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 principal insurance product lines include whole life, term life, universal life, indexed universal life, variable universal life, fixed annuities, indexed annuities, and variable annuities.

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 of life 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 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, 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 which are both wholly owned by NLIC. NLVF indirectly owns National Life Distribution, LLC (“NLD”), whose sole member is LSW.

On March 6, 2015, National Life Distribution, LLC was formed as a subsidiary of LSW. NLD serves as a master agency for National Life Group’s field force operations. The life companies incur commission expenses based on applicable product commission schedules agreed to with NLD.

On August 15, 2015, Catamount Reinsurance Company (“Catamount”) was formed as a subsidiary of NLIC. Catamount is a special purpose financial insurance company domiciled in the state of Vermont. Catamount entered into a coinsurance with funds withheld agreement with NLIC to reinsure the majority of NLIC’s in force Closed Block policies for statutory reporting. In 2016, the Catamount legal entity was transferred as a dividend to NLVF.

On August 17, 2016, Longhorn Reinsurance Company (“Longhorn”) was formed as a subsidiary of NLIC. Longhorn is a special purpose financial insurance company domiciled in the state of Vermont. Longhorn entered into a coinsurance with funds withheld agreement with LSW to reinsure certain individual indexed universal life insurance policies issued by LSW from January 1, 2011 through December 31, 2015. Effective July 1, 2017, Longhorn reinsured certain indexed universal life insurance policies issued by LSW from January 1, 2016 through December 31, 2016, in addition to the existing reinsured policies.

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. The results of operations of this mutual fund business were included in the Company’s statements of comprehensive income, change in shareholder’s equity and cash flows through the date of the sale.

As of December 31, 2017, the Company had $30.2 billion of assets under management, of which $24.3 billion was attributable to life insurance policy and annuity contract values with more than 783,000 customers. The remainder was attributable to the corporate segment, including fair value for the investment portfolio, the disability income business, and Company-sponsored pension plans.

Distribution

Our target market is middle America customers comprised primarily of families, small business owners, multicultural markets, and K-12 educators. Our strategy is to leverage our living benefit riders in both our life insurance and 403(b) products to provide peace of mind to everyone we touch. The Company markets and distributes its products throughout the United States through three principal channels: Career, Affiliated Independent and Institutional Markets.

- ***Career:*** The Career channel consists of approximately 800 full-time producing agents and general agents who specialize in selling products to the middle and emerging affluent markets, professionals, business owners and other affluent individuals for financial and business planning purposes.

- ***Affiliated Independent:*** The Affiliated Independent channel consists of approximately 15,500 producing agents. While the agents have access to all products, approximately 4,000 of the 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. All other agents 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, college funding, and chronic or long term illness.

- ***Institutional Markets:*** Institutional Markets works directly with institutional clients, issuing funding agreements directly with Federal Home Loan Banks in Boston and Dallas. Additionally, Institutional Markets works directly with fixed income asset managers to provide stable value wrap products to their stable value portfolios. In the future, business partners may expand to include banks, corporations, consultants and certain brokers in order to increase Institutional Markets product offerings.

Overview of Financial Results

The following discussion provides an overview of the consolidated financial position and results of operations of the Company as of and for the years ended December 31, 2017 and 2016, and, where applicable, factors that may affect the Company's future financial performance. 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, 2017 and 2016 and for each of the years in the three-year period ended December 31, 2017, 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 the Company. The Company's consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Our fixed indexed life and annuity products may experience significant period to period income statement volatility due to changes in external market-related factors that are not aligned with the long-term results of these products. In addition to net income, we use core earnings and pre-tax operating income, both non-GAAP financial measures, to evaluate our financial performance. Pre-tax operating income equals net income before taxes and net realized capital gains (losses). Core earnings equal pre-tax operating income before the impact on reserves and related derivatives of movements in market factors, such as interest rates and equity market indices, that affect the value of those assets and liabilities under U.S. GAAP. As these items fluctuate from period to period in a manner unrelated to core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and discussion of pre-tax operating income, core earnings, and net income provide information that will enhance readers' understanding of our underlying results, operating trends and profitability. A non-GAAP reconciliation of core earnings, pre-tax operating income and net income is presented on page 6.

RESULTS OF OPERATIONS

Core earnings increased $15.3 million, or 7.3%, to $225.2 million in 2017 from $209.9 million in 2016. Net income increased $103.8 million to $259.9 million in 2017 from $156.1 million in 2016. Included in net income are the market-related impacts on our reserves and related derivatives, which were an increase to pre-tax operating income of $22.9 million and $17.4 million in 2017 and 2016, respectively.

The increase in core earnings was primarily due to higher net investment income from growth in invested assets and higher policy and contract charges, primarily driven by growth in indexed universal life ("IUL") account value. These increases were partially offset by higher operating expenses related to our continued strong sales growth.

Core earnings in 2017 included a $14.1 million positive adjustment to deferred acquisition costs ("DAC") related to a refinement in the asset mix used to support our IUL reserves. The impact of actuarial assumption updates reduced core earnings by $1.1 million in 2017, compared to a positive adjustment of $17.7 million in 2016. 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. The assumption updates in the 2016 period primarily reflected an extension of the DAC amortization period for annuities, partially offset by additions to reserves for guaranteed living benefit features, related to updated utilization and lapse assumptions.

The following tables present the Company's summary consolidated financial and other data as of and for the years ended December 31, 2017, and 2016. The selected consolidated financial data has been derived from the Company's consolidated financial statements. Each of the components of core earnings and the factors contributing to the changes for the year ended December 31, 2017 are described in detail below.

	For the Year Ended December 31,	
	2017	**2016**
	(in thousands)	
Revenues:		
Insurance premiums	**$ 220,629**	$ 218,435
Policy and contract charges	**564,064**	503,559
Mutual fund commissions, fees and other income	**111,297**	119,029
Net investment income	**1,080,077**	1,032,210
Change in value of trading equity securities	**1,136**	425
Total revenues	**1,977,203**	1,873,658
Benefits and expenses:		
Decrease in policy liabilities	**(21,468)**	(72,265)
Policy benefits	**474,918**	533,071
Policyholders' dividends and dividend obligations	**58,196**	51,632
Interest credited to policyholder account liabilities	**545,400**	569,707
Operating expenses	**316,377**	302,128
Interest expense	**39,620**	39,305
Policy acquisition expenses and amortization of present value of future profits, net	**338,979**	240,134
Total benefits and expenses	**1,752,022**	1,663,712
Core earnings	**$ 225,181**	$ 209,946

Insurance Premiums

Insurance premiums include considerations on traditional whole, term life insurance and disability income contracts. Deposits received for investment-type products such as fixed annuities, fixed index annuities and universal life policies, which comprise the majority of our new sales, are not included in premiums. Revenue from universal life products is reflected in policy and contract charges. Premium income increased to $220.6 million in 2017 from $218.4 million in 2016. The increase was driven by sales of whole life and term life products, partially offset by 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 $60.5 million, or 12.0%, to $564.1 million in 2017 from $503.6 million in 2016. The increase was driven by an increase in policyholder account value due to continued strong sales of IUL products.

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. Prior to the sale of Sentinel’s mutual fund business on October 27, 2017, mutual fund fees consisted primarily of 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. Other income includes revenues from reinsurance, corporate owned life insurance and miscellaneous fee income. Revenues from mutual fund commissions, fees and other income decreased $7.7 million, or 6.5%, to $111.3 million in 2017 from $119.0 million in 2016. This decrease was primarily due to the sale of Sentinel’s mutual fund business. This decrease was largely offset by a $5.0 million decrease in mutual fund commissions, which are reported within policy acquisition expenses and amortization of present value of future profits, net.

Net Investment Income

Net investment income represents income earned on our investment portfolio, which includes interest income on bonds, mortgage loans, contract loans and short term investments, as well as bond premium/discount amortization, dividends on 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 included as a component of interest credited in the presentation of core earnings. Net investment income increased $47.9 million, or 4.6%, to $1.08 billion in 2017 from $1.03 billion in 2016. The increase was primarily driven by an increase in the size of the bond and mortgage portfolio, due to the overall growth of in-force business, as well as an increase in partnership distributions.

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,	
	2017	**2016**
	(in thousands)	
Net investment income		
Debt securities interest	**$ 867,329**	$ 844,022
Equity securities dividends	**5,292**	3,087
Mortgage loan interest	**142,478**	140,100
Policy loan interest	**41,846**	40,565
Real estate income	**7,009**	8,029
Derivative income	**(5,703)**	(8,886)
Partnership income	**46,563**	31,554
Other investment income	**1,363**	1,560
Gross investment income	**1,106,177**	1,060,031
Less: Investment expenses	**(26,100)**	(27,821)
Net investment income	**$ 1,080,077**	$ 1,032,210

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 net decrease in policy liabilities was $21.5 million in 2017 compared to $72.3 million in 2016. A net decrease in policy liabilities indicates that reserves released as a result of claims or surrenders, including those for the Closed Block, exceeded the addition of reserves from new sales. The lower net decrease in reserves in 2017 compared to 2016 was primarily related to the Closed Block, which had fewer death benefits compared to 2016, resulting in lower reserves released than in the prior 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 decreased $58.2 million, or 10.9%, to $474.9 million in 2017 from $533.1 million in 2016. The decrease was driven by more favorable mortality experience in the Closed Block.

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 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 increased $6.6 million, or 12.7%, to $58.2 million in 2017 from $51.6 million in 2016. This increase reflects higher earnings in the Closed Block compared to 2016.

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 living benefits. For the non-GAAP measure of core earnings, core interest credited also includes income on options that economically hedge our indexed products. Core interest credited decreased $24.3 million to $545.4 million in 2017 from $569.7 million in 2016. The decrease was primarily driven by assumption changes in the prior year for our indexed annuity products, which increased reserves for guaranteed living benefit features due to updated utilization and lapse assumptions.

Operating Expenses

Operating expenses consist primarily of administrative and maintenance expenses related to servicing the business and overhead needs of the Company's operations. Operating expenses increased $14.3 million, or 4.7%, to $316.4 million in 2017 from $302.1 million in 2016. The increase was attributable to an increase in personnel expenses and premium taxes due to continued sales growth.

Interest Expense

Interest expense consists of interest paid on the Company's surplus notes and senior notes. Interest expense totaled $39.6 million in 2017 and $39.3 million in 2016.

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

Policy acquisition expenses include commissions and other costs that are directly related to the successful acquisition of new or renewal business. Policy acquisition expenses are net of amounts deferred on life and annuity sales and include the amortization of amounts previously deferred. For the non-GAAP measure of core earnings, policy acquisition expenses exclude amortization of DAC related to net realized capital gains (losses) on assets that support policy reserves. Policy acquisition expenses included in core earnings increased $98.9 million, or 41.2%, to $339.0 million in 2017 from $240.1 million in 2016. The increase was driven by the positive impact of assumption changes in the prior year related to extending the amortization period on indexed annuity products.

Net Income Reconciliation

	For the Year Ended December 31,	
	2017	**2016**
	(in thousands)	
Net income	**$ 259,938**	$ 156,068
Net realized capital losses, net of offsets (see below)	**28,441**	6,672
Income tax expense (benefit) on operations	**(40,318)**	64,591
Pre-tax operating income	**248,061**	227,331
Net effect of derivatives, embedded derivatives and other market effects	**(22,880)**	(17,385)
Core earnings	**$ 225,181**	$ 209,946

Net Realized Capital (Losses) Gains, Net of Offsets

Net realized capital losses as presented in pre-tax operating income were $28.4 million in 2017 compared to net losses of $6.7 million in 2016. Further details are provided in the table below:

	For the Year Ended December 31,	
	2017	**2016**
	(in thousands)	
Net realized capital gains (losses) on:		
Debt securities	**$ 6,773**	$ (6,885)
Equity securities	**864**	2,483
Mortgage loans	**(1,074)**	(2,751)
Partnerships	**(8,613)**	(736)
Other invested assets	**(900)**	95
Real estate	**(2,371)**	334
Sale of mutual fund business (see page 1)	**9,346**	—
Debt retirement	**(775)**	—
Impairment of capitalized software	**(40,689)**	—
Net realized capital losses, U.S. GAAP basis	**(37,439)**	(7,460)
Offsets included for core earnings presentation:		
Amortization of deferred acquisition costs	**(536)**	1,684
Interest credited	**(1,380)**	1,969
Policyholder dividend obligation	**1,050**	(6,457)
Income tax benefit	**9,864**	3,592
Net realized capital losses, net of offsets	**$ (28,441)**	$ (6,672)

Income Tax on Operations

Income tax on operations is the federal income tax expense less any taxes for net realized capital gains (losses). The federal income tax benefit for 2017 was $50.2 million, which represented an effective tax rate of (23.9%), compared to income tax expense of $61.0 million in 2016 with an effective tax rate of 28.1%. The Company's significant net tax benefit in 2017 was 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 page 11).

Net Effect of Derivatives, Embedded Derivatives and Other Market Effects

Net effect of derivatives, embedded derivatives, and other market effects contributed $22.9 million to pre-tax operating earnings in 2017 compared to $17.4 million in 2016. These non-core earnings reflect the net impact from the change in the interest rates that influence the values of the embedded derivatives and related options, changes in our portfolio earned rates, and the overall movement of equity market indices including the Standard & Poor's ("S&P") 500 index.

SUMMARY OF FINANCIAL POSITION

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

	As of December 31, 2017	As of December 31, 2016
	(in thousands)	
Balance Sheet Data		
Cash and investments	**$ 26,823,160**	$ 24,440,118
Other general account assets	**2,570,367**	2,486,103
Separate account assets	**814,928**	733,099
Total assets	**$ 30,208,455**	$ 27,659,320
Total liabilities	**27,228,171**	25,120,767
Retained earnings	**2,591,881**	2,399,476
Accumulated other comprehensive income	**388,403**	139,077
Total stockholder's equity	**2,980,284**	2,538,553
Total liabilities and stockholder's equity	**$ 30,208,455**	$ 27,659,320

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, 2017	For the Year Ended December 31, 2016
	(in thousands)	
Cash Flow Data		
Net cash provided by operating activities	**$ 60,538**	$ 49,141
Net cash used in investing activities	**(1,469,875)**	(1,557,091)
Net cash provided by financing activities	**1,448,907**	1,611,282
Net increase in cash	**$ 39,570**	$ 103,332

	As of December 31, 2017	As of December 31, 2016	Change
		(in thousands)	
Other Selected Data			
Life insurance in force (before reinsurance ceded)	**$ 119,912,288**	$ 104,912,567	$ 14,999,721
Total assets under management	**$ 30,208,458**	$ 33,125,307	$ (2,916,849)
Weighted New Annualized Premium (WNAP)			
Life	**$ 241,304**	$ 193,225	$ 48,079
Annuity	**241,032**	225,631	15,401
Mutual Funds	**46,108**	68,596	(22,488)
Institutional Markets	**64,448**	151,113	(86,665)
Total WNAP	**$ 592,892**	$ 638,565	$ (45,673)

The increase in Life WNAP reflected continued growth in sales of IUL, including the successful launch of the PeakLife product in September 2017, and the increase in Annuity WNAP reflected strong annuity flow sales. The decrease in Mutual Funds WNAP was a result of the October 2017 sale of the mutual fund business. Sales of Institutional Markets products are opportunistic based on market conditions, and lower asset spreads throughout much of 2017 resulted in lower issuances of funding agreements in this business compared to 2016.

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;
- goodwill and intangibles impairment; 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 4.63% and 4.76% as of December 31, 2017 and 2016, 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. The embedded derivative values are measured based on actuarial and capital market assumptions related to projected cash flows over the expected lives of the contracts. Option pricing models are used to estimate fair value, 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 $3.35 billion and $3.21 billion reported on the Company's consolidated balance sheet were net of related valuation allowances of $1.7 million and $2.1 million as of December 31, 2017 and 2016, respectively, and net of $3.3 million of impairments at both balance sheet dates.

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 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 mutual funds and 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, but some investments are advised by an affiliate.

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.

Goodwill and Intangibles Impairment

Goodwill and other intangible assets with indefinite useful lives are reviewed for impairment in accordance with FASB ASC 350, *Intangibles – Goodwill and Other* on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The assessment for impairment begins with a qualitative determination of factors that could indicate that an impairment is more likely than not to exist. If it is determined that an impairment is more likely than not to exist, then a quantitative assessment is completed. The quantitative impairment testing is performed using the fair value approach, which requires the use of estimates and judgment, at the reporting unit or intangible asset level. The determination of a reporting unit’s fair value is based on management’s best estimate, which generally considers a discounted cash flow analysis as well as market-based earnings and revenue multiples of the unit’s peer companies. If the carrying value of a reporting unit or intangible asset exceeds its fair value, an impairment is recognized as a charge against income equal to the excess of the carrying value of goodwill or intangible asset over its fair value. The goodwill balance at December 31, 2017 represents the Company’s acquisition of LSW. There were no impairments recorded in 2017 or 2016. In 2017, goodwill and intangible assets in the amount of $49.5 million were disposed of as a result of the sale of certain assets related to the mutual fund business (see page 1), which was reflected in the net realized capital gain recorded on the sale.

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, due to a re-measurement of net deferred tax liabilities resulting from the decrease in the federal corporate income tax rate from 35% to 21%. The Company elected to adopt Accounting Standards Update ("ASU") 2018-05 *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income* ("ASU 2018-05") in 2017. As permitted under ASU 2018-05, the portion of this decrease in tax expense attributable to the reduction in deferred tax liabilities related to unrealized gains (losses) was reflected in the consolidated Statement of Changes in Shareholder's Equity as a reclassification of $67.5 million from retained earnings to accumulated other comprehensive income.

STATUTORY INFORMATION

Statutory net income and capital and surplus amounts may increase or decrease in any period depending upon a variety of factors, and such volatility may be compounded in extreme scenarios or if multiple factors occur at the same time.

The table below sets forth statutory income and statutory capital and surplus for NLIC, LSW, Catamount and Longhorn. The statutory capital and surplus amounts as of December 31, 2017 and December 31, 2016 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, 2017 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)			
	2017	**$ 14.9**	**$ 2,020.6**
	2016	$ (51.1)	$ 1,925.2
Life Insurance Company of the Southwest (1)			
	2017	**$ 61.2**	**$ 1,207.6**
	2016	$ 168.7	$ 1,067.9
Catamount Reinsurance Company			
	2017	**$ 9.2**	**$ 53.8**
	2016	$ 10.0	$ 63.0
Longhorn Reinsurance Company (2)			
	2017	**$ (3.2)**	**$ 59.7**
	2016	$ (76.0)	$ 61.6

(1) Effective January 1, 2017 NLIC and LSW entered into a revised expense allocation agreement in order to align expenses more appropriately and provide a more accurate presentation of operations for both companies. Under previous expense allocation agreements, the majority of the Company's general expenses were recorded on a statutory basis in NLIC.

(2) Longhorn Reinsurance Company's net losses in 2017 and 2016 were driven by nonrecurring ceding commission payments to LSW of $5 million and $100 million, respectively.

The following table summarizes the Company's financial strength ratings from the major independent rating organizations:

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

These ratings are not a recommendation to buy or hold any of the Company's debt securities, and they may be revised or revoked at any time at the sole discretion of the rating organization.

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 some that are relatively illiquid;
- Subjectivity in determining the amount of allowances and impairments taken on certain Company investments;
- Defaults on commercial mortgages held by the Company;
- Exposure to mortgage-backed securities;
- Impairments of other institutions;
- Changes in interest rates;
- Effectiveness of the Company's hedging strategies;
- Impact of economic conditions on customers and vendors;
- Downgrades or potential downgrades in the Company's financial strength ratings;
- Changes in accounting rules;
- Adverse regulatory and legislative developments;
- Litigation and regulatory investigations;
- Effectiveness of the Company's risk management policies and procedures;
- Availability of reinsurance;
- Failure of counterparties to perform under reinsurance agreements and 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 the Company's control;
- Adequacy of the Company's reserves for future policy benefits and claims;
- Deviations from assumptions regarding future mortality, morbidity, lapse rates, and interest rates used in calculating reserve amounts and pricing the Company's products;
- Ability to attract and retain career agents, independent 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 and 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 December 31, 2017 and 2016 and for each of the years in the three-year period ended December 31, 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, 2017 and 2016

(in thousands)	2017	2016
Assets:		
Cash and investments:		
Available-for-sale debt securities	**$ 20,048,333**	$ 18,165,166
Available-for-sale equity securities	**35,839**	60,142
Trading equity securities	**19,812**	14,764
Mortgage loans	**3,350,570**	3,205,842
Policy loans	**877,927**	838,541
Real estate investments	**24,465**	31,354
Derivative assets	**993,249**	824,214
Other invested assets	**960,415**	853,171
Short term investments	**228,480**	202,424
Cash and restricted cash	**284,070**	244,500
Total cash and investments	**26,823,160**	24,440,118
Deferred policy acquisition costs	**1,539,129**	1,512,211
Accrued investment income	**217,982**	208,048
Premiums and fees receivable	**22,577**	19,449
Amounts recoverable from reinsurers	**122,889**	147,489
Present value of future profits of insurance acquired	**—**	6,642
Property and equipment, net	**153,110**	186,268
Corporate owned life insurance	**420,069**	273,706
Other assets	**94,611**	132,290
Separate account assets	**814,928**	733,099
Total assets	**$ 30,208,455**	$ 27,659,320
Liabilities:		
Policy liabilities:		
Policy benefit liabilities	**$ 4,408,663**	$ 4,408,994
Policyholder account liabilities	**19,485,437**	17,679,354
Policyholders' deposits	**97,900**	89,115
Policy claims payable	**68,645**	100,487
Policyholders' dividends and dividend obligations	**184,931**	145,147
Total policy liabilities	**24,245,576**	22,423,097
Amounts payable to reinsurers	**23,457**	25,891
Derivative liabilities	**566,986**	489,398
Other liabilities and accrued expenses	**682,703**	543,880
Pension and other post-retirement benefit obligations	**194,257**	202,152
Deferred income taxes	**181,517**	231,439
Federal income tax payable	**66,109**	18,201
Debt	**452,638**	453,610
Separate account liabilities	**814,928**	733,099
Total liabilities	**$ 27,228,171**	$ 25,120,767
Stockholder's equity:		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	**$ —**	$ —
Class B common stock, par value of $0.01, 1,001 shares authorized, 100 shares issued and outstanding	**—**	—
Preferred stock, 500 shares authorized, no shares issued and outstanding	**—**	—
Retained earnings	**2,591,881**	2,399,476
Accumulated other comprehensive income	**388,403**	139,077
Total stockholder's equity	**$ 2,980,284**	$ 2,538,553
Total liabilities and stockholder's equity	**$ 30,208,455**	$ 27,659,320

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
For the Years Ended December 31, 2017, 2016 and 2015

(in thousands)	2017	2016	2015
Revenues:			
Insurance premiums	**$ 220,629**	$ 218,435	$ 227,547
Policy and contract charges	**564,064**	503,559	445,899
Mutual fund commissions and fee income	**85,453**	92,351	100,826
Net investment income	**1,415,211**	1,154,842	925,208
Net realized capital gains (losses)	**(37,439)**	(7,460)	(8,581)
Change in value of trading equity securities	**1,136**	425	(1,130)
Other income	**25,844**	26,678	16,661
Total revenues	**2,274,898**	1,988,830	1,706,430
Benefits and expenses:			
Decrease in policy liabilities	**(21,468)**	(72,264)	(1,720)
Policy benefits	**474,918**	533,071	440,896
Policyholders' dividends and dividend obligations	**57,144**	58,089	64,289
Interest credited to policyholder account liabilities	**819,837**	679,079	427,754
Operating expenses	**316,377**	302,128	274,790
Interest expense	**39,620**	39,305	40,149
Policy acquisition expenses and amortization of present value of future profits, net	**378,714**	232,354	309,024
Total benefits and expenses	**2,065,142**	1,771,762	1,555,182
Income before income taxes	**209,756**	217,068	151,248
Income tax expense (benefit)	**(50,182)**	61,000	41,944
Net income	**$ 259,938**	$ 156,068	$ 109,304
Other comprehensive income (loss), net of tax:			
Unrealized gains (losses) on available-for-sale investments	**263,789**	106,164	(258,047)
Cash flow hedge on debt issuance	**(80)**	34	34
Change in funded status of retirement plans	**(14,383)**	6,304	14,917
Total other comprehensive income (loss)	**249,326**	112,502	(243,096)
Comprehensive income (loss)	**$ 509,264**	$ 268,570	$ (133,792)

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholder's Equity
For the Years Ended December 31, 2017, 2016 and 2015

(in thousands)	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
December 31, 2014	$ —	$ —	$ —	$ 2,134,104	$ 269,671	$ 2,403,775
Net income	—	—	—	109,304	—	109,304
Other comprehensive income (loss)	—	—	—	—	(243,096)	(243,096)
Total comprehensive income (loss)						(133,792)
December 31, 2015	—	—	—	2,243,408	26,575	2,269,983
Net income	—	—	—	156,068	—	156,068
Other comprehensive income (loss)	—	—	—	—	112,502	112,502
Total comprehensive income (loss)						268,570
December 31, 2016	—	—	—	**2,399,476**	**139,077**	**2,538,553**
Net income	—	—	—	**259,938**	**—**	**259,938**
Other comprehensive income (loss)	—	—	—	**—**	**181,793**	**181,793**
Effect of change in tax rate on accumulated other comprehensive income	—	—	—	**(67,533)**	**67,533**	**—**
Total comprehensive income (loss)						**441,731**
December 31, 2017	**$ —**	**$ —**	**$ —**	**$ 2,591,881**	**$ 388,403**	**$ 2,980,284**

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2017, 2016 and 2015

(in thousands)	2017	2016	2015
Cash flows from operating activities:			
Net income	**$ 259,938**	$ 156,068	$ 109,304
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for deferred income taxes	**(145,808)**	20,320	29,663
Interest credited to policyholder account liabilities	**819,837**	679,079	427,754
Amortization of deferred policy acquisition costs	**265,002**	129,733	202,049
Policy and contract charges	**(564,064)**	(503,559)	(445,899)
Net realized capital losses	**37,439**	7,460	8,581
Change in fair value of derivatives	**(335,329)**	(122,093)	79,606
Change in corporate owned life insurance policies	**(6,363)**	(5,591)	(7,156)
Amortization of present value of future profits of insurance acquired	**6,642**	3,108	3,485
Depreciation	**28,478**	28,242	24,694
Other	**(22,529)**	(10,625)	(9,040)
Changes in assets and liabilities:			
Accrued investment income	**(9,935)**	(9,023)	(14,148)
Deferred policy acquisition costs	**(417,730)**	(371,790)	(318,636)
Policy liabilities	**80,165**	85,138	67,769
Other assets and liabilities	**64,795**	(37,326)	6,973
Net cash provided by operating activities	**60,538**	49,141	164,999
Cash flows from investing activities:			
Proceeds from sales, maturities and repayments of investments	**3,255,054**	3,403,072	3,272,590
Cost of investments acquired	**(4,582,323)**	(4,990,900)	(4,613,227)
Property and equipment additions	**(38,414)**	(41,980)	(40,036)
Cost of corporate owned life insurance acquired	**(140,000)**	—	(15,934)
Change in policy loans	**(39,386)**	(15,084)	(14,858)
Change in short term investments	**(26,056)**	41,619	26,277
Change in short term broker collateral	**113,506**	55,650	(145,130)
Other	**(12,256)**	(9,468)	(33,898)
Net cash used by investing activities	**(1,469,875)**	(1,557,091)	(1,564,216)
Cash flows from financing activities:			
Policyholders' deposits	**2,333,006**	2,105,604	1,823,046
Policyholders' withdrawals	**(1,153,580)**	(1,103,703)	(1,017,670)
Advances from Federal Home Loan Banks	**325,579**	606,936	610,770
Repayments to Federal Home Loan Banks	**(79,510)**	—	(100,000)
Debt retirement	**(1,995)**	—	(15,079)
Change in other deposits	**25,407**	2,445	(19,134)
Net cash provided by financing activities	**1,448,907**	1,611,282	1,281,933
Net increase (decrease) in cash	**39,570**	103,332	(117,284)
Cash and restricted cash:			
Beginning of year	**244,500**	141,168	258,452
End of year	**$ 284,070**	$ 244,500	$ 141,168
Supplemental disclosure of cash flow information:			
Interest paid	**$ 39,320**	$ 38,898	$ 40,421
Income taxes paid (received)	**$ 23,789**	$ 3,554	(18,645)