

SUMMARY CONSOLIDATED FINANCIAL AND OTHER DATA

The following table presents the Company's summary consolidated financial and other data for each of the years in the three-year period ended December 31, 2007 and as of December 31, 2007, 2006 and 2005. The selected consolidated financial and other data have been derived from the Company's consolidated financial statements, which have been prepared in accordance with GAAP.

| | For the Year Ended December 31, | | |
|---|---------------------------------|-------------------|------------------|
| | 2007 | 2006 | 2005 |
| | (In thousands) | | |
| Income Statement Data | | | |
| Revenues: | | | |
| Insurance premiums | \$ 322,328 | \$ 336,007 | \$ 347,547 |
| Policy and contract charges | 178,770 | 156,950 | 145,845 |
| Net investment income | 758,058 | 797,462 | 682,023 |
| Net realized investment gains (losses) and change in value of trading equity securities | (4,106) | 2,660 | 2,301 |
| Mutual fund commissions, fees and other income | 125,817 | 124,482 | 120,696 |
| Total revenues | 1,380,867 | 1,417,561 | 1,298,412 |
| Benefits and expenses: | | | |
| Increase in policy liabilities | 29,717 | 81,783 | 76,918 |
| Policy benefits | 411,267 | 349,718 | 356,332 |
| Policyholders' dividends and dividend obligations | 111,097 | 122,308 | 116,103 |
| Interest credited to policyholder account liabilities | 283,111 | 336,650 | 238,444 |
| Operating expenses | 169,600 | 174,797 | 159,180 |
| Interest expense on debt | 21,944 | 21,975 | 20,465 |
| Sales practice remediation benefit and early retirement of debt and other financing | - | - | 974 |
| Policy acquisition expenses and amortization of present value of future profits, net | 200,405 | 179,549 | 195,649 |
| Total benefits and expenses | 1,227,141 | 1,266,780 | 1,164,065 |
| Income tax expense | 44,743 | 40,237 | 35,651 |
| Minority interest in consolidated subsidiaries | - | (103) | 1,237 |
| Net income | \$ 108,983 | \$ 110,647 | \$ 97,459 |

A reconciliation of net income to pre-tax operating income is as follows:

| | For the Year Ended December 31, | | |
|---|---------------------------------|-------------------|-------------------|
| | 2007 | 2006 | 2005 |
| | (In thousands) | | |
| Income Statement Data (continued) | | | |
| Net income | \$ 108,983 | \$ 110,647 | \$ 97,459 |
| Net realized investment losses (gains), net of related policy acquisition expense, policyholder dividend obligation and income tax effects | 1,988 | (4,590) | (1,785) |
| Adjustments to reverse the effect of: Sales practice remediation benefit and early retirement of debt, net of related income taxes..... | - | - | 974 |
| Income tax expense on operations | 45,813 | 37,767 | 34,808 |
| Minority interest in consolidated subsidiaries | - | (103) | 1,237 |
| Cumulative effect of accounting change, net of related income taxes | - | - | - |
| Pre-tax operating income | \$ 156,784 | \$ 143,721 | \$ 132,693 |

| | As of December 31, | | |
|---|---------------------|---------------------|---------------------|
| | 2007 | 2006 | 2005 |
| | (In thousands) | | |
| Balance Sheet Data | | | |
| Total cash and investments | \$12,931,063 | \$12,605,518 | \$11,832,403 |
| Other general account assets | 1,596,229 | 1,462,130 | 1,346,781 |
| Separate account assets | 983,815 | 941,376 | 840,125 |
| Total assets..... | <u>\$15,511,107</u> | <u>\$15,009,024</u> | <u>\$14,019,309</u> |
| Total liabilities and minority interest in consolidated subsidiaries | <u>\$14,045,530</u> | <u>\$13,645,976</u> | <u>\$12,761,337</u> |
| Common stock, additional paid-in capital and retained earnings | \$ 1,447,763 | \$ 1,338,932 | \$ 1,228,285 |
| Accumulated other comprehensive income | 17,814 | 24,116 | 29,687 |
| Total equity | <u>\$ 1,465,577</u> | <u>\$ 1,363,048</u> | <u>\$ 1,257,972</u> |

| | As of December 31, | | |
|---|---------------------|---------------------|---------------------|
| | 2007 | 2006 | 2005 |
| | (In thousands) | | |
| Other Selected Data | | | |
| Life insurance in force (before reinsurance ceded) | \$57,434,357 | \$54,858,299 | \$52,926,644 |
| Assets under management: | | | |
| NL Financial Alliance | \$ 2,988,100 | \$ 2,892,700 | \$ 3,099,400 |
| Independent Producers Alliance..... | 5,865,500 | 5,402,000 | 4,724,100 |
| Independent Financial Alliance..... | 325,600 | 254,400 | 198,900 |
| Sentinel Asset Management | 4,701,800 | 4,252,200 | 4,150,000 |
| Corporate and Other | 6,288,100 | 6,498,500 | 6,158,500 |
| Total assets under management | <u>\$20,169,100</u> | <u>\$19,299,800</u> | <u>\$18,330,900</u> |

GENERAL DISCUSSION OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides an assessment of the consolidated financial position and results of operations of NLV Financial Corporation (“NLVF” or the “Company”). This discussion and analysis is based on, should be read in conjunction with, and is qualified in its entirety by reference to, the Company’s consolidated financial statements as of December 31, 2007 and 2006 and for each of the years in the three-year period ended December 31, 2007, which have been audited by PricewaterhouseCoopers LLP. This discussion provides a general overview of, and is not intended to provide a detailed analysis of, the operations, financial results or financial condition of NLVF. The Company’s consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles (“GAAP”) in the United States of America.

Overview

The Company offers a broad range of financial products and services, including life insurance, annuities, mutual funds, and investment advisory and administrative services. Life insurance and annuity products are offered through National Life Insurance Company (“National Life”), the Company’s flagship company chartered in 1848, and Life Insurance Company of the Southwest. The life and annuity portfolios include participating whole life, traditional and indexed universal life, term life, variable universal life and survivorship life insurance, flexible and single premium fixed annuities (traditional and indexed) and variable deferred annuities. Sentinel Asset Management, Inc. (“Sentinel”) provides investment advisory and administrative services to The Sentinel Group Funds, Inc. which include a variety of mutual funds including growth, capital preservation, income, international and fixed income. The Company markets its diverse product portfolio to individuals, families, small business owners, professionals and other middle to upper income customers. 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.

In 1999, National Life reorganized from a mutual to a stock insurance company as part of a reorganization into a mutual insurance holding company structure in order, among other things, to compete more effectively, have a more flexible and cost-effective capital structure and be part of an enterprise which is better positioned to make strategic acquisitions as compared with remaining a mutual insurance company. Concurrent with the reorganization into a mutual insurance holding company structure, National Life created a Closed Block of insurance and annuity policies to provide reasonable assurance to owners of policies in the Closed Block that assets will be available to provide for the continuation of dividend payments following the reorganization. National Life Holding Company, a Vermont mutual insurance holding company, owns 100% of the outstanding common stock of NLVF, an intermediate stock insurance holding company incorporated under the laws of Delaware. NLVF owns 100% of the outstanding common stock of National Life, Sentinel, and other subsidiaries.

As of December 31, 2007, the Company had \$20.1 billion of assets under management and served in excess of 700,000 customers. Of these totals, about \$9 billion was attributable to life insurance and annuity account values under management with more than 500,000 policy and contract holders. Approximately \$5 billion was attributable to mutual fund and client managed assets representing more than 200,000 customers. The remainder is attributable to the corporate segment, including fair value adjustments for the investment portfolio, the disability income business, closed block business and Company sponsored pension plans.

Distribution

The Company markets and distributes its products throughout the United States through four principal channels: NL Financial Alliance; Independent Producers Alliance, Independent Financial Alliance; and Sentinel Asset Management.

- **NL Financial Alliance:** NL Financial Alliance, the career agency channel, consists of approximately 550 full-time agents who specialize in selling products to professionals, business owners and other affluent individuals for financial and business planning purposes. This channel also markets personal trust and custody services.

- ***Independent Producers Alliance:*** The Independent Producers Alliance channel consists of approximately 3,500 independent agents who sell life insurance and annuity products, with an emphasis on the 403(b) qualified tax deferred retirement savings market for individuals employed by public schools.
- ***Independent Financial Alliance:*** The Independent Financial Alliance channel consists of approximately 3,500 independent agents who offer life insurance, annuity and mutual fund products to middle income customers for purposes of providing for the financial consequences of specific life events, such as death, retirement, college funding, disability and chronic or long term illness.
- ***Sentinel Asset Management:*** The Sentinel Asset Management channel consists of independent broker/dealers who sell Sentinel mutual funds and variable annuity products along with providing investment management services to institutional and private clients in addition to the Company's life insurance subsidiaries.

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements of NLVF have been prepared in conformity with GAAP. 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.

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.

Results of Consolidated Operations

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Overall business growth and solid investment returns resulted in an increase in pre-tax operating income in 2007 compared to 2006. Pre-tax operating income increased \$13.1 million, or 9.1%, to \$156.8 million in 2007 from \$143.7 million in 2006. Net income decreased \$1.7 million, or 1.5%, to \$109.0 million in 2007 from \$110.7 million in 2006. The decrease in net income was primarily due to realized investment losses related to pre-tax impairment charges of \$11.2 million in its total available-for sale debt and equity security portfolio, primarily related to securities in the housing and lending sectors which were effected by the credit market challenges in the latter part of 2007.

Insurance Premiums

Insurance premiums include premiums from whole life insurance, term life insurance, disability income insurance and immediate annuity policies. Total insurance premiums for 2007 decreased \$13.7 million, or 4%, to \$322.3 million from \$336.0 million in 2006. The decrease is primarily attributable to several large policies that were written in the prior year not repeating in 2007 and a continued shift of business from traditional insurance products to investment-type products.

Policy and Contract Charges

Policy and contract charges for universal life, variable universal life and annuity policies consist of costs of insurance, expense loads, surrender charges, and other related fees. Policy and contract charges increased \$21.8 million, or 14%, to \$178.8 million in 2007 from \$157.0 million in 2006. The increase during the current year is primarily due to significant sales of new indexed universal life products where product charges are front-loaded in earlier years.

Net Investment Income

Net investment income includes revenues from the Company's general account assets and changes in the values of S&P 500 and Russell 2000 indexes option contracts that hedge the liabilities of the Company's indexed products. Net investment income decreased \$39.4 million, or 5%, to \$758.1 million in 2007 from \$797.5 million in 2006. The decrease is primarily due to a decrease in option values and income received related to the hedging of the Company's indexed product liabilities partially offset by an increase in net investment income related to growth in invested assets resulting

from increased policyholder account values. Net investment income excluding the change in option values was \$756.1 million in 2007, an increase of \$35.9 million, or 5%, from \$720.2 million in 2006.

Net Realized Investment Gains (Losses) and Change in Value of Trading Equity Securities

Net realized investment losses and change in value of trading equity securities were \$4.1 million in 2007 compared to gains of \$2.7 million in 2006. Net realized investment losses in 2007 were primarily a result of realized investment losses related to pre-tax impairment charges of \$11.2 million in its total available-for sale debt and equity security portfolio and primarily related to securities in the housing and lending sectors which were effected by the credit market challenges in the latter part of 2007. These losses were substantially offset by gains realized on securities sold during the year.

Mutual Fund Commissions, Fees and Other Income

Mutual fund commissions consist of dealer concessions earned by the Company's affiliated broker/dealers, Equity Services, Inc. and Sentinel Financial Services Company. Mutual fund fees consist primarily of asset management fees earned by the Company's affiliated investment advisors, Sentinel Advisors Company and Sentinel Asset Management, Inc. Other income primarily consists of expense allowances provided under a reinsurance agreement with UNUM Life Insurance Company of America ("UNUM") and changes in the market value of assets held and policy benefits earned on corporate owned life insurance policies in which the Company has invested.

Revenues from mutual fund commissions, fees and other income increased \$1.3 million, or 1%, to \$125.8 million in 2007 as compared with \$124.5 million in 2006. The increase was primarily the result of an increase in other income of \$3.2 million or 17%, to \$21.8 million in 2007 from \$18.6 million in 2006 due to an experience refund from the Company's reinsurance agreement with UNUM. The increase was somewhat offset by a decrease in mutual fund commissions and fee income of \$1.9 million, or 2%, to \$104.0 million in 2007 from \$105.9 million in 2006 due to decreased commission income related to sales of certain classes of mutual funds and other security products.

Increase in Policy Liabilities

Policy liabilities consist primarily of reserves for life insurance, disability income insurance and certain annuities. Policy liabilities increased \$29.7 million in 2007 as compared with an increase of \$81.8 million in 2006. The decrease in increase in policy liabilities expense was primarily the result of policy liabilities released due to increased policy surrenders, principally in the Closed Block, partially offset by a strengthening of reserves related to the Company's disability income business.

Policy Benefits

Policy benefits include death benefits for life insurance policies, policy surrenders for whole life policies and disability income benefits. In addition, policy benefits include a small amount of miscellaneous benefits such as payments on life-contingent immediate annuities and premium waiver benefits due to disability. Policy benefits increased \$61.6 million, or 18%, to \$411.3 million in 2007 as compared with \$349.7 million in 2006. The increase in policy benefits for 2007 compared to 2006 was primarily due to an increase of \$49.4 million in surrender benefits, principally in the Closed Block, and an increase in death benefits.

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 ("PDO") arising from the Closed Block within National Life. Dividends are based on a scale that seeks to reflect the relative contribution of each group of policies to the Company's overall operating results. The dividend scales are approved annually by National Life's Board of Directors. The total policyholder dividend expense decreased \$11.2 million, or 9%, to \$111.1 million in 2007 compared to \$122.3 million in 2006. These amounts include both dividends accrued and paid to policyholders of \$114.5 million in 2007 and \$111.5 million in 2006. The increase in policyholders' dividends paid for 2007 compared to 2006 resulted mainly from increases in the values of in-force policies upon which dividends are primarily paid. Actual experience of the Closed Block was less than projected in 2007, giving rise to a decrease of \$3.4 million in PDO during 2007 as compared to an increase of \$10.8 million in PDO during 2006. This decrease was primarily due to unfavorable mortality and surrender activity as compared to 2006.

Interest Credited to Policyholder Account Liabilities

Interest credited to policyholder account liabilities consists of interest for universal life insurance, fixed deferred annuities and indexed products. Interest credited decreased \$53.6 million, or 16%, to \$283.1 million in 2007 from \$336.7 million in 2006. The decrease was primarily due to the change in the S&P 500 and Russell 2000 indexes being less than the corresponding change in 2006, resulting in lower credits to indexed products policyholder account values and were somewhat offset by interest credited related to growth in policyholder account values related to increased sales of indexed universal life policies.

Operating Expenses

Operating expenses consist primarily of administrative and maintenance expenses related to servicing the business and overhead needs of the Company's operations. Expenses directly related to the acquisition of new business, including commissions paid on new insurance and annuity policies, are included in policy acquisition expenses and are deferred and amortized in relation to estimated gross profits of the business. Operating expenses decreased \$5.2 million, or 3%, to \$169.6 million in 2007 from \$174.8 million in 2006. The decrease in operating expenses is primarily attributable to improved operational efficiency and a change in the Company's deferral assumption related to acquisition costs for agent benefits included in operating expenses.

Interest Expense on Debt

Interest expense on debt consists of interest paid on the Company's \$20 million of Trust Preferred Securities and \$275 million of Senior Notes due 2033 (\$200 million) and 2035 (\$75 million). Interest expense on debt totaled \$22.0 million in 2007 and 2006.

Policy Acquisition Expenses and Amortization of Present Value of Future Profits, Net

Policy acquisition expenses include commissions and other costs of acquiring business that vary with and are primarily attributable to the production of new business. Policy acquisition expenses are net of amounts deferred and include the amortization of amounts previously deferred. Policy acquisition expenses increased \$20.9 million, or 12%, to \$200.4 million in 2007 as compared with \$179.5 million in 2006. The increase in policy acquisition expenses were primarily attributable to an increase in the amortization of the deferred acquisition costs which have increased over the last couple of years based on increased sales levels and mix of products sold.

Income Tax Expense

Federal income tax expense of \$44.7 million and \$40.2 million for 2007 and 2006, respectively, was recorded with an effective tax rate of 29.1% for 2007 as compared to an effective rate of 26.7% for 2006. The Company's effective tax rate is less than the nominal income tax rate of 35% due to credits generated from the investment in qualified affordable housing projects, earnings related to the Company's corporate owned life insurance investments, the dividends received deduction, and other permanent differences. The effective tax rate for 2007 was higher than that for 2006 primarily due to a reduction in affordable housing tax credits recognized, lower corporate owned life insurance investment earnings, and the absence in 2007 of the release of tax liabilities for issues settled as occurred in 2006.

Recent Developments

The company announced on November 13, 2007, the preliminary agreement with Citizens Advisers, Inc. for the reorganization of eight Citizens Funds, representing assets under management of approximately \$800 million, into the Sentinel Funds. The reorganization is expected to occur in the first quarter of 2008, pending approval of the Citizens Funds Shareholders and other contingencies.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Overall business growth and solid investment results resulted in strong income growth in 2006 compared to 2005. Pre-tax operating income increased \$11.0 million, or 8%, to \$143.7 million in 2006 from \$132.7 million in 2005. Net income increased \$13.1 million, or 13%, to \$110.6 million in 2006 from \$97.5 million in 2005. The increase in net

income was primarily due to growth in pre-tax operating income and a favorable settlement of the tax audit for years 2002 and 2003.

Insurance Premiums

Insurance premiums include premiums from whole life insurance, term life insurance, disability income insurance and immediate annuity policies. Total insurance premiums for 2006 decreased \$11.5 million, or 3%, to \$336.0 million from \$347.5 million in 2005. The decrease over the period is due primarily to several large policies surrendering during the year from the company's Closed Block, partially offset by growth in sales.

Policy and Contract Charges

Policy and contract charges for universal life, variable universal life and annuity policies consist of costs of insurance, expense loads, surrender charges, and other related fees. Policy and contract charges increased \$11.2 million, or 8%, to \$157.0 million in 2006 from \$145.8 million in 2005. The increase over the period reflects sales and growth of universal life insurance in force generated primarily from the Company's NL Financial Alliance and Independent Financial Alliance distribution channels.

Net Investment Income

Net investment income includes revenues from the Company's general account assets and changes in the values of S&P 500 index option contracts that hedge the liabilities of the Company's indexed annuity business. Net investment income increased \$115.5 million, or 17%, to \$797.5 million in 2006 from \$682.0 million in 2005. The increase is primarily due to an increase in option values and income received related to the hedging of the Company's indexed annuity liabilities, coupled with growth in assets related to increased customer deposits and account values. Net Investment Income excluding the change in option values was \$720.2 million in 2006, an increase of \$41.6 million, or 6%, from \$678.6 million in 2005.

Net Realized Investment Gains and Change in Value of Trading Equity Securities

Net realized investment gains and change in value of trading equity securities were \$2.7 million in 2006 compared to \$2.3 million in 2005. Net realized investment gains in 2006 and 2005 consisted primarily of gains in the Company's equity and real estate portfolios and the gain on the sale of AG&T partially offset by losses on the Company's corporate bond portfolio.

Mutual Fund Commissions, Fees and Other Income

Mutual fund commissions consist of dealer concessions earned by the Company's affiliated broker/dealers, Equity Services, Inc. and Sentinel Financial Services Company. Mutual fund fees consist primarily of asset management fees earned by the Company's affiliated investment advisors, Sentinel Advisors Company and Sentinel Asset Management, Inc. Other income primarily consists of expense allowances provided under a reinsurance agreement with UNUM and changes in the market value of assets held in corporate owned life insurance policies in which the Company has invested.

Revenues from mutual fund commissions, fees and other income increased \$3.8 million, or 3%, to \$124.5 million in 2006 as compared with \$120.7 million in 2005. The increase was primarily the result of an increase in mutual fund commissions and fee income of \$2.8 million, or 3%, to \$105.9 million in 2006 from \$103.1 million in 2005 due to an increase in the sales of non-proprietary mutual fund and other security products. The other primary contributor to the increase was receipt of proceeds from one death from the Company's corporate owned life insurance policies in 2006.

Increase in Policy Liabilities

Policy liabilities consist primarily of reserves for life insurance, disability income insurance and certain annuities. Policy liabilities increased \$81.8 million in 2006 as compared with an increase of \$76.9 million in 2005. The increase in policy liabilities expense was the result of business growth primarily in the participating life insurance business.

Policy Benefits

Policy benefits include death benefits for life insurance policies, policy surrenders for whole life policies and disability income benefits. In addition, policy benefits include a small amount of miscellaneous benefits such as payments on life-contingent immediate annuities and premium waiver benefits due to disability. Policy benefits decreased \$6.6 million, or 2%, to \$349.7 million in 2006 as compared with \$356.3 million in 2005. The decrease in policy benefits for 2006 compared to 2005 was primarily due to less surrender benefits paid, as 2005 was impacted by the payout of a few longer-term policies with significant surrender values. Death benefits rose modestly in absolute terms in 2006, but declined as a percentage of inforce.

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 (PDOs) arising from the Closed Block. Dividends are based on a scale that seeks to reflect the relative contribution of each group of policies to the Company's overall operating results. The dividend scales are approved annually by National Life's Board of Directors. The total policyholder dividend expense increased \$6.2 million, or 5%, to \$122.3 million in 2006 compared to \$116.1 million in 2005. These amounts include both dividends accrued and paid to policyholders of \$111.5 million in 2006 and \$116.5 million in 2005. The decrease in policyholders' dividends paid for 2006 compared to 2005 resulted mainly from a reduction in the Closed Block dividend scale, partially offset by increases in the account values of in force policies upon which dividends are primarily paid. Actual experience of the Closed Block was slightly better than projected in 2006, giving rise to an increase of \$10.8 million in PDO during 2006. This increase was due to favorable mortality partially offset by lower investment returns as compared to 2005.

Interest Credited to Policyholder Account Liabilities

Interest credited to policyholder account liabilities consists of interest for universal life insurance, fixed deferred annuities and indexed annuities. Interest credited increased \$98.2 million, or 41%, to \$336.6 million in 2006 from \$238.4 million in 2005. The increase was primarily due to growth in the S&P 500 Index resulting in higher credits to indexed annuity policyholder account values, coupled with growth in policyholder account values. While credited interest rates have declined steadily over the last few years in line with market interest rates and investment yields, the Company's sales of universal life, and fixed annuities (traditional and indexed) have resulted in increased account values upon which interest is credited.

Operating Expenses

Operating expenses consist primarily of administrative and maintenance expenses related to servicing the business and overhead needs of the Company's operations. Expenses directly related to the acquisition of new business, including commissions paid on new insurance and annuity policies, are included in policy acquisition expenses and are deferred and amortized in relation to estimated gross profits of the business. Operating expenses increased \$15.6 million, or 10%, to \$174.8 million in 2006 from \$159.2 million in 2005. The increase in operating expenses is primarily attributable to expansion of the Company's distribution, agency restructurings, increased regulatory related expenses, and funding the Company's charitable foundation, which also reduced the effective tax rate, partially offset by improved operational efficiency.

Interest Expense on Debt

Interest expense on debt consists of interest paid on the Company's \$20 million of Trust Preferred Securities and \$275 million of Senior Notes due 2033 (\$200 million) and 2035 (\$75 million). Interest expense on debt totaled \$22.0 million in 2006 compared to \$20.5 million in 2005. The increase was due to the rise in the three-month Libor rate the Trust Preferred interest expense is tied to. In the fourth quarter of 2006, the floating rate obligation was swapped to a fixed rate.

Sales Practice Remediation Benefit and Early Retirement of Debt

The sales remediation benefit and debt retirement charge are non-recurring items that are not an ongoing part of the Company's business. The sales remediation benefit and debt retirement charge resulted in no charge in 2006 compared to a charge of \$1.0 million in 2005. In 2005, the charge was due to redeeming preferred stock in connection

with the Company's legal entity restructuring to align with its strategy while increasing financial flexibility and reducing costs.

Policy Acquisition Expenses and Amortization of Present Value of Future Profits, Net

Policy acquisition expenses include commissions and other costs of acquiring business that vary with and are primarily attributable to the production of new business. Policy acquisition expenses are net of amounts deferred and include the amortization of amounts previously deferred. Policy acquisition expenses decreased \$16.1 million, or 8%, to \$179.5 million in 2006 as compared with \$195.6 million in 2005 primarily due to 2005 including the amortization of \$11 million for the remaining deferred acquisition cost asset related to the Company's discontinued disability income block of business. Also, the deferral policy was reviewed and standardized in 2006 to provide consistency throughout the company resulting in an additional \$3.8 million of underwriting and issuance cost deferrals in 2006.

Income Tax Expense

Federal income tax expense of \$40.2 million and \$35.7 million for 2006 and 2005, respectively, was recorded with an effective tax rate of 26.7% for 2006 as compared to an effective rate of 26.5% for 2005. The effective tax rate for 2006 was higher than that for 2005 primarily due to higher pretax income in 2006. For both periods, the Company's effective tax rate is less than the nominal income tax rate of 35% due to credits generated from the Company's investment in qualified affordable housing projects and other permanent differences.

Minority Interest in Consolidated Subsidiaries

Minority interest in consolidated subsidiaries represents the portion of net income or loss of the Company's consolidated partnerships allocated to minority shareholders. The minority interest in consolidated subsidiaries was a credit of (\$0.1) million in 2006, compared to a charge of \$1.2 million in 2005. During 2006, the company sold its two remaining entities which had minority interests. On December 30, 2005, the company acquired the sole minority interest (4%) in the Sentinel partnerships from the Penn Mutual Life Insurance Company.