

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, 2008 and as of December 31, 2008, 2007 and 2006. 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,		
	2008	2007	2006
	(In thousands)		
Income Statement Data			
Revenues:			
Insurance premiums	\$ 322,470	\$ 322,328	\$ 336,007
Policy and contract charges	210,113	178,770	156,950
Net investment income	575,766	758,058	797,462
Net realized investment gains (losses) and change in value of trading equity securities	(113,644)	(4,106)	2,660
Mutual fund commissions, fees and other income	118,496	125,817	124,482
Total revenues	1,113,201	1,380,867	1,417,561
Benefits and expenses:			
Increase in policy liabilities	45,105	29,717	81,783
Policy benefits	406,068	411,267	349,718
Policyholders' dividends and dividend obligations	113,798	111,097	122,308
Interest credited to policyholder account liabilities	108,679	274,928	327,445
Operating expenses	168,655	169,600	174,797
Interest expense on debt	21,666	21,944	21,975
Sales practice remediation benefit and early retirement of debt and other financing	-	-	-
Policy acquisition expenses and amortization of present value of future profits, net	241,710	198,994	179,242
Total benefits and expenses	1,105,681	1,217,547	1,257,268
Income tax expense	(7,840)	48,101	43,566
Minority interest in consolidated subsidiaries	-	-	(103)
Net income	\$ 15,360	\$ 115,219	\$ 116,830

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

	For the Year Ended December 31,		
	2008	2007	2006
	(In thousands)		
Income Statement Data (continued)			
Net income	\$ 15,360	\$ 115,219	\$ 116,830
Net realized investment losses (gains), net of related policy acquisition expense, policyholder dividend obligation and income tax effects	59,150	1,987	(4,590)
Income tax expense on operations	24,010	49,171	41,083
Minority interest in consolidated subsidiaries	—	—	(103)
Pre-tax operating income	\$ 98,520	\$ 166,377	\$ 153,220

	As of December 31,		
	2008	2007	2006
	(In thousands)		
Balance Sheet Data			
Total cash and investments.....	\$12,267,186	\$12,931,063	\$12,605,518
Other general account assets	2,333,387	1,587,621	1,455,425
Separate account assets	609,236	983,815	941,376
Total assets	<u>\$15,209,809</u>	<u>\$15,502,499</u>	<u>\$15,002,319</u>
Total liabilities and minority interest in consolidated subsidiaries	<u>\$14,149,261</u>	<u>\$14,014,181</u>	<u>\$13,622,766</u>
Common stock, additional paid-in capital and retained earnings.....	\$ 1,483,880	\$ 1,470,504	\$ 1,355,437
Accumulated other comprehensive income	(423,332)	17,814	24,116
Total equity	<u>\$ 1,060,548</u>	<u>\$ 1,488,318</u>	<u>\$ 1,379,553</u>

	As of December 31,		
	2008	2007	2006
	(In thousands)		
Other Selected Data			
Life insurance in force (before reinsurance ceded).....	\$59,405,340	\$57,434,357	\$54,858,299
Assets under management:			
NL Financial Alliance	\$ 2,726,100	\$ 2,988,100	\$ 2,892,700
Independent Producers Alliance	6,467,600	5,865,500	5,402,000
Independent Financial Alliance	427,800	325,600	254,400
Sentinel Investments.....	4,358,800	4,701,800	4,252,200
Corporate and Other	5,548,500	6,288,100	6,498,500
Total assets under management	<u>\$19,528,800</u>	<u>\$20,169,100</u>	<u>\$19,299,800</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, 2008 and 2007 and for each of the years in the three-year period ended December 31, 2008, 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 Investments (“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, 2008, the Company had \$19.5 billion of assets under management and served in excess of 870,000 customers. Of these totals, about \$9.6 billion was attributable to life insurance and annuity account values under management with more than 600,000 policy and contract holders. Approximately \$4.4 billion was attributable to mutual fund and client managed assets representing more than 250,000 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 Investments.

- **NL Financial Alliance:** NL Financial Alliance, the career agency channel, consists of approximately 510 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 4,000 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 4,000 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 Investments:** The Sentinel Investments channel consists of wholesale distribution through independent financial advisors and wire-houses 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, 2008 Compared to Year Ended December 31, 2007

Pre-tax operating income decreased \$67.9 million, or 40.8%, to \$98.5 million in 2008 from \$166.4 million in 2007. Net income decreased \$99.8 million, or 86.6%, to \$15.4 million in 2008 from \$115.2 million in 2007. The decrease in pre-tax operating income was primarily due to the impact of the decline in the equity markets on earnings generated by our annuity products, our asset management business and our corporate surplus investments. The decline in net income was primarily due to the decline in pre-tax operating income and realized investment losses related to impairment charges in the company's available-for sale debt and equity securities portfolio. The realized losses were primarily associated with securities in the financial services and manufacturing sectors.

Insurance Premiums

Insurance premiums include premiums from whole life insurance, term life insurance, disability income insurance and immediate annuity policies. Total insurance premiums for 2008 were \$322.5 million as compared to \$322.3 million in 2007. An increase in single premiums was offset by a decrease in renewal premiums as business continued to shift 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 \$31.3 million, or 17.5%, to \$210.1 million in 2008 from \$178.8 million in 2007. The increase is primarily due to continued growth in deposit-type business, including universal life and annuities.

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 index options contracts, which are used to hedge the liabilities associated with the Company's indexed products. Net investment income decreased \$182.3 million, or 24.0%, to \$575.8 million in 2008 from \$758.1 million in 2007. The decrease is primarily due to a decrease in option values and lower partnership income, 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 \$773.0 million in 2008, an increase of \$16.9 million, or 2.2%, from \$756.1 million in 2007.

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 was \$113.6 million in 2008 compared to \$4.1 million in 2007. Net realized investment losses in 2008 were primarily the result of impairment charges in the Company's available-for sale debt and equity securities portfolio, which were primarily related to securities in the financial services and manufacturing sectors.

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 Administrative Services, Inc. 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 decreased \$7.3 million, or 5.8%, to \$118.5 million in 2008 as compared with \$125.8 million in 2007. The decrease was primarily the result of a decrease in assets under management due to market declines partially offset by an increase in assets under management acquired through certain mutual fund acquisitions during the year. Assets under management associated with Sentinel Investments decreased \$0.3 billion during 2008.

Increase in Policy Liabilities

Policy liabilities consist primarily of reserves for life insurance, disability income insurance and certain annuities. Policy liabilities increased \$45.1 million in 2008 as compared with an increase of \$29.7 million in 2007. The increase in policy liabilities expense was primarily the result of a decrease in Closed Block policy surrenders.

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 \$5.2 million, or 1.3%, to \$406.1 million in 2008 as compared with \$411.3 million in 2007. The decrease in policy benefits for 2008 compared to 2007 was primarily due to a decrease of \$17.4 million in surrender benefits, principally in the Closed Block, partially offset by 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. 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 \$2.7 million, or 2.4%, to \$113.8 million in 2008 compared to \$111.1 million in 2007. These amounts include both dividends accrued and paid to policyholders of \$116.6 million in 2008 and \$114.5 million in 2007. The increase in policyholders' dividends paid for 2008 compared to 2007 resulted mainly from increases in the values of in-force policies upon which dividends are primarily paid.

Interest Credited to Policyholder Account Liabilities

Interest credited to policyholder account liabilities consists of interest credited to universal life insurance, fixed deferred annuities and indexed products. Interest credited decreased \$166.2 million, or 60.5%, to \$108.7 million in 2008 from \$274.9 million in 2007. The decrease was primarily due to a significant drop in the S&P 500 and Russell 2000 indexes in 2008, resulting in a decrease in the fair value of the embedded derivative associated with indexed products, and therefore lower crediting rates to indexed product policyholder account values. . These effects were partially offset by an increase in interest credited associated with growth in policyholder account values due to increased sales of indexed products.

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 of \$168.7 million for 2008 were essentially unchanged compared to \$169.6 million in 2007.

Interest Expense on Debt

Interest expense on debt consists of interest paid on the Company's Trust Preferred Securities and Senior Notes. Interest expense on debt totaled \$21.7 million in 2008 and \$21.9 million in 2007.

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 \$42.7 million, or 21.5%, to \$241.7 million in 2008 as compared with \$199.0 million in 2007. The increase is primarily attributable to an increase in the amortization of deferred acquisition costs due to business growth.

Income Tax (Benefit) Expense

The federal income tax benefit of \$7.8 million in 2008 was primarily related to affordable housing tax credits of \$4.6 million and dividends received deduction of \$3.1 million, which more than offset our expected income tax of \$2.6 million on income before income taxes of \$7.5 million at the nominal income tax rate of 35%. The company recorded an income tax expense of \$48.1 million in 2007 with an effective tax rate of 29.1%. The Company's effective tax rate for 2007 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.

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 \$10.7 million, or 6.8%, to \$166.4 million in 2007 from \$155.7 million in 2006. Net income decreased \$1.6 million, or 1.3%, to \$115.2 million in 2007 from \$116.8 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.

