GENERAL DISCUSSION OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

About the Company

NLV Financial Corporation (“NLVF”) through its subsidiaries (collectively, the “Company”, “we”, “our”) offers life insurance policies, annuity contracts, and investment products and services.

The Company’s leading life insurance product lines include indexed universal life, whole life, term life, and universal life. The Company offers a wide array of options and riders in connection with these policies to provide such benefits as waiver of premium, accidental death benefits, paid up additions, supplemental term insurance, lifetime income and accelerated benefits.

The Company’s leading annuity product lines are indexed annuities and fixed interest rate annuities. The Company offers a guaranteed lifetime income rider on its index annuity products, which allows the contract holder the option to elect a guaranteed annual income that is fixed and will continue for the remaining life of the contract holder, even if the annuity’s account value reaches zero. The Company also offers variable annuities, but does not offer, and has never offered, guaranteed minimum withdrawal, accumulation or income benefits on its variable annuities. A return of premium guaranteed minimum death benefit is the only guarantee the Company currently offers on its variable annuity products.

For indexed life and annuity products, indexed interest, if any, is credited based on the change in an equity index over a specified period, subject to a cap rate, a participation rate and a floor of zero percent. Indexed products also offer the contract holder the option of selecting a guaranteed fixed interest rate instead of indexed interest.

Prior to October 27, 2017, the Company also distributed and provided investment advisory and administrative services to the Sentinel Group Funds, Inc. through Sentinel Asset Management, Inc. (“SAMI”) and its subsidiaries. On October 27, 2017, the Company executed the sale of certain assets under management, related to the investment advisory and investment management services provided to the mutual fund business, to Touchstone Investments, a subsidiary of Western & Southern Financial Group.

Distribution

The Company provides a broad range of life insurance and annuity products to a national client base, primarily through an extensive network of independent agents and a career agency distribution channel. The Company focuses on serving Middle America in its target market of customers with household income of between $75,000 and $150,000, offering products with benefits that help Middle America customers meet needs during their lifetime, including lifetime income in retirement and accelerated death benefits if the insured becomes terminally, chronically or critically ill. In its individual annuity business, the Company focuses on the 403(b) K-12 educator markets. The Company also provides financial solutions in the form of estate, business succession and retirement planning, and deferred compensation and other key executive benefit planning to small business owners, professionals, and other middle to upper income individuals. The Company markets and distributes its products throughout the United States through two principal channels: Career and Affiliated Independent:

- ***Career:*** The Career channel consists of producing and general agents who specialize in selling products to the middle and emerging affluent markets, professionals, business owners and other individuals for financial and business planning purposes.

- ***Affiliated Independent:*** The Affiliated Independent channel consists of agents who primarily offer life insurance, annuity, and mutual fund products to the middle and emerging affluent markets, for purposes of providing for the financial consequences of specific life events, such as death, retirement, and chronic or long-term illness. While the agents have access to all products, certain agents 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.

Organization

In 1999, National Life Insurance Company ("NLIC") 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. Concurrent with the reorganization into a mutual insurance holding company structure, NLIC created a closed block for the benefit of holders of certain of NLIC's individual participating life insurance and annuity policies ("the Closed Block"). The Closed Block is designed to give reasonable assurance to owners of policies in the Closed Block that assets will be available to provide for payment of policy benefits, including the continuation of dividends. 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 the state of Delaware. NLVF directly owns 100% of the outstanding common stock of NLIC, Sentinel Asset Management, Inc. ("Sentinel Investments"), Equity Services, Inc. ("ESI"), Catamount Reinsurance Company ("Catamount"), and certain other subsidiaries, and indirectly owns 100% of the outstanding common stock of Life Insurance Company of the Southwest ("LSW"), and Longhorn Reinsurance Company ("Longhorn") which are both wholly owned by NLIC. NLVF indirectly owns National Life Distribution, LLC ("NLD"), whose sole member is LSW.

Non-GAAP Measures

The discussion herein, unless otherwise noted, is prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). In addition to net income, we use pre-tax operating income and core earnings, which are both pre-tax, non-GAAP financial measures, to evaluate our financial performance. Pre-tax operating income excludes income taxes and net realized capital gains (losses). It also excludes the portion of amortization of deferred policy acquisition costs ("DAC") and deferred sales inducements, and policyholder dividend obligations that are related to net realized capital gains (losses).

Core earnings equal pre-tax operating income after excluding volatility caused by the periodic fair value measurement of certain liabilities for indexed life and annuity products, and the related impact to DAC and deferred sales inducements. Significant short-term income volatility may result from the measurement of these indexed product liabilities under GAAP, because they are sensitive to movements in equity market indexes and future interest rate assumptions. As a result, we exclude such volatility from core earnings. Core earnings is a useful measure for the Company to analyze our results and trends because it excludes such short-term volatility and is more consistent with the economics and long-term performance of our indexed products. We believe the combined presentation and discussion of pre-tax operating income, core earnings, and net income provides information that will enhance readers' understanding of our underlying results, operating trends and profitability.

A reconciliation of net income to non-GAAP pre-tax operating income and core earnings is presented below:

	For the Year Ended December 31,	
	2018	**2017**
	(in thousands)	
Net income	**$ 150,054**	$ 259,938
Net realized capital losses	**23,480**	36,303
Amortization of DAC and sales inducements, and policyholder dividend obligations, related to net realized capital losses	**704**	866
Income tax expense (benefit)	**23,560**	(50,182)
Pre-tax operating income	**197,798**	246,925
Non-core earnings (loss), primarily volatility resulting from the measurement of indexed product liabilities	**26,929**	(21,744)
Core earnings	**$ 224,727**	$ 225,181

ANNUAL FINANCIAL PERFORMANCE REVIEW

This annual financial performance review provides an overview of the Company's results of operations for the years ended December 31, 2018 and 2017, and, where applicable, factors that may affect the Company's future financial performance. This review should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements as of and for the years ended December 31, 2018 and 2017, which have been audited by PricewaterhouseCoopers LLP.

In 2018, the Company continued to deliver top line growth and stable bottom line results while maintaining its capital strength. Sales of life and annuity products in 2018 exceeded prior year by 15% in total. Life sales increased 28% over 2017, led by very strong growth in sales of indexed universal life, and reflected the highest levels in the Company's history. This sales growth was primarily driven by expanding our distribution footprint through an increase in the number of producing agents in our career and affiliated independent agencies, and customer demand for indexed products and living benefits. As discussed below, our 2018 financial performance was solid in this challenging period of growth in sales, declining investment yields and market volatility.

Net income decreased $109.8 million to $150.1 million in 2018, from $259.9 million in 2017, due to one-time tax benefits in 2017 and volatility in non-core earnings. Total income tax expense in 2018 was $23.6 million compared to a benefit of $50.2 million in 2017. In 2017, the Company recorded a one-time federal income tax benefit of $119.7 million, due to the remeasurement of net deferred tax liabilities to reflect the decrease in the federal corporate income tax rate from 35% to 21%.

Pre-tax operating income of $197.8 million decreased by $49.1 million from $246.9 million in 2017, due to market volatility in non-core earnings, which reflect the short-term volatility related to the measurement of our indexed product reserves. Non-core earnings decreased pre-tax operating income by $26.9 million in 2018 and increased pre-tax operating income by $21.7 million in 2017, primarily due to movement in equity market indexes, particularly the volatility in the fourth quarter of 2018.

Core earnings in 2018 of $224.7 million were consistent with the prior year, decreasing just 0.2% from $225.2 million in 2017. Core earnings in 2018 were impacted by growth in life policy charge revenues and strong investment performance, partially offset by higher operating expenses and interest expense on $350 million of surplus notes issued in July 2018. In 2018, we added personnel and upgraded systems to improve service and customer experience, in addition to supporting the higher volume of business resulting from strong sales.

The net impact of actuarial assumption updates increased core earnings by $12.6 million in 2018, compared to net adjustments that increased core earnings by $13.0 million in 2017. Included in the 2017 adjustments was a $14.1 million positive impact on core earnings from an adjustment to deferred acquisition costs related to refining the composition of assets that support our indexed universal life products. The adjustments in the 2018 period primarily reflected updated assumptions for life mortality. The adjustments in the 2017 period primarily reflected updated assumptions for life premium persistency and mortality, which were largely offset by refinements in modeling and spread assumptions for indexed annuity products.

Each of the components of core earnings and the factors that contribute to the changes for the years ended December 31, 2018, and 2017 are described in detail below.

	For the Year Ended December 31,	
	2018	**2017**
	(in thousands)	
Revenues:		
Insurance premiums	**$ 217,241**	$ 220,629
Policy and contract charges	**648,395**	564,064
Mutual fund commissions, fees and other income	**82,453**	112,433
Net investment income	**1,146,975**	1,080,077
Total revenues, on a core earnings basis	**2,095,064**	1,977,203
Benefits and expenses:		
Decrease in policy liabilities	**(83,762)**	(21,468)
Policy benefits	**536,813**	474,918
Policyholders' dividends and dividend obligations	**40,191**	58,196
Interest credited to policyholder account liabilities	**634,371**	545,400
Operating expenses	**322,770**	316,377
Interest expense	**49,286**	39,620
Policy acquisition expenses and amortization of present value of future profits, net	**370,668**	338,979
Total benefits and expenses, on a core earnings basis	**1,870,337**	1,752,022
Core earnings	**$ 224,727**	$ 225,181

Insurance Premiums

Insurance premiums include considerations on traditional whole, term life insurance and disability income contracts. Insurance premiums do not include deposits received for investment-type products such as fixed interest annuities, index annuities and universal life policies, which comprise the majority of our new sales. Annuity products earn a net spread between net investment income on assets that support the policies and expenses for interest credited to policyholders. Revenue from universal life products is primarily reflected in policy and contract charges.

Insurance premiums decreased slightly to $217.2 million in 2018 from $220.6 million in 2017, due to lower sales of whole life products and lower renewal premiums due to the expected run-off of the Closed Block.

Policy and Contract Charges

Policy and contract charges include fees charged on indexed universal life products, variable annuities, premium loads, cost of insurance charges, surrender charges and rider charges. Policy and contract charges increased $84.3 million, or 15%, to $648.4 million in 2018 from $564.1 million in 2017. This significant increase was driven by growth in overall account value due primarily to continued strong sales of indexed universal life products.

Mutual Fund Commissions, Fees and Other Income

Mutual fund commissions in 2018 consist of dealer concessions earned by the Company’s affiliated broker-dealer, Equity Services, Inc. Prior to the October 27, 2017 sale of assets under management related to the mutual fund business, mutual fund fees also included mutual fund administration and asset management fees earned by the Company's affiliated administrator and investment advisor, Sentinel Administrative Services, Inc. and Sentinel Asset Management, Inc., respectively. Revenues from mutual fund commissions decreased $29.9 million, or 27%, to $82.5 million in 2018 from $112.4 million in 2017. This decrease was primarily due to the sale of the mutual fund business and was largely offset by a corresponding decrease in mutual fund commission expense, which is reported within policy acquisition expenses and amortization of present value of future profits, net. Other income includes revenues from reinsurance, corporate owned life insurance and miscellaneous fee income.

Net Investment Income

Net investment income represents interest income on our portfolio of bonds, mortgage loans, contract loans and short-term investments, as well as amortization of premium or accretion of discount on bonds, dividends from preferred and common stock, and partnership income. For the non-GAAP measure of core earnings, net investment income excludes income from options that economically hedge our indexed products; such income is reflected as an offset within interest credited to policyholder account liabilities in the presentation of core earnings. Net investment income increased $66.9 million, or 6%, to $1.15 billion in 2018 from $1.08 billion in 2017. The increase was primarily driven by higher partnership income in the current year and an increase in the size of the bond and mortgage portfolio, due to the overall growth of in-force business.

The table below provides a breakdown of the components of net investment income, excluding income on options that economically hedge our indexed products:

	For the Year Ended December 31,	
	2018	**2017**
	(in thousands)	
Net investment income		
Debt securities interest	**$ 895,800**	$ 867,329
Equity securities dividends	**5,849**	5,292
Mortgage loan interest	**155,535**	142,478
Policy loan interest	**43,109**	41,846
Real estate income	**8,564**	7,009
Derivative losses	**(51)**	(5,703)
Partnership income	**66,997**	46,563
Other investment income	**6,044**	1,363
Gross investment income	**1,181,847**	1,106,177
Less: Investment expenses	**(34,872)**	(26,100)
Net investment income	**$ 1,146,975**	$ 1,080,077

Policy Liabilities

Policy liabilities reflect the impact of changes in the product liability reserves for whole and term life insurance, disability income insurance and the additional reserves held on certain annuities. The change in policy reserves was a net decrease of $83.8 million in 2018 compared to a $21.5 million net decrease in 2017. The year over year decrease was primarily related to reserves released by the surrender of certain large whole life policies within the Closed Block in the current year.

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 $61.9 million to $536.8 million in 2018 from $474.9 million in 2017. The increase was primarily driven by higher mortality for indexed universal life and Closed Block policies, as well as the surrender of certain large whole life policies. In 2017, a premium persistency assumption update adjustment increased policy benefit expense by $9 million.

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") primarily arising from the Closed Block. Dividends are based on a scale that is designed to reflect the relative contribution of each group of policies to the Company's overall operating results. The dividend scales are approved annually by the Company's Board of Directors. For the non-GAAP measure of core earnings, policyholders' dividends and dividend obligations exclude amounts related to current period net realized capital gains (losses). Policyholders' dividends and dividend obligations included in core earnings decreased $18.0 million to $40.2 million in 2018 from $58.2 million in 2017. This decrease was related to lower earnings in the Closed Block compared to prior year.

Interest Credited to Policyholder Account Liabilities

Interest credited to policyholder account liabilities represents amounts credited to universal life insurance, fixed deferred annuities and indexed products, as well as the change in reserves related to guaranteed lifetime income riders ("GLIR") and the amortization of sales inducements. For the non-GAAP presentation of core earnings, interest credited also includes income on options that economically hedge our indexed products. Core interest credited increased $89.0 million to $634.4 million in 2018 from $545.4 million in 2017.

This increase was primary attributable to growth in account value within our indexed product lines, as well as actuarial assumption updates. The actuarial assumption adjustments in 2018 included a decrease in core interest credited expense of $3.7 million. The actuarial assumption adjustments in 2017 decreased core interest credited expense by $14.4 million, which included an update of spread assumptions and a refinement of sales inducement amortization. As a result, the year over year change in the impact of actuarial assumption updates was a $10.7 million increase in interest credited expense.

Operating Expenses

Operating expenses consist primarily of administrative, maintenance and operational expenses related to servicing the Company's business. Operating expenses increased $6.4 million to $322.8 million in 2018 from $316.4 million in 2017. The increase was primarily related to growth-related expenses including additional personnel to support a higher level of customer service, higher premium taxes, increased software maintenance costs, and higher legal expenses, partially offset by a decrease in operating expenses related to the October 2017 sale of the mutual fund business.

Interest Expense

Interest expense consists of interest paid on the Company's surplus notes and senior notes. Interest expense totaled $49.3 million in 2018 and $39.6 million in 2017. The increase in interest expense compared to the prior year was due to the issuance in July 2018 of $350 million of surplus notes of NLIC that mature in 2068. These surplus notes will accrue interest at a fixed rate of 5.25% until July 18, 2048, and thereafter at a floating rate. Interest is payable semi-annually, subject to approval of the Vermont Insurance Commissioner. The surplus notes are redeemable by NLIC on or after July 19, 2048.

NLIC also completed in July 2018 an exchange transaction in which it issued an additional $22.1 million of the 5.25% 2068 surplus notes in exchange for a portion of its outstanding 10.5% surplus notes, originally issued in 2009, with a principal balance of $12.8 million. The discount at the time of the exchange, $9.3 million, will be charged to interest expense over the non-callable period of the 5.25% surplus notes.

In 2018 and 2017, the Company also repurchased $7.1 million and $1.2 million, respectively, of NLIC's outstanding 10.5% surplus notes. Losses of $3.9 million and $0.8 million were recorded on the repurchases and included in net realized capital losses in 2018 and 2017, respectively.

Policy Acquisition Expenses and Amortization of Present Value of Future Profits ("PVFP"), Net

Policy acquisition expenses include commissions and other costs related to the acquisition of new or renewal life and annuity business, as well as amortization of previously deferred acquisition costs ("DAC"). Commissions and other costs that are directly related to the successful acquisition of new or renewal insurance contracts are eligible to be deferred under U.S. GAAP. DAC for participating life insurance, universal life insurance, and annuities is amortized and recognized in income in relation to future estimated gross profits. DAC for non-participating term and whole life insurance and participating limited-payment and single-payment life insurance is amortized and recognized in relation to premium income. Policy acquisition expenses are reported net of amounts deferred in the current year and include the amortization of DAC.

For the non-GAAP presentation of core earnings, policy acquisition expenses exclude amortization of DAC related to net realized capital gains (losses) on assets that support policy reserves, and amortization of DAC related to non-core earnings.

Policy acquisition expenses for the life and annuity businesses included in core earnings increased $46.9 million, or 17%, to $323.8 million in 2018 from $276.9 million in 2017 (excluding amortization of mutual fund commissions and PVFP, discussed below). The increase was primarily due to higher amortization expense primarily driven by higher gross profits on an increased volume of indexed universal life and annuity products.

At least annually, the Company reviews its actuarial assumptions for reserves and DAC, including assumptions for premium persistency, investment income, gross profits, mortality, and lapse and surrender rates, and any resulting adjustments to the DAC asset are reflected in current year core earnings. In 2018, such adjustments to DAC amortization expense increased core earnings by $7.5 million, due to assumption updates related primarily to mortality rates. In 2017, actuarial assumption adjustments to DAC decreased core earnings by $6.3 million, mainly due to spread assumptions on indexed annuities and mortality assumptions for universal life products. In addition, 2017 core earnings also included a positive $14.1 million adjustment to DAC amortization related to a refinement in the asset mix used to support our indexed universal life reserves.

Policy acquisition expenses reported in core earnings also includes mutual fund commissions. Mutual fund commissions decreased $8.6 million to $46.9 million in 2018 from $55.5 in 2017. The decrease was due to the sale of the mutual fund business (see "Mutual Fund Commissions" above).

Prior to December 31, 2017, the Company held PVFP attributable to two blocks of insurance purchased prior to 2000. Amortization of PVFP was $6.6 million for the year ended December 31, 2017, which included $3.8 million of accelerated amortization to write the remaining asset balance down to zero in 2017, as the underlying blocks of business were no longer projecting future profits.

Net Realized Capital Gains (Losses)

The Company recorded net realized capital losses of $23.5 million in 2018 and $36.3 million in 2017. Net realized capital losses in 2017 included $40.7 million of impairments in capitalized software costs, and a $9.3 million gain on the sale of assets related to the mutual fund business (see “About the Company,” above). The non-GAAP measure of pre-tax operating income excludes net realized capital gains (losses) and is also adjusted to exclude amortization of DAC and sales inducements, and policyholder dividend obligations, related to net realized capital gains (losses) (see “Non-GAAP Measures,” above). Details of net realized capital gains (losses) by asset category are provided in the table below:

	For the Year Ended December 31,	
	2018	**2017**
	(in thousands)	
Net realized capital gains (losses) on:		
Debt securities	**$ (6,187)**	$ 6,773
Equity securities	**(3,599)**	2,000
Mortgage loans	**(627)**	(1,074)
Partnerships	**(9,531)**	(8,613)
Other invested assets	**319**	(900)
Real estate	**(405)**	(2,371)
Embedded derivative	**(98)**	—
Sale of mutual fund business	**538**	9,346
Debt retirement	**(3,890)**	(775)
Impairment of capitalized software	**—**	(40,689)
Net realized capital losses	**(23,480)**	(36,303)

Federal Income Taxes

Federal income tax expense for 2018 was $23.6 million, which represented an effective tax rate of 13.6%, compared to income tax benefit of $50.2 million in 2017 with an effective tax rate of -23.9%. The low effective tax rate in 2018 was due in part to the benefit of contributions to the Company's qualified home office employee pension plan, which was fully funded as of December 31, 2018. The Company’s significant net tax benefit and negative effective tax rate in 2017 were primarily due to a one-time tax benefit of $119.7 million resulting from the Company’s re-measurement of net deferred tax liabilities to reflect the decrease in the federal corporate income tax rate from 35% to 21% under the Tax Cuts and Jobs Act enacted on December 22, 2017 (see “Critical Accounting Estimates – Federal Income Taxes” below). Income tax expense in 2018 and benefit in 2017 included income tax benefits of $3.4 million in 2018 and $9.9 million in 2017 related to net realized capital gains and losses.

Non-Core Earnings

Non-core earnings primarily include short-term income volatility that results from the measurement under GAAP of certain indexed product liabilities, and the related impact to DAC and deferred sales inducements, which are sensitive to movement in equity market indexes and future interest rate assumptions. Non-core earnings reduced pre-tax operating earnings by $26.9 million in 2018 and contributed $21.7 million of positive non-core earnings to pre-tax operating earnings in 2017. The negative non-core earnings in 2018 were primarily due to volatile equity markets in the fourth quarter of 2018, which temporarily increased our accounting reserves for indexed products, and more than offset positive non-core earnings from the first half of 2018. The positive non-core earnings in 2017 were due primarily to appreciation in equity market indexes in 2017. Interest crediting on the majority of our indexed products is tied to the S&P 500 Index, which declined 6% in 2018 (14% in the fourth quarter of 2018), compared to an increase in the index of 19% in 2017.

SUMMARY OF FINANCIAL POSITION

Balance Sheet Information

The Company's investment objective is to keep its promises to policyholders by earning competitive net investment income within prudent and strategic asset allocation, asset liability management, and risk management frameworks. This includes portfolio and issuer diversification and careful consideration of various scenarios including interest rate, credit, and liquidity risks through market cycles. The Company's investment portfolio consists primarily of available-for-sale debt and equity securities, agency residential mortgage-backed securities, directly underwritten commercial real estate mortgages, and contract loans.

As of December 31, 2018, total assets under management (excluding unrealized gains and losses) were $30.5 billion, of which $24.2 billion was attributable to life insurance policy and annuity contract values with more than 856,000 customers. The Company's investments in available-for-sale debt and equity securities grew $1.2 billion to just over $20 billion as of December 31, 2018 compared to 2017, after excluding the change in net unrealized gains and losses (which declined in 2018 due to modest increases in market interest rates). The growth in our portfolio was driven primarily by strong life sales throughout 2018. The remainder of the portfolio consists primarily of commercial mortgage loans, other invested assets, cash, trading debt and equity securities, policy loans, and other short-term investments. The fair value of derivative assets, which are primarily options used to hedge our indexed product liabilities, declined $762.0 million during 2018, primarily due to equity market volatility in the fourth quarter of 2018.

Total liabilities as of December 31, 2018 were $27.8 billion, compared to $27.2 billion for the same period in 2017. The year to date increase of $547.7 million was primarily due to an increase in policyholder account liabilities, which was consistent with our strong sales growth in 2018. This growth was partially offset by a decrease in the market value of derivative liabilities, primarily due to equity market volatility in the fourth quarter of 2018.

Additionally, total debt increased by $338.2 million as of December 31, 2018 to $790.9 million, compared to $452.6 million at December 31, 2017, due to the issuance of $350 million of new 5.25% surplus notes and other surplus note activity in 2018 (see "Interest Expense" above).

The following table provides a summary of the Company's consolidated balance sheet data:

	As of December 31,	
	2018	**2017**
	(in thousands)	
Assets:		
Cash and investments	**$ 26,395,180**	$ 26,823,160
Other general account assets	**3,271,985**	2,570,367
Separate account assets	**769,763**	814,928
Total assets	**$ 30,436,928**	$ 30,208,455
Liabilities and Stockholder's Equity:		
Total liabilities	**27,775,918**	27,228,171
Stockholder's Equity:		
Retained earnings	**2,741,935**	2,591,881
Accumulated other comprehensive (loss) income	**(80,925)**	388,403
Total stockholder's equity	**2,661,010**	2,980,284
Total liabilities and stockholder's equity	**$ 30,436,928**	$ 30,208,455

Cash Flow Information

The following table includes the Company's consolidated cash flows provided by or used in operating, investing, and financing activities:

	For the Year Ended December 31, 2018	2017
	(in thousands)	
Net cash (used) provided by operating activities	**$ (134,706)**	$ 60,538
Net cash used in investing activities	**(1,922,286)**	(1,469,875)
Net cash provided by financing activities	**1,930,508**	1,448,907
Net (decrease) increase in cash	**$ (126,484)**	$ 39,570

Net cash used by operations was $134.7 million in 2018, compared to $60.5 million of net cash provided by operations in the same period in the prior year. The decrease was primarily due to higher acquisition expenditures related to increased sales, higher benefit payments in the current year, and $46.9 million of contributions to the Company's qualified pension plans.

Net cash used in investing activities increased to $1.9 billion in 2018, compared to $1.5 billion in the prior year. The increase in net investing activity is directly correlated to the increase in net cash provided by financing activities in the current year.

Net cash provided by financing activities was $1.9 billion in 2018, compared to $1.4 billion in 2017. The increase was due to the issuance of $350 million of surplus notes, less $5 million of associated costs, as well as a $178 million increase in net policyholder deposits and withdrawals. Net issuances of FHLB funding agreements (advances net of repayments) were $268 million in 2018, compared to net issuances of $246 million in the prior year. Our Institutional Markets FHLB activity is managed opportunistically, so the volume of funding agreements issued depends on pricing and the availability of desirable assets to support these liabilities. New issuances of funding agreements in 2018 were primarily in the fourth quarter, because lower asset spreads throughout much of 2018 resulted in no issuances in the second and third quarters of 2018.

	As of December 31, 2018	2017	Change
		(in millions)	
Other Selected Data			
Life insurance in force (before reinsurance ceded)	**$ 142,317**	$ 119,912	$ 22,405
Total assets under management (excluding unrealized gains and losses)	**$ 30,474**	$ 29,398	$ 1,076
Weighted New Annualized Premium (WNAP) Sales			
Life	**$ 309**	$ 241	$ 68
Annuity	**247**	241	6
Total Life and Annuity WNAP	**$ 556**	$ 482	$ 74

The increase in Life WNAP reflected continued growth in sales of indexed universal life, primarily driven by expanding our distribution footprint through an increase in the number of producing agents in our career and independent agencies, and customer demand for indexed products and living benefits. The increase in Annuity WNAP reflected strong sales of single premium deferred annuities, partially offset by lower WNAP from flow (flexible premium) annuities. Flow annuity sales slowed in 2018, primarily due to challenges in accessing teachers in K-12 public schools due to heightened school security nationwide.

CRITICAL ACCOUNTING ESTIMATES

The preparation of U.S. GAAP financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. The most significant areas of management’s judgment include:

- actuarial assumptions affecting policyholder reserves and estimated gross profits;
- policy liabilities;
- valuation of derivatives;
- valuation of mortgages;
- pension and other postretirement employee benefits;
- evaluation of other-than-temporary impairments; and
- federal income taxes.

Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the debt or equity markets could have a material impact on the consolidated financial statements.

Actuarial Assumptions Affecting Policyholder Reserves and Estimated Gross Profits

Commissions and other costs that are directly related to the successful acquisition of new or renewal insurance contracts are eligible to be deferred. Deferred policy acquisition costs for participating life insurance, universal life insurance, and non-life contingent annuities are amortized in relation to estimated gross profits. Amortization is adjusted retrospectively for actual experience and when estimates of future gross profits are revised. Deferred policy acquisition costs for these products are also adjusted for related unrealized gains (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.

DAC for non-participating term and whole life insurance and participating single-payment and limited-payment life insurance is amortized in relation to premium income using assumptions consistent with those used in computing policy benefit liabilities.

At least annually, the Company reviews long-term assumptions underlying the projections of estimated gross profits and its calculation of the recoverability of DAC balances. These assumptions include changes in projected investment rates, interest crediting rates, policyholder dividend scales, mortality, expenses, contract lapses, withdrawals, surrenders and amortization period.

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 profits, and are included in policy benefit liabilities. The average investment yield used in estimating gross profits for participating contracts was 4.50% and 4.63% as of December 31, 2018 and 2017, respectively.

Policy benefit liabilities for non-participating life insurance, disability income, 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 universal life insurance 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 account value and embedded derivative values. The underlying account value is primarily based on the initial deposit plus any interest credited less applicable fees or policy charges. The embedded derivative values are measured at fair value based on actuarial and capital market assumptions related to projected cash flows over the expected lives of the contracts. Option pricing models are used, taking into account assumptions for future equity indexed crediting rates in light of market conditions and policyholder behavior assumptions. The fair value of the embedded derivatives incorporates an explicit risk margin for variance of policyholder behavior and the impact the Company's own credit rating would have in the view of a market participant.

Valuation of Derivatives

Derivative instruments held include options, swaptions, interest rate swaps, and futures contracts, all of which are carried at fair value. The fair value of derivatives is based on modeling using publicly available data. When that data is not available, the Company uses independent broker pricing quotes.

Valuation of Mortgages

Mortgage loans on commercial real estate are carried at amortized cost less a valuation allowance for probable losses on unidentified loans. The evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience, and other relevant factors. These assumptions require the use of significant management judgment and include the probability and timing of borrower default as well as loss frequency and severity estimates.

For mortgage loans that are deemed impaired, an impairment loss is recognized through realized capital losses as the difference between the carrying amount and the Company's share of either (a) the present value of the expected future cash flows discounted at the loan's original effective interest rate, (b) the loan's observable market price, or (c) the fair value of the collateral. Mortgage loans of $3.67 billion and $3.35 billion reported on the Company's consolidated balance sheet were net of related valuation allowances of $1.1 million and $1.7 million as of December 31, 2018 and 2017, respectively, and net of $3.3 million and $3.3 million of impairments as of December 31, 2018 and 2017, respectively.

Pension and Other Postretirement Employee Benefits

The Company sponsors a qualified defined benefit pension plan covering substantially all employees. The plan is non-contributory, with benefits for NLIC employees hired prior to July 1, 2001, based on an employee's retirement age, years of service, and compensation near retirement. Benefits for NLIC 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. The plan was fully funded as of December 31, 2018. The Company also sponsors a frozen non-contributory qualified defined benefit plan that provided benefits to employees in the Career channel general agencies. The plan was amended effective January 1, 2004 to freeze plan benefits. No new participants were admitted to the plan after December 31, 2003, and there were no increases in benefits after December 31, 2003 for existing participants. These pension plans are separately funded. Plan assets are primarily bonds held in a Company separate account and funds invested in a group variable annuity contract held in the general account of NLIC. None of the securities held in the Company's separate account were issued by the Company.

The Company also sponsors other pension plans, including a non-contributory defined benefit plan for Career general agents who met the eligibility requirements to enter the plan prior to January 1, 2005 and a non-contributory defined supplemental benefit plan for certain executives. These defined benefit pension plans are non-qualified and are not separately funded.

The Company sponsors defined benefit postretirement plans that provide medical benefits to employees, agency staff and agents. Medical coverage is contributory, with retiree contributions adjusted annually, and contain cost sharing features such as deductibles and copayments. The postemployment 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 Company also sponsors various defined contribution and deferred compensation plans.

Evaluation of Other-Than-Temporary Impairments

The evaluation of securities for impairment is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in fair value of investments should be recognized in current period earnings and whether the securities are other-than-temporarily impaired ("OTTI"). The risks and uncertainties include changes in general economic conditions, the issuer's financial condition and/or future prospects, the effects of changes in interest rates or credit spreads and the expected recovery period. The Company has a security monitoring process overseen by investment and accounting professionals that identifies securities, using certain quantitative and qualitative characteristics, which could be potentially impaired. These identified securities are subjected to an enhanced analysis to determine if the impairments are other-than-temporary.

Federal Income Taxes

The Company files a consolidated tax return. 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.

Effective December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act into law. Under U.S. GAAP, the effects of changes in tax rates and laws are recognized in the period in which the new legislation is enacted. As a result, the Company recorded a one-time decrease in federal income tax expense of $119.7 million in 2017, due to the re-measurement of net deferred tax liabilities resulting from the decrease in the federal corporate income tax rate from 35% to 21%. Under U.S. GAAP, the Company was permitted to reflect the portion of this 2017 decrease in tax expense attributable to the reduction in deferred tax liabilities related to unrealized gains (losses) in the Consolidated Statement of Changes in Stockholder's Equity, as a reclassification of $67.5 million from retained earnings to accumulated other comprehensive income.

STATUTORY INFORMATION

Statutory information reflects financial data prepared in conformity with the statutory accounting practices prescribed or permitted by the Vermont Department of Financial Regulation. In any particular year, the statutory net income and surplus of the Company's insurance subsidiaries may increase or decrease depending on a variety of factors, including changes in interest rates, equity market and credit market conditions, other macroeconomic conditions, the amount of capital needed to support business growth, the value of certain fixed-income and equity securities in their investment portfolios, and the value of certain hedging instruments.

The table below sets forth statutory income and statutory capital and surplus for the Company's insurance subsidiaries NLIC, LSW, Catamount and Longhorn. The statutory capital and surplus amounts as of December 31, 2018 and December 31, 2017 in the table below are based on actual statutory filings with the applicable U.S. regulatory authorities. For all of these companies, statutory capital and surplus as of December 31, 2018 was significantly in excess of the aggregate minimum required statutory capital and surplus, with minimum requirements defined as the level of risk-based capital that would trigger state regulatory action.

		Net Income (Loss)	Capital and Surplus
		(in millions)	
National Life Insurance Company (1)			
	2018	$ **(22.8)**	$ **2,131.1**
	2017	14.9	2,015.6
Life Insurance Company of the Southwest (1)			
	2018	**(193.8)**	**1,241.1**
	2017	61.2	1,207.6
Catamount Reinsurance Company			
	2018	**13.4**	**60.3**
	2017	9.2	53.8
Longhorn Reinsurance Company (2)			
	2018	**13.9**	**60.4**
	2017	(3.2)	59.7

(1) The net losses in 2018 for National Life Insurance Company and Life Insurance Company of the Southwest were primarily driven by:
   a. Higher commissions and premium taxes related to significant growth in sales and volume of business, and
   b. The effect of equity market volatility, particularly in the fourth quarter of 2018, on the mark-to-market valuation of derivative instruments used to hedge indexed products.

(2) Longhorn Reinsurance Company's net loss in 2017 was driven by a nonrecurring ceding commission payment of $5 million to LSW, related to a 2017 reinsurance transaction in which LSW ceded to Longhorn certain indexed universal life insurance policies that had been issued by LSW from January 1, 2016 through December 31, 2016.

The following table summarizes the financial strength ratings of the Company's primary insurance subsidiaries, NLIC and LSW, from the major independent rating organizations as of December 31, 2018:

A.M. Best	Standard & Poor's	Moody's
A (Excellent)	A+ (Strong)	A2 (Good)

These ratings may be revised or revoked at any time at the sole discretion of the rating organization. These financial strength ratings are not ratings of the debt securities of NLVF or any of its subsidiaries, nor are they a recommendation to buy or hold any such debt securities.

PROSPECTIVE INFORMATION

Forward-looking statements contained in the following discussion are not guarantees of future performance and involve risks and uncertainties. Actual results may differ materially from those in the forward-looking statements as a result of various factors. The following uncertainties, among others, may have such an effect:

- Difficult conditions in the global capital markets and the economy;
- Significant market valuation fluctuations of the Company's investments, including any that are relatively illiquid;
- Differing interpretations in the methodologies, estimations and assumptions for the valuation of fixed maturity, equity and trading securities;
- Subjectivity in determining the amount of allowances and impairments taken on certain Company investments;
- Defaults on commercial mortgages held by the Company and volatilities in performance;
- Exposure to structured finance securities;
- Exposure to alternative investments;
- Exposure to mortgage-backed securities;
- Impairments of other institutions;
- Changes in interest rates and exposure to credit spreads;
- Effectiveness of the Company's hedging strategies and availability of hedging instruments;
- Impact of economic conditions on customers and vendors;
- Downgrades or potential downgrades in the Company's ratings;
- Changes in accounting rules;
- Adverse regulatory and legislative developments;
- Litigation and regulatory investigations;
- Changes in tax laws and the interpretation thereof;
- Inability to pay guaranteed policy benefits;
- Effectiveness of the Company's risk management policies and procedures;
- Lack of available, affordable or adequate reinsurance;
- Failure of counterparties to perform under reinsurance agreements, hedging instruments, or other contracts with the Company;
- Significant competition in the Company's businesses;

- Sensitivity of the amount of statutory capital the Company must hold to factors outside of its control;
- Adequacy of the Company's reserves for future policy benefits and claims;
- Deviations from assumptions regarding future mortality, morbidity, and interest rates used in calculating reserve amounts and pricing the Company's products;
- Ability to attract and retain independent agents, career agents, and key personnel;
- Ability to raise additional capital;
- Costs related to future pension obligations;
- Impact of international tension between the United States and other nations, terrorist attacks or ongoing military and other actions;
- Pandemics or other catastrophic events; and
- A computer system failure or security breach.

Consequently, such forward-looking statements should be regarded solely as our current plans, estimates, and beliefs. We do not intend, and do not undertake, any obligation to update any forward-looking statements to reflect future events or circumstances after the date of such statements.

Our goals over the next several years include continued responsible growth across all of our product lines, as well as improving the efficiency and effectiveness of the overall organization. The Company will continue to deliver new and innovative products and riders, and partner with distributors who share our mission, values, and purpose. We will also continue to invest in our technology infrastructure to improve services for all our key stakeholders.

We will continue to effectively manage our investment portfolio to maximize risk-adjusted returns and to maintain targeted duration matching of our product obligations and related investments.

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements of NLVF have been prepared in conformity with U.S. GAAP. These financial statements should be read in conjunction with and are qualified in their entirety by reference to the Company's consolidated financial statements as of and for the years ended December 31, 2018 and 2017, which have been audited by PricewaterhouseCoopers LLP, including the accompanying notes which are an integral part of the audited financial statements. The preparation of financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect the reported amounts and related disclosures. Actual results could differ, possibly materially, from those estimates.

The consolidated financial statements of the Company include the accounts of NLVF and its direct and indirect subsidiaries. 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
Consolidated Balance Sheets
As of December 31, 2018 and 2017

(in thousands)	**2018**	2017
Assets:		
Cash and investments:		
Available-for-sale debt securities	**$ 20,122,717**	$ 20,048,333
Available-for-sale equity securities	**30,978**	35,839
Trading debt securities	**19,082**	—
Trading equity securities	**24,382**	19,812
Mortgage loans	**3,674,383**	3,350,570
Policy loans	**921,516**	877,927
Real estate investments	**16,210**	24,465
Derivative assets	**231,174**	993,249
Other invested assets	**932,402**	960,415
Short term investments	**264,750**	228,480
Cash and restricted cash	**157,586**	284,070
Total cash and investments	**26,395,180**	26,823,160
Deferred policy acquisition costs	**2,093,111**	1,539,129
Accrued investment income	**232,368**	217,982
Premiums and fees receivable	**22,639**	22,577
Amounts recoverable from reinsurers	**132,164**	122,889
Property and equipment, net	**165,934**	153,110
Corporate owned life insurance	**493,679**	420,069
Federal income tax recoverable	**31,306**	—
Other assets	**100,784**	94,611
Separate account assets	**769,763**	814,928
Total assets	**$ 30,436,928**	$ 30,208,455
Liabilities:		
Policy liabilities:		
Policy benefit liabilities	**$ 4,159,561**	$ 4,408,663
Policyholder account liabilities	**21,115,895**	19,485,437
Policyholders' deposits	**90,082**	97,900
Policy claims payable	**95,698**	68,645
Policyholders' dividends and dividend obligations	**62,342**	184,931
Total policy liabilities	**25,523,578**	24,245,576
Amounts payable to reinsurers	**38,734**	23,457
Derivative liabilities	**102,391**	566,986
Other liabilities and accrued expenses	**309,911**	682,703
Pension and other post-retirement benefit obligations	**149,422**	194,257
Deferred income taxes	**91,253**	181,517
Federal income tax payable	**—**	66,109
Debt	**790,866**	452,638
Separate account liabilities	**769,763**	814,928
Total liabilities	**$ 27,775,918**	$ 27,228,171
Stockholder's equity:		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	**$ —**	$ —
Class B common stock, par value of $0.01, 1,001 shares authorized, 100 shares issued and outstanding	**—**	—
Preferred stock, 500 shares authorized, no shares issued and outstanding	**—**	—
Retained earnings	**2,741,935**	2,591,881
Accumulated other comprehensive (loss) income	**(80,925)**	388,403
Total stockholder's equity	**$ 2,661,010**	$ 2,980,284
Total liabilities and stockholder's equity	**$ 30,436,928**	$ 30,208,455

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
For the Years Ended December 31, 2018 and 2017

(in thousands)	2018	2017
Revenues:		
Insurance premiums	**$ 217,241**	$ 220,629
Policy and contract charges	**648,395**	564,064
Mutual fund commissions and fee income	**51,571**	85,453
Net investment income	**980,790**	1,415,211
Net realized capital losses	**(23,480)**	(36,303)
Other income	**30,882**	25,844
Total revenues	**1,905,399**	2,274,898
Benefits and expenses:		
Decrease in policy liabilities	**(83,762)**	(21,468)
Policy benefits	**536,813**	474,918
Policyholders' dividends and dividend obligations	**40,224**	57,144
Interest credited to policyholder account liabilities	**504,945**	819,837
Operating expenses	**322,770**	316,377
Interest expense	**49,286**	39,620
Policy acquisition expenses and amortization of present value of future profits, net	**361,509**	378,714
Total benefits and expenses	**1,731,785**	2,065,142
Income before income taxes	**173,614**	209,756
Income tax expense (benefit)	**23,560**	(50,182)
Net income	**$ 150,054**	$ 259,938
Other comprehensive (loss) income, net of tax:		
Unrealized (losses) gains on available-for-sale investments	**(473,345)**	263,789
Cash flow hedge on debt issuance	**41**	(80)
Change in funded status of retirement plans	**3,976**	(14,383)
Total other comprehensive (loss) income	**(469,328)**	249,326
Comprehensive (loss) income	**$ (319,274)**	$ 509,264

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholder's Equity
For the Years Ended December 31, 2018 and 2017

(in thousands)	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
December 31, 2016	$ —	$ —	$ —	$ 2,399,476	139,077	2,538,553
Net income	—	—	—	259,938	—	259,938
Other comprehensive income	—	—	—	—	181,793	181,793
Effect of change in tax rate on accumulated other comprehensive income	—	—	—	(67,533)	67,533	—
Total comprehensive income						441,731
December 31, 2017	**—**	**—**	**—**	**2,591,881**	$ **388,403**	$ **2,980,284**
Net income	—	—	—	**150,054**	**—**	**150,054**
Other comprehensive loss	—	—	—	**—**	**(469,328)**	**(469,328)**
Total comprehensive loss						**(319,274)**
December 31, 2018	**$ —**	**$ —**	**$ —**	**$ 2,741,935**	**$ (80,925)**	**$ 2,661,010**

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2018 and 2017

(in thousands)	2018	2017
Cash flows from operating activities:		
Net income	**$ 150,054**	$ 259,938
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for deferred income taxes	**34,489**	(145,808)
Interest credited to policyholder account liabilities	**504,945**	819,837
Amortization of deferred policy acquisition costs	**250,042**	265,002
Policy and contract charges	**(648,395)**	(564,064)
Net realized capital losses	**23,480**	37,439
Change in fair value of derivatives	**166,865**	(335,329)
Change in corporate owned life insurance policies	**(13,610)**	(6,363)
Amortization of present value of future profits of insurance acquired	**—**	6,642
Depreciation	**29,115**	28,478
Other	**(6,243)**	(22,529)
Changes in assets and liabilities:		
Accrued investment income	**(14,385)**	(9,935)
Deferred policy acquisition costs	**(507,138)**	(417,730)
Policy liabilities	**35,390**	80,165
Other assets and liabilities	**(139,315)**	64,795
Net cash (used) provided by operating activities	**(134,706)**	60,538
Cash flows from investing activities:		
Proceeds from sales, maturities and repayments of investments	**3,057,579**	3,255,054
Cost of investments acquired	**(4,601,584)**	(4,582,323)
Property and equipment additions	**(49,662)**	(38,414)
Cost of corporate owned life insurance acquired	**(60,000)**	(140,000)
Change in policy loans	**(43,589)**	(39,386)
Change in short term investments	**(36,270)**	(26,056)
Change in short term broker collateral	**(192,689)**	113,506
Other	**3,929**	(12,256)
Net cash used by investing activities	**(1,922,286)**	(1,469,875)
Cash flows from financing activities:		
Policyholders' deposits	**2,684,083**	2,333,006
Policyholders' withdrawals	**(1,326,884)**	(1,153,580)
Advances from Federal Home Loan Banks	**440,598**	325,579
Repayments to Federal Home Loan Banks	**(172,165)**	(79,510)
Proceeds from debt issuance	**345,022**	—
Debt retirement	**(10,940)**	(1,995)
Change in other deposits	**(29,206)**	25,407
Net cash provided by financing activities	**1,930,508**	1,448,907
Net (decrease) increase in cash	**(126,484)**	39,570
Cash and restricted cash:		
Beginning of year	**284,070**	244,500
End of year	**$ 157,586**	$ 284,070
Supplemental disclosure of cash flow information:		
Interest paid	**$ 39,273**	$ 39,320
Income taxes paid	**$ 50,429**	$ 23,789