	341	287
Interest received	37	369	286

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):

	2006	2005	2004
Additions for impaired loans charged to realized losses	\$ –	\$ –	\$ –
Changes to previously established valuation allowances	(860)	–	(1,344)
Decrease in valuation allowances	(860)	–	(1,344)
Balance, beginning of year	860	860	2,204
Balance, end of year	\$ –	\$860	\$ 860

Net Investment Income

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

	2006	2005	2004
Debt securities interest	\$538,839	\$502,000	\$467,134
Equity securities dividends	14,242	13,287	13,749
Mortgage loan interest	121,614	111,826	119,159
Policy loan interest	39,286	40,154	42,224
Real estate income	17,222	21,063	3,777
Options	77,348	3,438	43,993
Other investment income	12,056	18,326	9,851
Gross investment income	820,607	710,094	699,887
Less: investment expenses	29,592	34,201	17,016
Net investment income	\$791,015	\$675,893	\$682,871

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

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):

	2006	2005	2004
Debt securities	\$(37,872)	\$ 954	\$8,742
Equity securities	3,457	6,630	1,669
Sale of AG&T	8,144	–	–
Real estate partnership	30,609	–	–
Mortgage loans	190	–	(106)
Real estate investments	(2,013)	(1,069)	31
Other invested assets	(1,393)	(4,369)	(1,917)
Total	\$ 1,122	\$2,146	\$8,419

Derivatives

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

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

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, 2006, total indexed annuity liabilities of \$2,927.4 million were comprised of \$2,334.5 million of host contract and \$592.9 million of embedded derivative value. At December 31, 2005, total 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. Policyholder account liabilities at December 31, 2006 and 2005 were \$2,885.3 million and \$2,355.6 million, respectively.

Results of operations for 2006, 2005, and 2004 included after-tax earnings from indexed annuities of \$17.4 million, \$16.2 million, and \$13.3 million, respectively. The cost of options and changes in assumptions favorably impacted results of operations in 2006 and 2005.

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

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

NOTE 3 – INVESTMENTS (continued)

Derivatives (continued)

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

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

	2006	2005
Notional amounts:		
Futures	\$37,094	\$19,967

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

	2006	2005
Carrying values:		
Options purchased (included in other invested assets)	\$220,110	\$109,209
Options written (included in other liabilities)	(80,424)	(22,088)
Futures purchased (included in other invested assets)	3,380	3,583
Net carrying value	\$143,066	\$ 90,704

Fair Value of Financial Instruments

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

	2006		2005	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Cash and cash equivalents	\$ 717,918	\$ 717,918	\$ 520,803	\$ 520,803
Available-for-sale debt securities	8,977,724	8,977,724	8,578,515	8,578,515
Available-for-sale equity securities	194,566	194,566	202,444	202,444
Trading equity securities	22,317	22,317	23,129	23,129
Mortgage loans	1,600,394	1,616,210	1,510,512	1,552,845
Policy loans	696,123	695,337	691,647	685,052
Derivatives	143,066	143,066	90,704	90,704
Investment product liabilities	5,806,762	5,816,380	5,212,435	5,226,350
Debt	294,679	310,939	362,145	382,099

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 – 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 \$9.0 million, \$7.6 million, and \$8.7 million for 2006, 2005, and 2004, respectively, related to the Company's disability income reinsurance. Such income is primarily offset by expenses incurred by the Company related to this block of business. Reserve transfers and interest payments under modified coinsurance agreements are included on the statements of operations as a component of increase in policy liabilities expense.

Interest costs included in reinsurance agreements in place at December 31, 2006 and 2005 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 – REINSURANCE (continued)

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

	2006	2005	2004
Insurance premiums:			
Direct	\$405,222	\$415,634	\$436,598
Reinsurance assumed	1,439	1,414	1,198
Reinsurance ceded	(70,654)	(69,501)	(62,250)
Total insurance premiums	\$336,007	\$347,547	\$375,546
Increase in policy liabilities:			
Direct	\$64,412	\$67,944	\$35,461
Reinsurance assumed	(35)	(14)	–
Reinsurance ceded	17,406	16,535	28,127
Total increase in policy liabilities	\$81,783	\$84,465	\$63,588
Policy benefits:			
Direct	\$447,136	\$429,429	\$489,438
Reinsurance assumed	540	1,962	41
Reinsurance ceded	(95,909)	(76,893)	(81,809)
Total policy benefits	\$351,767	\$354,498	\$407,670
Policyholders' dividends:			
Direct	\$124,462	\$118,775	\$118,227
Reinsurance ceded	(2,154)	(2,672)	(3,219)
Total policyholders' dividends	\$122,308	\$116,103	\$115,008

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, 2006 and 2005 was \$54.9 billion and \$52.9 billion, respectively.

NOTE 5 – DEFERRED POLICY ACQUISITION COSTS

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

	2006	2005	2004
Balance, beginning of year	\$799,755	\$680,755	\$606,144
Acquisition costs deferred during the year	171,736	156,047	159,544
Amortization during the year	(88,479)	(96,779)	(87,939)
Amortization of remaining deferred acquisition costs on disability income contracts	–	(11,000)	–
Adjustment through other comprehensive income during the year	16,020	70,732	3,006
Balance, end of year	\$899,032	\$799,755	\$680,755

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):

	2006		2005		2004	
	Amount	Rate	Amount	Rate	Amount	Rate
Current	\$16,649		\$30,232		\$15,955	
Deferred	23,588		5,419		11,750	
Total income tax expense	\$40,237		\$35,651		\$27,705	
Expected income taxes	\$52,773	35.0%	\$47,021	35.0%	\$40,608	35.0%
Dividends received deduction	(2,821)	(1.9)	(2,725)	(2.0)	(2,306)	(2.0)
Affordable housing tax credit	(6,796)	(4.5)	(7,292)	(5.5)	(7,394)	(6.4)
Audit settlements	(2,261)	(1.5)	–	–	–	–
Corporate owned life insurance	(2,401)	(1.6)	(2,660)	(2.0)	(1,705)	(1.5)
Other, net	1,743	1.2	1,307	1.0	(1,498)	(1.1)
Total income tax expense	\$40,237		\$35,651		\$27,705	
Effective federal income tax rate		26.7%		26.5%		24.0%

The Company paid \$20.1 million, \$25.2 million, and \$24.6 million in federal income taxes during 2006, 2005, and 2004, respectively.

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

	2006	2005
Deferred income tax assets:		
Pension and other post retirement liabilities	\$ 59,239	\$ 66,232
Policy liabilities	258,262	233,060
Other liabilities and accrued expenses	9,714	18,578
Affordable housing tax credit carryforwards	–	2,367
Other	489	507
Total deferred income tax assets	327,704	320,744
Deferred income tax liabilities:		
Debt and equity securities	12,341	5,374
Net unrealized gain on available-for-sale securities	24,860	30,042
Deferred policy acquisition costs	243,472	215,095
Present value of future profits of insurance acquired	17,147	20,006
Property and investments	4,877	5,452
Other	10,324	9,506
Total deferred income tax liabilities	313,021	285,475
Total net deferred income tax assets	\$ 14,683	\$ 35,269

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, 2006.

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

NOTE 6 – FEDERAL INCOME TAXES (continued)

During 2006 the Internal Revenue Service completed the audit of the Company's Federal Income Tax Returns for the years 2002 and 2003. A number of issues were settled resulting in a \$2.3 million dollar favorable impact to income tax expense for 2006. In management's opinion adequate tax liabilities have been established for all open years.

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 prior to December 31, 2005 may be eligible for life insurance retiree benefits if they reach retirement age and meet certain minimum service requirements while working for the Company. Substantially all agents and agency staff employees who 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 balance sheet.

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		
	2006	2005	2004	2006	2005	2004
Change in benefit obligation:						
Benefit obligation, beginning of year	\$251,354	\$229,866	\$217,945	\$36,268	\$30,736	\$31,911
Service cost for benefits earned during the period	5,540	5,058	5,004	1,164	1,019	963
Interest cost on benefit obligation	13,723	13,675	13,340	1,999	1,843	1,978
Actuarial (gains) losses	(5,850)	17,741	12,068	(755)	4,760	2,057
Adoption of FSP 106-2 – Medicare Part D	–	–	–	–	–	(4,000)
Curtailment	–	(929)	(4,298)	–	–	(275)
Benefits paid	(14,860)	(14,057)	(14,193)	(2,166)	(2,090)	(1,898)
Benefit obligation, end of year	\$249,907	\$251,354	\$229,866	\$36,510	\$36,268	\$30,736

Change in plan assets:						
Plan assets, beginning of year	\$108,682	\$ 99,147	\$87,784			
Contributions	22,300	7,081	6,728			
Actual income on plan assets	7,625	8,739	12,115			
Benefits paid	(6,902)	(6,285)	(7,480)			
Plan assets, end of year	\$131,705	\$108,682	\$99,147			

	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
Funded status:						
Funded plans:						
Benefit obligation	\$159,707	\$ 157,327	\$ 139,669			
Plan assets	(131,705)	(108,682)	(99,147)			
Benefit obligation greater than plan assets	28,002	48,645	40,522			
Benefit obligation – other plans	90,200	94,027	90,197	\$36,510	\$36,268	\$30,736
Unrecognized actuarial losses	(47,260)	(54,438)	(40,257)	(3,332)	(5,185)	(197)
Unrecognized prior service (costs) benefits	(382)	(503)	(617)	61	1,200	2,340
Accrued benefit cost at October 1	70,560	87,731	89,845	33,239	32,283	32,879
Net activity subsequent to measurement date	1,062	(2,048)	(3,058)	–	–	–
Accrued benefit cost at December 31	\$ 71,622	\$ 85,683	\$ 86,787	\$33,239	\$32,283	\$32,879

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

	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
Service cost for benefits earned during the period	\$ 5,540	\$ 5,058	\$ 5,004	\$ 1,164	\$ 1,019	\$ 963
Interest cost on benefit obligation	13,723	13,675	13,340	1,999	1,843	1,978
Expected (income) on plan assets	(9,221)	(7,949)	(7,416)	–	–	–
Net amortization of unrecognized losses (gains)	2,924	1,841	1,140	1,167	(228)	717
Amortization of plan amendments for curtailment	–	–	250	–	–	(563)
Amortization of prior service costs (benefits) and plan amendments	121	114	113	(1,139)	(1,140)	(1,515)
Net periodic benefit cost (included in operating expenses)	\$ 13,087	\$ 12,739	\$ 12,431	\$ 3,191	\$ 1,494	\$ 1,580

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 \$87.4 million and \$91.4 million at the 2006 and 2005 measurement dates, respectively. The total ABO for the separately funded defined benefit pension plans was \$147.4 million and \$143.7 million at the 2006 and 2005 measurement dates, respectively.

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

	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
Discount rate	5.75%	5.50%	6.00%	5.75%	5.50%	6.00%
Rate of increase in future compensation levels	3.0% - 6.5%	3.0% - 6.5%	3.0% - 6.5%			
Expected long term return on plan assets	7.75%	8.0%	8.0%			

Additional minimum pension liabilities at December 31, 2006, 2005, and 2004, were \$32.6 million, \$38.7 million, and \$24.2 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 \$11.4 million, \$13.6 million, and \$8.5 million, as a component of accumulated other comprehensive income in 2006, 2005, and 2004, respectively.

Included in the pension and other post-retirement benefit obligations liability as reported on the balance sheets are deferred compensation and employee disability liabilities of \$29.8 million and \$30.2 million as of December 31, 2006 and 2005, respectively.

The projected health care cost trend rate (“HCCTR”) in 2006 and 2005 for the pre-65 population was eliminated due to a plan amendment and for the post-65 population was 10%. This projected rate declines linearly to 5% in 2011 and remains level thereafter. Increasing the assumed HCCTR by one percentage point in each year would increase the accumulated postretirement benefit obligation (“APBO”) by about \$3.6 million and increase the 2006 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 \$3.0 million and the 2006 service cost component of net periodic postretirement benefit cost by about \$0.1 million. The Company uses the straight-line method of amortization for prior service cost and unrecognized gains and losses.

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

Plan Asset Category	October 1, 2006	October 1, 2005
Bonds	39%	36%
Common stocks	58	60
Group annuity contract and other	3	4
Total	100%	100%

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

NOTE 7 – BENEFIT PLANS (continued)

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

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

Projected benefit payments for defined benefit obligations, and for projected Medicare Part D reimbursements for each of the five years following December 31, 2006, 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
2007	\$16,284	\$ 2,524	\$ 210
2008	16,273	2,645	230
2009	16,155	2,761	250
2010	16,209	2,854	269
2011	16,470	2,937	286
2012-2016	90,404	15,163	1,689

The pension benefit obligation and accumulated benefit obligation attributable to National Life employees hired after June 30, 2001 and other Company employees was \$2.2 million, \$1.6 million and \$0.9 million at December 31, 2006, 2005, and 2004, respectively. The crediting rates were 4.47%, 4.76% and 5.14% at December 31, 2006, 2005, and 2004, respectively.

The Company's expected 2007 contribution into its separately funded defined benefit pension plan is \$6.0 million. The Company may elect to make smaller or larger contributions in 2007, 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

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

NOTE 7 – BENEFIT PLANS (continued)

50% match on up to 6% of an employee's salary, subject to applicable maximum contribution guidelines. Additional employee voluntary contributions may be made to the plans subject to contribution guidelines. Vesting and withdrawal privilege schedules are attached to the Company's matching contributions.

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

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

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

	2006	2005
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.	\$199,649	\$199,636
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.	74,411	74,390
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	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	\$294,679	\$362,145

During 2006, the Company sold its interest in a consolidated real estate partnership resulting in the deconsolidation of the partnership, including its \$67.5 million real estate investment mortgage.

Interest paid on the 7.5% senior notes was \$15.0 million in 2006, 2005, and 2004. Interest paid on the 6.5% senior notes was \$4.9 million, \$2.4 million, and \$0 in 2006, 2005, and 2004 respectively. Dividends paid or accrued on the TPS were \$1.1 million in 2004. Interest paid on the \$20.6 million note payable was \$1.9 million and \$1.5 million in 2006 and 2005, respectively. 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.

Interest paid or accrued on the real estate investment mortgage was \$3.0 million in 2006 and \$2.3 million in 2005 and is included as a component of net investment income.

The Company has two lines of credit available. A \$25 million line of credit with State Street Bank, based on an adjustable rate equal to the prevailing federal funds rate plus 50 basis points. The outstanding balance was \$0 as of December 31, 2006 and 2005. 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, 2006 and 2005. Total interest on the combined lines of credit was less than \$10,000 in 2006, 2005, and 2004.

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 9 – COMMITMENTS AND CONTINGENCIES

Total outstanding mortgage loan funding commitments at December 31, 2006 and 2005, were \$32.3 million and \$68.7 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 currently leases rights to the use of certain data processing hardware and software from American International Technology Enterprises, Inc., Livingston, New Jersey. The Company has terminated this lease with an expected effective date in the second quarter of 2007. The Company has entered into a new lease for similar services with Perot Systems. The following is a schedule of future minimum lease payments as of December 31, 2006 (in millions):

Year	Operating Leases
2007	\$ 4.5
2008	4.4
2009	4.4
2010	4.4
2011	0.6
Total minimum lease payments	\$18.3

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, 2006 (in millions):

Year	Contract Obligation
2007	\$14.1
2008	14.1
2009	14.1
2010	1.2
Total contract obligation	\$43.5

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

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 \$21.7 million and \$10.9 million was required at December 31, 2006 and 2005, 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 \$56.6 million and \$92.6 million at December 31, 2006 and 2005, 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, 2006 and 2005 was \$78.3 million and \$103.5 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, 2006 and 2005, and for the three years ended December 31, 2006, is as follows (in thousands):

	2006	2005
Liabilities:		
Policy liabilities and accruals	\$ 3,851,743	\$ 3,869,945
Collateral held on loaned securities	64,299	–
Other liabilities	3,485	59,568
Total liabilities	\$ 3,919,527	\$ 3,929,513
Assets:		
Cash and cash equivalents	\$ 123,636	\$ 70
Available-for-sale debt and equity securities	2,347,363	2,470,689
Available-for-sale debt securities on loan	63,031	–
Other invested assets	1,950	7,134
Mortgage loans	388,330	407,429
Policy loans	518,115	529,526
Accrued investment income	45,169	45,363
Premiums and fees receivable	12,267	11,518
Other assets	90,126	110,044
Total assets	\$ 3,589,987	\$ 3,581,773
Excess of reported closed block liabilities over closed block assets	\$ 329,540	\$ 347,740
Closed block accumulated other comprehensive gain represented above	–	–
Maximum future earnings to be recognized from closed block assets and liabilities	\$ 329,540	\$ 347,740

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

NOTE 10 – NATIONAL LIFE CLOSED BLOCK (continued)

	2006	2005	2004
Revenues:			
Premiums and other income	\$ 222,437	\$ 240,103	\$ 255,941
Net investment income	211,095	210,827	219,248
Net investment loss	(429)	(1,237)	(1,924)
Total revenues	433,103	449,693	473,265
Benefits and Expenses:			
Increase (decrease) in policy liabilities	8,032	8,916	(44,439)
Policy benefits	252,366	271,965	343,187
Policyholders' dividends	120,924	115,773	115,414
Interest credited to policyholder account liabilities	12,130	9,095	11,664
Operating expenses	8,606	9,585	9,730
Commission expenses	3,045	3,337	4,015
Total benefits and expenses	405,103	418,671	439,571
Pre-tax results of operations	28,000	31,022	33,694
Income taxes	9,800	10,858	11,793
Closed block results of operations	18,200	20,164	21,901
Other comprehensive income:			
Unrealized loss	-	-	-
Total closed block comprehensive income	\$ 18,200	\$ 20,164	\$ 21,901
Excess of reported closed block liabilities over closed block assets:			
Beginning of year	\$ 347,740	\$ 367,904	\$ 389,805
Closed block comprehensive income	18,200	20,164	21,901
End of year	\$ 329,540	\$ 347,740	\$ 367,904

Amortized cost of bonds held by the Closed Block at December 31, 2006 and 2005 were \$2,328.9 million and \$2,378.1 million, respectively. Mortgage valuation allowances on Closed Block mortgage loans were \$0 and \$0.9 million at December 31, 2006 and 2005, respectively.

Participating insurance in force within the Closed Block was \$9.8 billion and \$10.4 billion at December 31, 2006 and 2005, 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. 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 \$708.0 million and \$623.5 million at December 31, 2006 and 2005, respectively. Statutory net gain from operations was \$80.8 million and \$125.5 million in 2006 and 2005, 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 \$3.1 million, \$3.5 million, and \$4.0 million for the years ended December 31, 2006, 2005, and 2004, 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 6.01%; the second accrues interest at 5.66%. Amortization of PVFP was \$8.2 million, \$8.8 million, and \$8.4 million for the years ended December 31, 2006, 2005, and 2004, 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
2007	\$5,500
2008	6,200
2009	5,500
2010	5,100
2011	4,700

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 55.1% and 57.8% of the face value of total insurance inforce at December 31, 2006 and 2005, respectively. The premiums on participating life insurance policies were 53.0%, 54.2%, and 55.2% of total individual life insurance premiums in 2006, 2005, and 2004, respectively.

NOTE 14 – ADOPTION OF NEW ACCOUNTING STANDARDS

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

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

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14 – ADOPTION OF NEW ACCOUNTING STANDARDS (continued)

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

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

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

SOP 03-01 – Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts. 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.

NOTE 15 – PENDING ACCOUNTING STANDARDS

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

The Company 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 15 – PENDING ACCOUNTING STANDARDS (continued)

FIN 48 – Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. In July 2006, the FASB issued FASB Interpretation No. 48 ('FIN 48') *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109. It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measure of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods and disclosures. It will be effective for fiscal years beginning after December 15, 2006. Earlier application of the provisions of FIN 48 is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period in which it is adopted. The provisions of FIN 48 apply to all income tax positions upon its adoption. Only income tax positions that meet the recognition threshold criteria at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 will be reported as an adjustment to the opening balance of retained earnings for that fiscal year, presented separately. The Company will be required to adopt FIN 48 on January 1, 2007. Although the Company will continue to evaluate the application of FIN 48, management does not currently believe adoption will have a material impact on the Company's consolidated financial statements or results of operations.

SFAS No. 155 - Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140. In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140* ("SFAS 155"), which permits fair value remeasurement for a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Under SFAS 155, an entity may make an irrevocable election to measure a hybrid financial instrument at fair value, in its entirety, with changes in fair value recognized in earnings. SFAS 155 also: (a) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"); (b) eliminates the interim guidance in SFAS 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets,* and establishes a requirement to evaluate beneficial interests in securitized financial assets to identify interests that are either freestanding derivatives or hybrid financial instruments that contain an embedded derivative requiring bifurcation; (c) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (d) eliminates restrictions on a qualifying special-purpose entity's ability to hold passive derivative financial instruments that pertain to beneficial interests that are or contain a derivative financial instrument. The Company expects to adopt SFAS 155 beginning January 1, 2007, for all financial instruments acquired, issued, or subject to a remeasurement event occurring after that date. Upon adoption of SFAS 155, the fair value election may also be applied to hybrid financial instruments that had previously been bifurcated pursuant to SFAS 133. Prior period restatement is not permitted. SFAS 155 is not expected to have a material impact on the Company's consolidated financial condition and results of operations at adoption.

SFAS No. 157 - Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"), which establishes a framework for measuring fair value under current accounting pronouncements that require or permit fair value measurement. SFAS 157 retains the exchange price notion, but clarifies that exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the most advantageous market for that asset or liability. Fair value measurement is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset, or nonperformance risk which would include the reporting entity's own credit risk. SFAS 157 establishes a three-level fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value. The highest priority is given to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs in situations where there is little or no market activity for the

NLV FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 15 – PENDING ACCOUNTING STANDARDS (continued)

asset or liability. In addition, SFAS 157 expands the disclosure requirements for annual and interim reporting to focus on the inputs used to measure fair value, including those measurements using significant unobservable inputs, and the effects of the measurements on earnings. SFAS 157 will be applied prospectively and is effective for fiscal years beginning after November 15, 2007. Retrospective application is required for certain financial instruments as a cumulative effect adjustment to the opening balance of retained earnings. The Company is currently evaluating the effects of SFAS 157 on its consolidated financial condition and results of operations.

SFAS No. 158 - Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R). In September 2006, the FASB issued SFAS No. 158, *"Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)"* ("SFAS 158"). The guidance requires the Company to recognize on the balance sheet the funded status of its defined benefit postretirement plans as either an asset or liability, depending on the plans' funded status, with changes in the funded status recognized through other comprehensive income. The funded status is measured as the difference between the fair value of the plan assets and the projected benefit obligation, for pension plans, or the accumulated postretirement benefit obligation for postretirement benefit plans. Prior service costs or credits and net gains or losses which are not recognized in current net periodic benefit cost, pursuant to SFAS No. 87, *"Employers' Account for Pensions"* or SFAS No. 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions,"* must be recognized in other comprehensive income, net of tax, in the period in which they occur. As these items are recognized in net periodic benefit cost, the amounts accumulated in other comprehensive income are adjusted. Disclosure requirements have also been expanded to separately provide information on the prior service costs or credits and net gains and losses recognized in other comprehensive income and their effects on net periodic benefit costs. SFAS 158 is effective for fiscal years ending after June 15, 2007 and is applied prospectively. The Company will adopt the provisions of SFAS 158 as of January 1, 2007. Accumulated other comprehensive income will be reduced by approximately \$11.9 million.

NOTE 16 – SALE OF AG&T

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

NOTE 17 – PENDING TRANSACTION

On December 14, 2006, the Company announced that SAMI had reached an agreement with Synovus for the reorganization of the four Synovus Funds, representing total assets under management of \$475 million, into the Sentinel Funds. The reorganization is expected to occur in the first quarter of 2007, pending approval of the Synovus Fund shareholders and other contingencies. The cost of the transaction is expected to approximate \$7.5 million which will be capitalized by the Company as a combination of goodwill and other intangible assets.