NLV Financial Corporation and Subsidiaries

Annual Performance Review and Consolidated Financial Statements

As of and for the Years Ended December 31, 2019 and 2018

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 primary insurance subsidiaries are National Life Insurance Company ("NLIC"), a Vermont-domiciled life insurer, and Life Insurance Company of the Southwest ("LSW"), a Texas-domiciled life insurer. Together with their affiliates, NLIC and LSW operate as a unified organization under the trade name of National Life Group.

National Life Group's leading life insurance product lines include indexed universal life, whole life, term life, and universal life. We offer a wide array of options and riders in connection with these policies to provide additional features such as accelerated benefits, waiver of premium, accidental death benefits, paid up additions, supplemental term insurance and lifetime income.

National Life Group's leading annuity product lines are indexed annuities and fixed interest rate annuities. We offer a guaranteed lifetime income rider on our indexed 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. National Life Group also offers variable annuities, but does not offer, and has never offered, guaranteed minimum withdrawal, accumulation or income benefits on our variable annuities. A return of premium guaranteed minimum death benefit is the only guarantee currently offered on our 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.

Distribution

National Life Group provides a broad range of life insurance and annuity products to a national client base, primarily through an extensive network of independent agents and career agents. We focus on serving Middle America in our 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 our individual annuity business, we focus on the 403(b) K-12 educator markets. National Life Group 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. We market and distribute our products throughout the United States through two principal channels: Affiliated Partner and Affiliated Independent:

- ***Affiliated Partner*** is an evolution of the traditional "career" channel, and includes 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*** consists of agents who primarily offer life insurance and annuity 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

National Life Insurance Company was established in Vermont in 1848. In 1999, 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"), Longhorn Reinsurance Company ("Longhorn"), and certain other subsidiaries, and indirectly owns 100% of the outstanding common stock of Life Insurance Company of the Southwest, which is 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 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 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. 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. On a non-GAAP core earnings basis, we also exclude from revenues any investment income (losses) from derivative instruments that hedge indexed product liabilities; instead, those hedging results are presented within interest credited to policyholder account liabilities. 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 total revenues on a GAAP basis to total revenues on a core earnings basis is presented below:

	For the Year Ended December 31,	
	2019	2018
Total revenues	**$ 2,772,100**	$ 1,905,399
Net losses	**38,858**	23,480
Net investment (income) loss from derivatives that hedge equity indexed products, which is included in interest credited to policyholder liabilities on a core earnings basis	**(476,800)**	166,185
Total revenues on a core earnings basis	**$ 2,334,158**	$ 2,095,064

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

	For the Year Ended December 31,	
	2019	2018
Net income	**$ 223,543**	$ 150,054
Net losses	**38,858**	23,480
Amortization of DAC and sales inducements, and policyholder dividend obligations, and other adjustments related to net gains and losses	**(501)**	704
Income tax expense	**56,501**	23,560
Pre-tax operating income	**318,401**	197,798
Non-core (earnings) losses, primarily volatility resulting from the measurement of indexed product liabilities	**(32,950)**	26,929
Core earnings	**$ 285,451**	$ 224,727

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, 2019 and 2018, 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, 2019 and 2018, which have been audited by PricewaterhouseCoopers LLP.

The Company delivered strong sales results and growth in core earnings in 2019 while continuing to maintain a strong balance sheet and capital position. As of December 31, 2019, sales of life and annuity products exceeded the prior year by 17% in total. Life sales increased 17% over the prior year, led by very strong growth in sales of indexed universal life. Sales of term and whole life, while still a small component of total sales, were also up significantly following the launch of updated product offerings in 2018 and 2019. This sales growth was driven by an increase in the number of producing agents in our Affiliated Partner and Affiliated Independent channels and by customer demand for indexed products and living benefits.

The Company's universal life, indexed universal life, and annuity products generate revenues through investment income and policy and contract charges that are earned during the life of the contracts. On a GAAP basis, investment income includes changes in the fair value of derivative instruments that economically hedge our indexed life and annuity products, primarily options and futures. Whole and term life insurance products generate primarily premium revenues. The increase in the Company's total revenues on a GAAP basis was driven by investment income from gains on derivative instruments of $477 million in 2019, compared to investment losses on derivative instruments of $166 million in 2018. The gains in the 2019 were primarily due to an increase in the value of derivatives resulting from a recovery in equity markets after a sharp decline late in 2018. On a core earnings basis, which excludes from revenue such derivative gains (losses) as well as net gains (losses), the Company's total revenues in 2019 grew 11% or $239 million. This included an increase in net investment income of 10% and an increase in policy and contract charges of 17% in 2019 compared to 2018, due to growth in the Company's volume of business.

Net income increased $74 million to $224 million in 2019 compared to 2018. The impact of the update of actuarial assumptions, which are reviewed annually, was a negative adjustment to net income of $19 million in 2019, compared to a net positive adjustment of $11 million in 2018. After excluding the impact of assumption updates in both years, net income increased approximately $104 million in 2019 compared to 2018.

Core earnings of $285 million in 2019 were up from $225 million in 2018. The increase in core earnings was driven by strong performance in all of our lines of business, primarily significant growth in policy and contract charge revenues from our indexed universal life business, as well as higher investment income from our partnership portfolio. These earnings were partially offset by an increase in operating expenses to support our growing level of sales and policies in force. The impact of actuarial assumption updates was a net negative adjustment to core earnings of $5 million in 2019, compared to a net positive adjustment of $5 million in 2018. After excluding the impact of assumption updates in both years, core earnings increased approximately $71 million in 2019 compared to 2018.

Each of the components of core earnings and the factors that contributed to the changes for the years ended December 31, 2019, and 2018 are described in detail below.

	For the Year Ended December 31,	
	2019	**2018**
Revenues:		
Insurance premiums	**$ 233,256**	$ 217,241
Policy and contract charges	**759,027**	648,395
Mutual fund commissions, fees and other income	**77,815**	82,453
Net investment income	**1,264,060**	1,146,975
Total revenues, on a core earnings basis	**2,334,158**	2,095,064
Benefits and expenses:		
Decrease in policy liabilities	**(12,695)**	(83,762)
Policy benefits	**486,940**	536,813
Policyholders' dividends and dividend obligations	**46,032**	40,191
Interest credited to policyholder account liabilities	**721,993**	634,371
Operating expenses	**359,056**	322,770
Interest expense	**63,360**	49,286
Policy acquisition expenses	**384,021**	370,668
Total benefits and expenses, on a core earnings basis	**2,048,707**	1,870,337
Core earnings	**$ 285,451**	**$** 224,727

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 increased to $233 million in 2019 from $217 million in 2018. This increase was driven by higher term life and whole life product sales, partially offset by a decrease 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 $111 million, or 17%, to $759 million in 2019 from $648 million in 2018. This 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 consist of dealer concessions earned by the Company's affiliated broker-dealer, Equity Services, Inc. Other income includes revenues from reinsurance, corporate owned life insurance and miscellaneous fee income. Revenues from mutual fund commissions, fees and other income decreased to $78 million in 2019 from $82 million in 2018, primarily due to decrease in reinsurance related other 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, partnership income, and income (losses) from derivative instruments. On a non-GAAP core earnings basis, we exclude from net investment income any income (losses) from derivative instruments that hedge indexed product liabilities; instead, those hedging results are presented within interest credited to policyholder account liabilities. Net investment income on a core earnings basis increased $117 million, or 10%, to $1.3 billion in 2019 from $1.1 billion in 2018. This increase was driven by higher income from the bond and mortgage loan portfolios due to the overall growth of in-force business, as well as higher partnership income in 2019.

The table below provides a breakdown of the components of net investment income on a core earnings basis, which excludes income on options that economically hedge our indexed products:

	For the Year Ended December 31,	
	2019	**2018**
Net investment income		
Debt securities interest	**$ 980,809**	$ 895,800
Equity securities dividends	**5,954**	5,849
Mortgage loan interest	**168,170**	155,535
Policy loan interest	**44,644**	43,109
Real estate income	**3,342**	8,564
Derivative income (loss)	**3,111**	(51)
Partnership income	**86,536**	66,997
Other investment income	**6,080**	6,044
Gross investment income	**1,298,646**	1,181,847
Less: Investment expenses	**(34,586)**	(34,872)
Net investment income on a core earnings basis	**$ 1,264,060**	$ 1,146,975

Increase (Decrease) in Policy Liabilities

The increase (decrease) in policy liabilities reflects changes in the product liability reserves for whole and term life insurance, disability income insurance and in additional reserves held on certain annuities. The change in policy reserves was a net decrease of $13 million in 2019 compared to a net decrease of $84 million in 2018. The smaller net decrease compared to 2018 was primarily related to reserves released in 2018 by the surrender of certain large whole life policies within the Closed Block (largely offset in policy benefit expense) as well as higher traditional life premiums in 2019.

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 $50 million to $487 million in 2019 from $537 million in 2018. This decrease was primarily due to the surrender of certain large whole life policies within the Closed Block in the first quarter of 2018.

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 gains (losses). Policyholders' dividends and dividend obligations included in core earnings increased $6 million in 2019 from 2018. This increase was primarily related to an increase in the PDO liability partially offset by lower dividends paid.

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 (losses) on options that economically hedge our indexed products. Core interest credited increased $88 million to $722 million in 2019 from $634 million in 2018.

This increase reflected growth in account value within our indexed product lines, as well as the impact from actuarial assumption updates in 2019. The actuarial assumption adjustments in 2019 included an increase of core interest credited expense of approximately $7 million, while actuarial assumption updates in 2018 included a reduction of core interest credited expense of approximately $4 million and were primarily due to a reduction in GLIR reserves related to refinements in lapse rate assumptions, based on experience.

Operating Expenses

Operating expenses consist primarily of administrative, maintenance and operational expenses related to servicing the Company's business. Operating expenses were $359 million in 2019 compared to $323 million in 2018. Operating expenses in 2019 included higher charitable contributions, certain affiliated distribution expenses previously reported within policy acquisition costs, lower capitalization of internal costs to develop software, and higher deferred compensation costs. The net change in certain defined contribution deferred compensation liabilities reported in operating expenses is largely offset by changes in the fair value of certain equity investments, which are reported within net gains and losses. Excluding the changes in these unusual items, operating expenses increased approximately 2% over 2018, primarily to support higher levels of in-force and new business.

Interest Expense

Interest expense consists of interest paid on the Company's surplus notes and senior notes. Interest expense totaled $63 million in 2019 compared to $49 million in 2018. The increase in interest expense was due to $350 million of 5.25% surplus notes due 2068 that were issued by NLIC in July 2018, as well as an additional $128 million of the 2068 5.25% surplus notes issued in April 2019.

Policy Acquisition Expenses

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 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 were $384 million in 2019, up from $371 million in 2018. This increase was primarily attributable to higher amortization expense driven by higher gross profits on an increased volume of indexed universal life and annuity products as well as the impact of the actuarial assumption updates.

The actuarial assumption adjustments included in core amortization expense in 2019 netted to approximately $2 million, due to changes to spread assumptions partially offset by favorable mortality. The actuarial assumption adjustments in 2018 included an increase in core amortization expense of approximately $8 million, mainly due to updated mortality rates. As a result, the year over year change in the impact of actuarial assumption updates was a $6 million increase in amortization expense in 2019 compared to 2018.

Net Gains (Losses)

The Company recorded net losses of $39 million in 2019 compared to net losses of $23 million in 2018. The non-GAAP measure of pre-tax operating income excludes net gains (losses) and is also adjusted to exclude amortization of DAC and sales inducements, and policyholder dividend obligations, related to net gains (losses) (see “Non-GAAP Measures,” above).

In accordance with ASU 2016-01, *Financial Instruments—Overall (subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, effective for fiscal years beginning after December 15, 2018, equity investments are measured at fair value with changes in fair value recognized in net income. This reflects a change in reporting for equity securities and certain partnerships where the changes in fair value were previously recognized through accumulated other comprehensive income (“AOCI”).

Details of net gains (losses) by asset category are provided in the table below:

	For the Year Ended December 31,	
	2019	**2018**
Net gains (losses) on:		
Debt securities	**$ (11,494)**	$ (6,187)
Equity securities	**6,760**	(3,599)
Mortgage loans	**(787)**	(627)
Partnerships	**(19,449)**	(9,531)
Other invested assets	**(5,756)**	857
Real estate	**(102)**	(405)
Embedded derivatives	**(4,556)**	(98)
Debt retirement	**(688)**	(3,890)
Impairment of software	**(2,786)**	—
Net losses	**$ (38,858)**	$ (23,480)

Federal Income Taxes

Federal income tax expense in 2019 was $57 million, which represented an effective tax rate of 20%, compared to income tax expense of $24 million in 2018 with an effective tax rate of 14%. 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. Income tax expense in 2019 and 2018 included income tax benefits of $8 million and $3 million, respectively, that were related to net gains and losses.

Non-Core Earnings

Non-core earnings primarily include short-term income volatility that results from the fair value 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 contributed $33 million of positive non-core earnings to pre-tax operating earnings in 2019 and negative non-core earnings reduced pre-tax operating earnings by $27 million in 2018. The positive non-core earnings in 2019 reflected positive movement in the equity markets, which rebounded in the first quarter of 2019 after the volatility and decline in the fourth quarter of 2018, partially offset by a $14 million negative impact to non-core earnings from actuarial assumption updates. The losses (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.

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, 2019, total assets were $35.8 billion, primarily attributable to investments that support life insurance policy and annuity contracts with more than 938,000 customers. Cash and investments increased $5.5 billion in 2019, which included a $1.2 billion increase in the fair value of derivative assets, primarily equity index options used to hedge our indexed product liabilities, and a $1.8 billion increase in net unrealized gains on available-for-sale debt securities and equity securities. After excluding net unrealized gains and losses, total assets at December 31, 2019 were $34.5 billion compared to $30.5 billion at December 31, 2018, and the Company's investments in available-for-sale debt and equity securities grew $1.8 billion to $22.0 billion, driven primarily by strong cash flows from our growing life and annuity business. 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.

Total liabilities as of December 31, 2019 were $32.1 billion, compared to $27.8 billion as of December 31, 2018. The increase of $4.3 billion in 2019 was primarily due to an increase in policyholder account liabilities consistent with our strong sales in 2019, an increase in the market value of derivative liabilities, an increase in other liabilities primarily related to the timing of cash settlements on investment purchases, and an increase in debt resulting from the April 2019 issuance of an additional $128 million of 5.25% surplus notes due 2068.

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

	As of December 31, 2019	As of December 31, 2018
	(in thousands)	
Assets:		
Cash and investments	**$ 31,849,806**	$ 26,395,180
Other general account assets	**3,034,511**	3,271,985
Separate account assets	**881,791**	769,763
Total assets	**$ 35,766,108**	$ 30,436,928
Liabilities and Stockholder's Equity:		
Total liabilities	**32,119,741**	27,775,918
Stockholder's Equity:		
Retained earnings	**3,011,282**	2,741,935
Accumulated other comprehensive income (loss)	**635,085**	(80,925)
Total stockholder's equity	**3,646,367**	2,661,010
Total liabilities and stockholder's equity	**$ 35,766,108**	$ 30,436,928

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, 2019	2018
	(in thousands)	
Net cash provided (used) by operating activities	**$ 62,807**	$ (125,499)
Net cash used in investing activities	**(1,864,979)**	(1,931,493)
Net cash provided by financing activities	**2,097,661**	1,930,508
Net increase (decrease) in cash	**$ 295,489**	$ (126,484)

Net cash provided by operations was $63 million in 2019, compared to $125 million net cash used by operations in 2018. The increase in cash provided compared to the prior year was primarily due to changes in other assets and liabilities. Cash used by operating activities in 2018 also included higher payment of income taxes and a $47 million pension contribution.

Net cash used in investing activities was $1.9 billion in 2019 and in 2018 which represented the investment of positive net cash provided by financing activities.

Net cash provided by financing activities was $2.1 billion in 2019, compared to $1.9 billion in 2018. The increase in net cash provided by financing activities was primarily due to a $288 million increase in policyholder deposits, net of withdrawals, related primarily to increased sales of indexed universal life products, as well as $125 million proceeds from the issuance of surplus notes. Net issuances of FHLB funding agreements (net of repayments) were $324 million in 2019, compared to $268 million in 2018. 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.

	As of December 31, 2019	As of December 31, 2018	Change
Other Selected Data		*(in millions)*	
Life insurance in force (before reinsurance ceded)	**$ 173,316**	$ 142,317	$ 30,999
Total assets under management (excluding unrealized gains and losses)	**$ 34,488**	$ 30,474	$ 4,014

	For the Year Ended 2019	2018	Change
<u>Weighted New Annualized Premium (WNAP) Sales</u>		*(in millions)*	
Life	**$ 361**	$ 309	$ 52
Annuity	**290**	247	43
Total Life and Annuity WNAP	**$ 651**	$ 556	$ 95

The increase in Life WNAP reflected continued growth in sales of indexed universal life, primarily driven by an increase in the number of producing agents in our Affiliated Partner and Affiliated Independent distribution channels, and customer demand for indexed products and living benefits. The increase in Annuity WNAP reflected strong sales of single premium deferred annuities and WNAP from flow (flexible premium) annuities.

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 producing 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 following 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, 2019 and 2018, 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

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Report of Independent Auditors

To the Board of Directors of NLV Financial Corporation:

We have audited the accompanying consolidated financial statements of NLV Financial Corporation and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of comprehensive income, of changes in stockholder's equity and of cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NLV Financial Corporation and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

February 24, 2020

NLV Financial Corporation and Subsidiaries
Consolidated Balance Sheets
As of December 31, 2019 and 2018

(in thousands)	2019	2018
Assets:		
Cash and investments:		
Available-for-sale debt securities	**$ 23,700,099**	$ 20,122,717
Equity securities	**62,882**	55,360
Trading debt securities	**136,630**	19,082
Mortgage loans	**3,718,391**	3,674,383
Policy loans	**959,969**	921,516
Real estate investments	**11,806**	16,210
Derivative assets	**1,409,070**	231,174
Other invested assets	**1,236,434**	932,402
Short term investments	**161,450**	264,750
Cash and restricted cash	**453,075**	157,586
Total cash and investments	**31,849,806**	26,395,180
Deferred policy acquisition costs	**1,856,701**	2,093,111
Accrued investment income	**248,668**	232,368
Premiums and fees receivable	**22,109**	22,639
Amounts recoverable from reinsurers	**108,588**	132,164
Property and equipment, net	**173,100**	165,934
Corporate owned life insurance	**507,237**	493,679
Federal income tax recoverable	**—**	31,306
Other assets	**118,108**	100,784
Separate account assets	**881,791**	769,763
Total assets	**$ 35,766,108**	$ 30,436,928
Liabilities:		
Policy liabilities:		
Policy benefit liabilities	**$ 4,255,302**	$ 4,159,561
Policyholder account liabilities	**23,565,407**	21,115,895
Policyholders' deposits	**99,692**	90,082
Policy claims payable	**76,447**	95,698
Policyholders' dividends and dividend obligations	**233,491**	62,342
Total policy liabilities	**28,230,339**	25,523,578
Amounts payable to reinsurers	**36,509**	38,734
Derivative liabilities	**881,670**	102,391
Other liabilities and accrued expenses	**715,966**	309,911
Pension and other post-retirement benefit obligations	**165,753**	149,422
Deferred income taxes	**257,671**	91,253
Federal income tax payable	**35,362**	—
Debt	**914,680**	790,866
Separate account liabilities	**881,791**	769,763
Total liabilities	**$ 32,119,741**	$ 27,775,918
Stockholder's equity:		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	**$ —**	$ —
Class B common stock, par value of $0.01, 1,001 shares authorized, 100 shares issued and outstanding	**—**	—
Preferred stock, 500 shares authorized, no shares issued and outstanding	**—**	—
Retained earnings	**3,011,282**	2,741,935
Accumulated other comprehensive income	**635,085**	(80,925)
Total stockholder's equity	**$ 3,646,367**	$ 2,661,010
Total liabilities and stockholder's equity	**$ 35,766,108**	$ 30,436,928

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

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income
For the Years Ended December 31, 2019 and 2018

(in thousands)	2019	2018
Revenues:		
Insurance premiums	**$ 233,256**	$ 217,241
Policy and contract charges	**759,027**	648,395
Mutual fund commissions and fee income	**53,230**	51,571
Net investment income	**1,740,859**	980,790
Net losses	**(38,858)**	(23,480)
Other income	**24,586**	30,882
Total revenues	**2,772,100**	1,905,399
Benefits and expenses:		
Decrease in policy liabilities	**(12,695)**	(83,762)
Policy benefits	**486,941**	536,813
Policyholders' dividends and dividend obligations	**46,499**	40,224
Interest credited to policyholder account liabilities	**1,082,820**	504,945
Operating expenses	**359,056**	322,770
Interest expense	**63,360**	49,286
Policy acquisition expenses	**466,075**	361,509
Total benefits and expenses	**2,492,056**	1,731,785
Income before income taxes	**280,044**	**173,614**
Income tax expense	**56,501**	23,560
Net income	**$ 223,543**	$ 150,054
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on available-for-sale investments	**721,298**	(473,345)
Cash flow hedge on debt issuance	**41**	41
Change in funded status of retirement plans	**(5,329)**	3,976
Total other comprehensive income (loss)	**716,010**	(469,328)
Comprehensive income (loss)	**$ 939,553**	$ (319,274)

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

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholder's Equity
For the Years Ended December 31, 2019 and 2018

	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
(in thousands)						
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					(469,328)	(319,274)
December 31, 2018	—	—	—	**2,741,935**	**(80,925)**	**2,661,010**
Net income	—	—	—	**223,543**	**—**	**223,543**
Other comprehensive income	—	—	—	**—**	**761,814**	**761,814**
Effect of implementation of ASU 2016-01, net	—	—	—	**45,804**	**(45,804)**	**—**
Total comprehensive income					**716,010**	**985,357**
December 31, 2019	**$ —**	**$ —**	**$ —**	**$ 3,011,282**	**$ 635,085**	**$ 3,646,367**

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

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018

(in thousands)	2019	2018
Cash flows from operating activities:		
Net income	**$ 223,543**	$ 150,054
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for deferred income taxes	**(23,913)**	34,489
Interest credited to policyholder account liabilities	**1,082,820**	504,945
Amortization of deferred policy acquisition costs	**367,769**	250,042
Policy and contract charges	**(759,027)**	(648,395)
Net losses	**38,858**	23,480
Change in fair value of derivatives	**(479,925)**	166,865
Change in corporate owned life insurance policies	**(13,558)**	(13,610)
Depreciation	**30,849**	29,115
Other	**(963)**	2,964
Changes in assets and liabilities:		
Accrued investment income	**(16,300)**	(14,385)
Deferred policy acquisition costs	**(595,010)**	(507,138)
Policy liabilities	**114,576**	35,390
Other assets and liabilities	**93,088**	(139,315)
Net cash provided (used) by operating activities	**62,807**	(125,499)
Cash flows from investing activities:		
Proceeds from sales, maturities and repayments of investments	**3,348,793**	3,048,372
Cost of investments acquired	**(5,431,743)**	(4,601,584)
Property and equipment additions	**(38,363)**	(49,662)
Cost of corporate owned life insurance acquired	**—**	(60,000)
Change in policy loans	**(38,454)**	(43,589)
Change in short term investments	**103,300**	(36,270)
Change in short term broker collateral	**257,687**	(192,689)
Other	**(66,199)**	3,929
Net cash used by investing activities	**(1,864,979)**	(1,931,493)
Cash flows from financing activities:		
Policyholders' deposits	**3,152,335**	2,684,083
Policyholders' withdrawals	**(1,507,400)**	(1,326,884)
Advances from Federal Home Loan Banks	**673,832**	440,598
Repayments to Federal Home Loan Banks	**(349,468)**	(172,165)
Proceeds from debt issuance	**124,518**	345,022
Debt retirement	**(1,921)**	(10,940)
Change in other deposits	**5,765**	(29,206)
Net cash provided by financing activities	**2,097,661**	1,930,508
Net increase (decrease) in cash	**295,489**	(126,484)
Cash and restricted cash:		
Beginning of year	**157,586**	284,070
End of year	**$ 453,075**	$ 157,586
Supplemental disclosure of cash flow information:		
Interest paid	**$ 58,197**	$ 39,273
Income taxes paid	**$ 4,876**	$ 50,429

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

NOTE 1 – NATURE OF OPERATIONS AND STRUCTURE

NLV Financial Corporation ("NLVF") and its subsidiaries and affiliates (collectively, the "Company") offer a broad range of financial products and services, including life insurance, annuities, mutual funds, and investment advisory and administrative services. The flagship company of the organization, National Life Insurance Company ("National Life"), was chartered in 1848. The Company employs approximately 1,280 people, primarily concentrated in Montpelier, Vermont and Addison, Texas. Life Insurance Company of the Southwest ("LSW"), a Texas domiciled stock life insurer, is a wholly owned subsidiary of National Life. National Life, together with LSW, makes up NLVF's insurance operations.

On January 1, 1999, pursuant to a mutual holding company reorganization, National Life converted from a mutual to a stock life insurance company. Concurrent with the conversion to a stock life insurance company, National Life created a closed block of insurance and annuity policies (the "Closed Block"). Prior to the conversion, policyowners held policy contractual and membership rights from National Life. The reference to "policyowner," "policyholder" or "policy" throughout this document includes both life insurance and annuity contract owners. The contractual rights, as defined in the various insurance and annuity policies, remained with National Life after the conversion. This reorganization was approved by policyowners of National Life and was completed with the approval of the Commissioner of the Vermont Department of Financial Regulation. Membership interests held by policyowners of National Life at December 31, 1998, were converted to membership interests in National Life Holding Company ("NLHC"), a mutual insurance holding Company created for this purpose. Under the provisions of the reorganization of National Life from a mutual to a stock life insurance company, National Life issued 2.5 million common stock $1 par shares to its parent, NLVF, as a transfer from retained earnings.

All of National Life's outstanding shares are currently held by its parent, NLVF, which is a wholly-owned subsidiary of NLHC, the mutual holding company. Policyholders of National Life hold membership interests in NLHC. NLHC and its subsidiaries are collectively known as the National Life Group. NLHC has ownership of all of NLVF's common stock class B shares outstanding. NLVF has assets and operations primarily related to the issuance of debt and as the sponsor of certain employee related benefit plans. Under the terms of the reorganization, NLHC must always hold a majority of the voting shares of NLVF.

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

On August 5, 2015, Catamount Reinsurance Company ("Catamount") was formed as a subsidiary of National Life. Catamount is a special purpose financial insurance company domiciled in the state of Vermont. Catamount entered into a coinsurance with funds withheld agreement with National Life to reinsure the majority of 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 National Life. 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 indexed universal life ("IUL") insurance policies issued by LSW from January 1, 2011 through December 31, 2015. Effective October 1, 2017, Longhorn reinsured additional IUL policies issued by LSW from January 1, 2016 through December 31, 2016. In 2019, the Longhorn legal entity was transferred as a dividend to NLVF.

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 additional features such as accelerated benefits, waiver of premium, accidental death benefits, paid up additions, supplemental term insurance and lifetime income.

NOTE 1 – NATURE OF OPERATIONS AND STRUCTURE (continued)

The Company's leading annuity product lines are indexed annuities and fixed interest rate annuities. The Company offers a guaranteed lifetime income rider on our indexed 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 our variable annuities. A return of premium guaranteed minimum death benefit is the only guarantee currently offered on our variable annuity products.

The Company provides this broad range of life insurance and annuity products to a national client base 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 has in excess of 938,000 customers and, through its subsidiaries, is licensed to do insurance business in all 50 states and the District of Columbia. National Life is licensed to do business in all 50 states and the District of Columbia. LSW is licensed in 49 states and the District of Columbia. Catamount and Longhorn are licensed to do business in Vermont only. About 42% of the Company's total collected premiums and deposits are from residents of the states of California and Texas.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

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").

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.

Use of 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates (continued)

The most significant estimates include those used in determining estimated gross profits used in the valuation and amortization of assets and liabilities associated with variable annuity and universal life-type insurance contracts; policy liabilities; valuation of investments; derivative instruments; and embedded derivatives; determination of hedging effectiveness on interest rate swaps; evaluation of other-than-temporary impairments; valuations related to benefit plans, income taxes and litigation and regulatory contingencies. 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 Company's consolidated financial position, results of operations or cash flows.

Subsequent Events

The Company has evaluated events subsequent to December 31, 2019 and through the consolidated financial statement issuance date of February 24, 2020. The Company has not evaluated subsequent events after the issuance date for presentation in these consolidated financial statements.

Cash and Restricted Cash

Included in cash are cash equivalents which consist of commercial paper with maturities of three months or less.

At December 31, 2019 and 2018, the Company had restricted cash of $306.4 million and $48.7 million, respectively, related to broker collateral on the Company's derivative investments.

Short Term Investments

Short term investments include money market accounts that are carried at amortized cost which approximates fair value. These short term investments include liquid debt instruments purchased with original maturities of one year or less.

Investments

The Company's investment portfolio consists primarily of available-for-sale ("AFS") debt securities and equity securities. These securities are reported at fair value. Changes in the fair values of AFS debt securities are reflected in other comprehensive income ("OCI") after adjustments for related deferred policy acquisition costs, policyholder dividend obligations, loss reserve recognition, reserves, and deferred income taxes. Changes in the fair values of equity securities are reflected through net gains and (losses) in the Consolidated Statements of Comprehensive Income. When determining fair value, the Company utilizes observable market inputs and considers available data from a third party pricing service, independent brokers and pricing matrices. Publicly available prices are used whenever possible. In the event that publicly available pricing is not available, the securities are submitted to independent brokers for pricing, or they are valued using a pricing matrix, which maximizes the use of observable inputs that include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers and/or cash flows. The Company periodically performs an analysis on prices received from third parties to ensure that the price represents fair value. This process includes quantitative and qualitative analysis and is performed by the Company's investment professionals.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition and Presentation 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 to identify securities, using certain quantitative and qualitative characteristics, that could potentially be impaired. These identified securities are subjected to an enhanced analysis to determine if the impairments are other-than-temporary.

A debt security is deemed to be other-than-temporarily impaired if it meets the following conditions: (1) the Company intends to sell, or it is more likely than not the Company will be required to sell, the security before a recovery in value, or (2) the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell, or it is more likely than not that the Company will be required to sell, the security before a recovery in fair value, a charge is recorded in net gains and (losses) equal to the difference between the fair value and amortized cost basis of the security. For those other-than-temporarily impaired debt securities which do not meet the first condition and for which the Company does not expect to recover the entire amortized cost basis, the difference between the security's amortized cost basis and the fair value is separated into the portion representing a credit impairment, which is recorded in net gains and (losses), and the remaining impairment, which is recorded in OCI. Generally, the Company determines a security's credit impairment as the difference between its amortized cost basis and its best estimate of expected future cash flows discounted at the security's effective yield prior to impairment. The remaining non-credit impairment, which is recorded in OCI, is the difference between the security's fair value and the Company's best estimate of expected future cash flows discounted at the security's effective yield prior to the impairment. The remaining non-credit impairment typically represents current market liquidity, risk premiums, and interest rate fluctuations. The previous amortized cost basis less the impairment recognized in net gains and (losses) becomes the security's new cost basis.

Debt securities that are in an unrealized loss position are reviewed quarterly to determine if the decline in fair value would be considered other-than-temporary based on certain quantitative and qualitative factors. The primary factors considered in evaluating whether a decline in value is other-than-temporary include: (a) the length of time and extent to which the fair value has been less than cost or amortized cost and the expected recovery period of the security, (b) the financial condition, credit rating, and future prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments, (d) the intent and ability of the Company not to sell the investment prior to anticipated recovery, and (e) the payment structure of the security.

For mortgage-backed or other collateralized structured debt securities, the Company considers factors including, but not limited to, commercial and residential property value declines that vary by property type and location, and average cumulative collateral loss rates that vary by vintage year. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries, which may include estimating the underlying collateral value. In addition, projections of expected future debt security cash flows may change based upon the new information regarding the performance of the issuer and/or underlying collateral such as changes in the projections of the underlying property value estimates.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition and Presentation of Other-Than-Temporary Impairments (continued)

The Company's best estimate of future cash flows involves assumptions including, but not limited to, various performance indicators, such as historical and projected default and recovery rates, credit ratings, current delinquency rates, loan-to-value ratios and the possibility of obligor re-financing. Estimating the underlying future cash flows is a quantitative and qualitative process, which incorporates information received from third-party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral. Where possible, this data is benchmarked against third party sources.

Trading Debt Securities

Assets held in a segregated custody account in support of a modified coinsurance arrangement have been designated as trading debt securities. Trading debt securities are reported at fair value with changes in fair value recognized in net gains and (losses). See Reinsurance Note 6 for additional information on the modified coinsurance arrangement.

Mortgage Loans

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 borrowers' 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 and loss frequency and severity estimates. Changes in the valuation allowance are recognized through net gains and (losses).

For mortgage loans that are deemed impaired, an impairment loss is recognized through net gains and (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. Interest income on an impaired loan is accrued to the extent it is deemed collectable and the loan continues to perform under its original or restructured terms. Interest income on defaulted loans is recognized when received.

Policy Loans

Policy loans are reported at their unpaid balance and are fully collateralized by related cash surrender values.

Real Estate

Real estate acquired in satisfaction of debt is classified either as held for investment or available for sale and transferred to real estate from mortgage loans at the lower of cost or fair value. Real estate investments held for investment purposes are reported at depreciated cost and real estate investments classified as available for sale are reported at the lower of cost or fair value, less the costs to sell, and are not depreciated. In evaluating real estate impairments, the Company considers, among other things, the fair value of the real estate compared to its carrying value.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other Invested Assets

Investments in limited partnerships are included in other invested assets. Partnerships over which the Company does not have significant influence are carried at fair value. The Company obtains the fair value of these investments generally from net asset value ("NAV") information provided by the general partner or manager of the limited partnership, the financial statements of which generally are audited annually. Changes in the fair value of these limited partnerships are included in net gains and (losses) within the Consolidated Statements of Comprehensive Income. Limited partnerships over which the Company has significant influence are accounted for using the equity method. Under the equity method, the Company's pro-rata share of the partnerships' profits and losses are recognized in the Company's net investment income, and dividends received from the partnerships are recognized as return of capital up until the point that the initial investment has been fully recovered.

The Company receives U.S. Treasuries as broker collateral on the Company's derivative investments. These assets are considered restricted and are included in other invested assets. The Company also receives cash as broker collateral. For additional information, see Cash and Restricted Cash herein.

The Company's investments in affordable housing projects are included in other invested assets and are amortized using the proportional amortization method within income tax expense. The associated tax credits are also included as a component of income tax expense. For additional information, see Note 8.

The Company's investments in solar tax credit entities are included in other invested assets and are accounted for using the equity method. The Company's share of the entities' profits and losses are recognized as a component of net investment income.

Variable Interest Entities

A variable interest entity ("VIE") is a legal entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support, or is structured such that equity investors lack the ability to make significant decisions related to the entity's operations through voting rights or do not substantively participate in the gains and losses of the entity. The primary beneficiary, which is the interest holder that has both the power to direct the activities that most significantly affect the VIE's economic performance and the obligation to absorb losses or the right to receive benefits that could be significant to the VIE, is required to consolidate the VIE. The Company has variable interests in VIEs through a certain investment in notes and other invested assets. At December 31, 2019 and 2018, the Company had no interests in VIEs that met the criteria for consolidation. See Note 5 for additional information.

Derivatives

Derivatives include long options, short options, swaptions, interest rate swaps, and futures contracts. All derivatives are carried at fair value. Changes in the fair value of derivatives not designated as hedges are reflected in net investment income.

The Company designates certain interest rate swaps as fair value hedges when they have met the requirements to be deemed fair value hedges. The interest rate swaps that are designated as fair value hedges are used to convert fixed rate assets to floating rate. The Company recognizes unrealized and realized gains and losses on the swaps and on the related hedged items within net investment income. For additional information, see Note 5.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Gains and (Losses)

Net gains and (losses) on the Company's Consolidated Statements of Comprehensive Income include realized capital gains (losses) which are recognized using the specific identification method. Net realized capital gains (losses) include adjustments for related deferred policy acquisition costs, sales inducement assets, reserves, policyholder dividend obligations, income taxes, and impairment of capitalized software.

Beginning in 2019, net gains and (losses) include the changes in fair value of equity securities held at fair value and limited partnerships that are not accounting for under the equity method.

Accumulated Other Comprehensive Income ("AOCI")

The balance of and changes in each component of AOCI attributable to the Company for the years ended December 31, 2019 and 2018, are as follows (in thousands):

	Unrealized gains (losses) on available-for-sale investments	Cash flow hedge on debt issuances	Change in funded status of retirement plans	Total
Balance, December 31, 2017	$ 495,202	$ (640)	$ (106,159)	$ 388,403
Other comprehensive income before reclassifications	(485,618)	41	(5,239)	(490,816)
Amounts reclassified from AOCI	12,273	—	9,215	21,488
Balance, December 31, 2018	$ 21,857	$ (599)	$ (102,183)	$ (80,925)
Other comprehensive income before reclassifications	**754,129**	**41**	**(17,441)**	**736,729**
Amounts reclassified from AOCI	**12,973**	**—**	**12,112**	**25,085**
Effect of implementation of ASU 2016-01, net	**(45,804)**	**—**	**—**	**(45,804)**
Balance, December 31, 2019	**$ 743,155**	**$ (558)**	**$ (107,512)**	**$ 635,085**

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2019

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accumulated Other Comprehensive Income (continued)

Reclassifications out of AOCI during the year ended December 31, 2019 were as follows (in thousands):

AOCI component		Amounts reclassified out of AOCI (1)	Affected line item in the Consolidated Statements of Comprehensive Income
Unrealized gains (losses) on available-for-sale investments	**$**	**14,459**	Sale of investments - in net gains and (losses)
		(30,880)	Impairment expense - in net gains and (losses)
	$	**(16,421)**	Total before tax
		3,448	Income tax benefit
		(12,973)	Net of tax
Change in funded status of retirement plans (2)	**$**	**(15,332)**	Amortization of actuarial gain/(loss) - in operating expenses
		3,220	Income tax benefit
		(12,112)	Net of tax
Total reclassifications for the period	**$**	**(25,085)**	Net of tax

(1) Positive amounts indicate gains/benefits reclassified out of AOCI. Negative amounts indicate losses/costs reclassified out of AOCI.
(2) These AOCI components are included in the computation of net periodic pension cost (see Note 9 for additional details).

Reclassifications out of AOCI during the year ended December 31, 2018 were as follows (in thousands):

AOCI component		Amounts reclassified out of AOCI (1)	Affected line item in the Consolidated Statements of Comprehensive Income
Unrealized gains (losses) on available-for-sale investments	$	2,033	Sale of investments - in net gains and (losses)
		(17,569)	Impairment expense - in net gains and (losses)
	$	(15,536)	Total before tax
		3,263	Income tax benefit
		(12,273)	Net of tax
Change in funded status of retirement plans (2)	$	(11,664)	Amortization of actuarial gain/(loss) - in operating expenses
		2,449	Income tax benefit
		(9,215)	Net of tax
Total reclassifications for the period	$	(21,488)	Net of tax

(1) Positive amounts indicate gains/benefits reclassified out of AOCI. Negative amounts indicate losses/costs reclassified out of AOCI.
(2) These AOCI components are included in the computation of net periodic pension cost (see Note 9 for additional details).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Federal Home Loan Banks

National Life is a member of the Federal Home Loan Bank of Boston ("FHLB Boston") which provides National Life with access to a secured asset-based borrowing capacity. National Life had a letter of credit of $80.0 million and $100.0 million as of December 31, 2019 and 2018, respectively, and pledged collateral of $291.5 million and $370.9 million as of December 31, 2019 and 2018, respectively. Outstanding advances under this program were $115.4 million and $101.8 million as of December 31, 2019 and 2018, respectively. The membership requires an investment in the common stock of FHLB Boston. The common stock is redeemable by FHLB Boston. It is considered restricted and is reported in other invested assets at par value.

LSW is a member of the Federal Home Loan Bank of Dallas ("FHLB Dallas") which provides LSW with access to a secured asset-based borrowing capacity, including the ability to obtain loans as an alternative source of liquidity and to issue funding agreements. LSW had pledged collateral of $2.7 billion and $2.3 billion as of December 31, 2019 and 2018, respectively. Outstanding advances under this program were $2.0 billion and $1.7 billion as of December 31, 2019 and 2018, respectively. The membership requires an investment in the common stock of FHLB Dallas. The common stock is redeemable by FHLB Dallas. It is considered restricted and is reported in other invested assets at par value.

All of the outstanding advances in the form of funding agreements are included in policyholder account liabilities. The proceeds from these advances have been invested in a pool of fixed and floating rate income assets. The Company had no outstanding advances in the form of borrowings as of December 31, 2019. Total interest expense of $2.6 million and $2.1 million was paid to FHLB Boston in 2019 and 2018, respectively. Total interest expense of $48.1 million and $29.8 million was paid to FHLB Dallas in 2019 and 2018, respectively.

NLIC repaid advances to FHLB Boston of $1.1 million and $0.3 million in 2019 and 2018, respectively. LSW repaid advances to FHLB Dallas of $348.4 million and $171.9 million in 2019 and 2018, respectively.

Policy Acquisition Expenses

Commissions and other costs that are related directly to the successful acquisition of new or renewal insurance contracts are eligible to be deferred. Deferred policy acquisition costs ("DAC") for participating life insurance, universal life insurance, and 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 adjusted for related unrealized gains (losses) on available-for-sale debt securities and prior to 2019, equity securities, (after deducting any related policyholder dividend obligations), through AOCI, net of related deferred income taxes. DAC for non-participating term and whole life insurance and participating limited-payment and single-payment life insurance is amortized in relation to premium income using assumptions consistent with those used in computing policy benefit liabilities.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Acquisition Expenses (continued)

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 rates, mortality, expenses, contract lapses, withdrawals, surrenders and amortization period. The adjustments to DAC to reflect the update of the actuarial assumptions in 2019 and 2018 resulted in a net decrease to policy acquisition expenses of $10.2 million and $5.6 million, respectively. The update of actuarial assumptions also resulted in, to a lesser extent, adjustments to sales inducement assets and liabilities and policy liabilities.

The Company offers various sales incentives including bonus interest credited on its annuity products at the point of sale, as well as higher interest crediting rates in the first policy year. The Company capitalizes and amortizes these sales inducements to the extent they are explicitly identified in the contract at inception, incremental to amounts credited on similar contracts without bonus interest, and higher than the contract's expected ongoing crediting rates for periods after the bonus period. Sales inducement assets are reported within DAC and are amortized based on the underlying gross profits of the products, with amortization adjusted periodically to reflect actual experience, as well as updates to assumptions for future estimated gross profits.

For internal replacements of insurance contracts, the Company determines whether the new contract has substantially changed from the original contract based on certain criteria such as whether the change requires additional underwriting, pricing that was not contemplated in the original contract or significant benefit changes. If the Company determines that the contract has substantially changed, the deferred acquisition costs related to the original contract are written off through a charge to policy acquisition expenses.

Property and Equipment

Property and equipment is reported at depreciated cost. Assets are depreciated over their useful life using the straight-line method of depreciation. The table below outlines the useful life for each asset class:

Asset Class	Years
Software	5
Equipment	5
Furniture	7
Renovations/semi-permanent fixtures	20
Home office/other buildings	40

The tables below reflect the cost and accumulated depreciation for each major asset class as of December 31, 2019 and 2018 (in millions):

	December 31, 2019		
	Cost	Accumulated Depreciation	Carrying Value
Software	**$ 280.6**	**$ (171.4)**	**$ 109.2**
Equipment	**41.2**	**(35.8)**	**5.4**
Furniture	**29.5**	**(20.0)**	**9.5**
Renovations	**15.2**	**(3.9)**	**11.3**
Home office	**104.6**	**(66.9)**	**37.7**
	$ 471.1	**$ (298.0)**	**$ 173.1**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment (continued)

	December 31, 2018		
	Cost	Accumulated Depreciation	Carrying Value
Software	$ 252.0	$ (148.8)	$ 103.2
Equipment	40.0	(32.5)	7.5
Furniture	25.8	(17.0)	8.8
Renovations	14.1	(4.0)	10.1
Home office	101.2	(64.9)	36.3
	$ 433.1	$ (267.2)	$ 165.9

Depreciation expense recognized in operating expenses was $32.8 million and $30.0 million for the years ended December 31, 2019 and 2018, respectively. In 2019, the Company recognized impairments on certain software investments totaling $2.8 million. No software impairments were recognized in 2018. The impairment loss was included in net gains and (losses).

Corporate Owned Life Insurance

The Company holds life insurance contracts on certain members of management and other key individuals. During 2018, the Company increased its investment in Corporate Owned Life Insurance ("COLI") and purchased additional COLI of $60.0 million. The Company made no COLI purchases in 2019. The Company's investment in COLI is reported at the cash surrender value of these COLI contracts, which totaled $507.2 million and $493.7 million at December 31, 2019 and 2018, respectively.

COLI income includes the net change in cash surrender value and any benefits received or accrued. COLI income was $13.6 million in 2019 and 2018 and is included in other income.

Receivable from Agents

The Company accrues receivables for any amounts due from agents. These amounts due can take various forms including commissions recoverable from policy lapses or surrenders. As of December 31, 2019 and 2018, the Company had receivables from agents of $78.2 million and $65.4 million, respectively, which are included in other assets on the Consolidated Balance Sheets. These receivables are reported net of an accrued valuation allowance if it is deemed that amounts may not be collectible. The allowance for receivables from agents was $7.7 million and $6.5 million as of December 31, 2019 and 2018, respectively.

Separate Accounts

Variable products are reported within the separate accounts when investment risk is borne by the policyholder, investment income and investment gains and losses accrue directly to the policyholder, and the separate account meets additional accounting criteria to qualify for separate account treatment. The assets supporting the variable portion of variable annuity and variable universal life contracts that qualify for separate account treatment are carried at fair value and reported as separate account assets, with an equivalent summary total reported as separate account liabilities. Liabilities for minimum guaranteed benefits related to separate account policies are included in policy liabilities. Separate account results related to policyholders' interests are excluded from the Company's consolidated results of operations.

The assets of the Company's separately funded pension plans are held in the Company's separate accounts at fair value.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 4.4% and 4.5% as of December 31, 2019 and 2018, respectively.

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

Policyholder account liabilities for non-indexed universal life insurance and investment-type annuities represent amounts that inure to the benefit of the policyholders before surrender charges. Policyholder account liabilities for indexed life insurance and annuity liabilities consist of a combination of underlying account value and embedded derivatives. The underlying account value is primarily based on deposits plus any interest credited, less amounts assessed for mortality, administrative and other policy fees. The embedded derivative component represents the fair value of the Company's future obligations related to interest crediting that is based on the performance of various indexes, as specified in the respective contracts. Such embedded derivatives are carried at fair value, with the change in fair value recorded through interest credited to policyholder account liabilities.

The fair value of the embedded derivative component includes assumptions about future interest rates and interest rate structures, future costs for options used to hedge the contract obligations, projected withdrawal and surrender activity, the level and limits on contract participation in any future increases in the underlying indexes, and an explicit risk margin for policyholder behavior, as well as a margin to reflect the impact the Company's own credit rating would have in the view of a market participant.

The guaranteed minimum interest rates for the Company's fixed interest rate annuities range from 0.25% to 4.5%. The guaranteed minimum interest rates for the Company's fixed interest rate universal life insurance policies range from 1.0% to 5.0%. These guaranteed minimum rates are before deduction for any policy administration fees or mortality charges.

As part of the Company's annual actuarial assumption update, certain assumptions were revised for various blocks of business, including premium persistency, investment income, mortality, pricing, and lapse and surrender rates, which resulted in a $29.5 million net increase and $3.8 million net decrease in policy liabilities as of December 31, 2019 and 2018, respectively.

The Company tests reserves for any premium deficiency using best estimate assumptions. If a deficiency is found to exist, an additional reserve is typically recorded. There were no increases to the premium deficiency reserve in 2019 or 2018. The Company also tests reserves for adequacy assuming that all unrealized gains (losses) on investments are realized, and posts shadow reserves for any deficiency. As of December 31, 2019 and 2018, the shadow loss reserve was $10.7 million and $4.3 million, respectively.

The Company also held a shadow reserve related to its Guaranteed Lifetime Income Rider in policy benefit liabilities of $127.5 million and ($23.4) million, as of December 31, 2019 and 2018. The change in this shadow reserve is recorded in unrealized gains (losses) on available-for-sale investments within other comprehensive income. The net impact to accumulated other comprehensive income after shadow DAC and tax offsets was $66.6 million and ($12.5) million as of December 31, 2019 and 2018, respectively.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

Reserves are established, as appropriate, for separate account product guarantees. These reserves, which are not significant, are primarily related to guaranteed minimum death benefits on variable annuities equal to the amount of premiums paid less prior withdrawals (regardless of investment performance). In addition, a policyholder less than seventy-six years of age may elect, at issue, to purchase an enhanced death benefit rider, which pays a benefit on death equal to the sum of the highest prior anniversary value and the net of premiums received and funds withdrawn since that date. Coverage from this rider ceases at age eighty. Guaranteed death benefits are reduced dollar-for-dollar for partial withdrawals. Partial withdrawals from policies issued after November 1, 2003 will use the pro-rata method. Separate account product guarantee reserves are calculated as a percentage of collected mortality and expense risk and rider charges, with the current period change in reserves reported in policy benefits.

The Company offers persistency bonuses on certain products, whereby policyholders can receive additional interest credits by maintaining their policy in force for predetermined durations. These additional interest credits are accrued ratably over the bonus period and adjusted for actual persistency.

The components of the sales inducement liability (“SIL”) are shown below (in thousands), and are included in policy liabilities:

	SIL	
	2019	2018
Beginning of year	**$ 85,533**	$ 76,690
Increase due to interest, amortization and assumption updates	**9,811**	15,702
Payments	**(6,785)**	(6,859)
End of year	**$ 88,559**	$ 85,533

Reinsurance

Amounts recoverable from and payable to reinsurers are estimated in a manner consistent with the related liabilities associated with the reinsured policies. Reinsurance premiums and benefits paid or provided are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Under a modified coinsurance (“modco”) arrangement through which a quota share of new sales of certain indexed annuity products are ceded to an unaffiliated reinsurer, we retain the reserves and the assets supporting these reserves. The assets are held in a segregated custody account and have been designated as trading debt securities. Investment results from these assets, including gains and losses from sales, are passed directly to the reinsurer, and as a result we record a modco embedded derivative. The modco embedded derivative is recorded at fair value within amounts payable to reinsurers. Changes in the modco embedded derivative, which are equal to and offset by changes in the fair value of the assets, are reported in net gains and (losses).

Policyholders’ Deposits

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policyholders' Dividends and Dividend Obligations

Policyholders' dividends consist of the pro-rata amount of dividends earned that will be paid or credited at the next policy anniversary and policyholder dividend obligations arising from the Closed Block. Dividends are based on a scale that seeks to reflect the relative contribution of each group of policies to LSW's and National Life's overall operating results. The dividend scale is approved annually by the Board of Directors for the respective company.

Recognition of Insurance Revenues and Related Expenses

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

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

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

Federal Income Taxes

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.

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS

Adopted

Revenue Recognition
In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606).* The objective of the amendments in this ASU is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS) to improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets and provide more useful information to users of financial statements through improved disclosure requirements. Insurance contracts are specifically excluded from the guidance, but it is applicable to the Company's non-insurance revenues. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 for non-public entities to fiscal years beginning after December 15, 2018. The Company determined that the adoption of this standard did not have an impact on the Company's consolidated financial condition, results of operations or cash flows.

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS (continued)

Financial Instruments
In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The guidance requires several changes to equity investment reporting. For non-public entities, it is effective for fiscal years beginning after December 15, 2018. In April 2019, the FASB issued ASU 2019-04 *Codification Improvements to Derivatives and Hedging (Topic 815)* to clarify, correct errors in, or improve ASU 2016-01.

In February 2018, the FASB issued ASU 2018-03 *Technical Corrections and Improvements to Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* This guidance is intended to improve certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2018.

Effective January 1, 2019 the Company adopted the above standards. Adoption of these ASUs impacted the Company's accounting and presentation related to equity investments. The most significant impact is that the changes in fair value of equity securities previously classified as AFS are reported in net income within net gains (losses) in the Consolidated Statements of Comprehensive Income. Prior to this, the changes in fair value on equity securities classified as AFS were reported in AOCI. The impact of the implementation of this guidance resulted in a $45.8 million, net of tax, reclass from AOCI to retained earnings. The Company has also updated its disclosures where applicable.

Compensation – Retirement Plans
In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Plans (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* The guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2018. The amendments should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement cost in the income statement, and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The Company determined that the adoption of this standard did not have an effect on the Company's consolidated financial condition, results of operations or cash flows.

Cash Flow Statement
In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The guidance addresses eight specific cash flow issues such as debt prepayment and distributions received from equity method investees. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2018. The amendments should be applied using a retrospective transition method to each period presented. If this is impracticable, then the amendments should be applied prospectively as of the earliest date practicable. The adoption of this standard was applied retrospectively. The Company has updated its statement of cash flows to conform to the new guidance.

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS (continued)

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230).* This guidance addresses the classification and presentation of changes in restricted cash on the statement of cash flows. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2018. The amendments should be applied using a retrospective transition method to each period presented.

<u>Not Yet Adopted</u>

Leases
In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* which requires lease assets and lease liabilities to be recognized on the balance sheet, and key information about leasing arrangements to be disclosed. In March 2019, the FASB issued *ASU 2019-01 Leases (Topic 842)* which responds to several stakeholder inquiries regarding the implementation of ASU 2016-02. For non-public entities, it is effective for fiscal years beginning after January 1, 2021. Early application is permitted. The Company is currently assessing the impact of this standard. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial condition, results of operations or cash flows.

Credit Losses
In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The guidance requires financial assets not reported at fair value to be presented at the amount expected to be collected, rather than only reporting losses probable of occurring. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2023. Early application is permitted. This guidance will be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date.

In May 2019, the FASB issued ASU 2019-05 *Financial Instruments—Credit Losses (Topic 326)* to provide transition relief related to the guidance in ASU 2016-13. For entities that have not yet adopted ASU 2016-13, the effective date remains the same as in ASU 2016-13. The Company is currently assessing the impact the implementation of this guidance will have on its consolidated financial statements.

Compensation – Retirement Plans
In August 2018, the FASB issued ASU 2018-14 *Compensation-Retirement Plans-Defined Benefit Plans-General (Subtopic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans.* This guidance is intended to improve the effectiveness of defined benefit plan disclosures in the notes to the financial statements. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2021. Early application is permitted. The Company is currently assessing the impact of this standard. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial condition, results of operations or cash flows.

Receivables
In March 2017, the FASB issued ASU 2017-08 *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.* This guidance shortens the amortization period for certain callable debt securities held at a premium. For non-public entities, the pronouncement is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The amendments should be applied on a modified retrospective basis. The Company is currently assessing the impact the implementation of this guidance will have on its consolidated financial statements.

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS (continued)

Derivatives and Hedging – Targeted Improvements

In August 2017, the FASB issued ASU 2017-12 *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.* This guidance simplifies the application of the hedge accounting guidance and permits entities to better align the entity's risk management activities and financial reporting for hedging relationships. For non-public entities, the pronouncement is effective for fiscal years beginning after January 1, 2021. Early application is permitted. In April 2019, the FASB issued ASU 2019-04 *Codification Improvements to Derivatives and Hedging (Topic 815)* to clarify, correct errors in, or improve ASU 2017-12. The Company is currently assessing the impact of this standard. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial condition, results of operations or cash flows.

Long-Duration Contracts

In August 2018, the FASB issued ASU 2018-12 *Financial Services-Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts.* This guidance is intended to simplify and improve the recognition, measurement, presentation, and disclosure requirements for long-duration contracts issued by an insurance entity. For non-public entities, the pronouncement is effective for fiscal years beginning after January 1, 2024. Early application is still permitted. The Company is currently assessing the impact of this standard. The adoption of this standard is expected to have a material effect on the Company's consolidated financial condition and results of operations.

Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13 *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement.* This guidance is intended to improve the effectiveness of fair value disclosures in the notes to the financial statements. For all entities, the pronouncement is effective for fiscal years beginning after December 15, 2019. Early application is permitted. The Company is currently assessing the impact of this standard. The adoption of this standard is not expected to have a material effect on the Company's consolidated financial condition, results of operations or cash flows.

Income Taxes

In December 2019, the FASB issued ASC Update No. 2019-12 *Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes*. This ASC update removes certain exceptions to the general principles in ASC 740, Income Taxes, including intra-period tax allocation when there is a loss from continuing operations, foreign subsidiary treatment under certain conditions and calculating interim income taxes when the year-to-date loss exceeds the anticipated loss. This update also clarifies and amends existing guidance related to changes in tax laws, business combinations and employee stock plans, among others. The updated guidance is effective for fiscal years beginning after December 15, 2021 and interim periods within fiscal years beginning after December 15, 2022. Early adoption is permitted, including interim periods. The Company does not expect the adoption of ASC Update No. 2019-12 to have a material effect on its financial position or results of operations.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price).

Fair value measurement requires consideration of three broad valuation techniques: (i) the market approach, (ii) the income approach, and (iii) the cost approach. Entities are required to determine the most appropriate valuation technique to use, given what is being measured and the availability of sufficient inputs. The guidance prioritizes the inputs to fair valuation techniques and allows for the use of unobservable inputs to the extent that observable inputs are not available.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

The Company has categorized its assets and liabilities into a three-level hierarchy, based on the priority of the inputs to the respective valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The Company categorizes financial assets and liabilities recorded at fair value on the balance sheet as follows:

- **Level 1** - Unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities utilizing Level 1 inputs include equity securities listed in active markets, U.S. Treasury securities, and certain short term investments.

- **Level 2** - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data (market-corroborated inputs). The types of assets and liabilities utilizing Level 2 inputs generally include U.S. agency and government securities, mortgage-backed securities ("MBSs") and asset-backed securities ("ABSs"), corporate debt, private placement investments, preferred stocks, and derivatives, including options and interest rate swaps, and short term investments. Generally, the Company classifies debt securities in Level 2 as market activity is not deemed to be substantial enough to warrant classification as an active market. Separate account assets classified within this level are generally similar to those classified within this level for the general accounts.

- **Level 3** - Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimate about the assumptions market participants would use at the measurement date in pricing the asset or liability. Consideration is given to the risk inherent in both the method of valuation and the valuation inputs. Generally, the types of assets and liabilities utilizing Level 3 valuations are embedded derivative liabilities.

In many situations, inputs used to measure the fair value of an asset or liability position may fall into different levels of the fair value hierarchy. In these situations, the Company will determine the level in which the fair value falls based upon the lowest level input that is significant to the determination of the fair value. In most cases, both observable (e.g., changes in interest rates) and unobservable (e.g., changes in risk assumptions) inputs are used in the determination of fair values that the Company has classified within Level 3. Consequently, these values and the related gains and losses are based upon both observable and unobservable inputs. If inputs to pricing models that were previously unobservable become observable, then an asset or liability can be transferred from Level 3 to Level 2.

Determination of fair values

The Company determines the fair values of certain financial assets and financial liabilities based on quoted market prices where available and where prices represent fair value. The Company also determines fair value based on future cash flows discounted at the appropriate current market rate. Fair values reflect adjustments for counterparty credit quality, the Company's default spreads, liquidity, and, where appropriate, risk margins on unobservable parameters. In the event that the Company believes that quoted prices are not representative of the true market value, due to distressed sales or inactive markets, the Company may make adjustments to quoted prices to estimate fair value.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Valuation Techniques

Available-for-sale debt securities and short term investments - The fair value of AFS securities and short term investments in an active and orderly market (e.g. not distressed or forced liquidation) is determined by management after considering one of four primary sources of information: unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date, third-party pricing services, independent broker quotations, or pricing matrices. Security pricing is applied using a “waterfall” approach whereby publicly available prices are first sought from third-party pricing services; the remaining unpriced securities are submitted to independent brokers for prices; or lastly, securities are priced using an internal pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, and/or cash flows, and prepayments speeds. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third-party pricing services will normally derive the security prices from recent reported trades for identical or similar securities, making adjustments through the reporting date based upon available market observable information as outlined above. If there are no recent reported trades, the third-party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and are then discounted at a market rate.

Prices from third-party pricing services are often unavailable for securities that are rarely traded or are traded only in privately negotiated transactions. As a result, certain securities are priced via independent broker quotations which utilize inputs that may be difficult to corroborate with observable market based data. Additionally, the majority of these independent broker quotations are non-binding. A pricing matrix is used to price securities for which the Company is unable to obtain either a price from a third-party pricing service or an independent broker quotation, by discounting the expected future cash flows from the security by a developed market discount rate utilizing current credit spreads on comparable securities.

The Company has analyzed the third-party pricing services’ valuation methodologies and related inputs, and has also evaluated the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs. Money markets included in short term investments are valued using NAV as a practical expedient and are not categorized in the fair value hierarchy. Most prices provided by a third-party pricing service are classified into Level 2 because the inputs used in pricing the securities are market observable. Due to a general lack of transparency in the process that brokers use to develop prices, valuations that are based on brokers’ prices are classified as Level 3. Some valuations may be classified as Level 2 if the price can be corroborated.

Information specific to the valuation of certain classes of investment securities is as follows:

U.S. government obligations - The fair values of U.S. government obligations, which include U.S. Treasuries, are based on observable broker bids from active market makers and inter-dealer brokers, as well as yield curves from dealers for same or comparable issues. U.S. Treasury securities are actively traded and categorized in Level 1 of the fair value hierarchy.

Government agencies - Government agencies, authorities and subdivisions securities include U.S. agencies and municipal bonds. The fair values of municipal bonds are using market quotations from recently executed transactions, spread pricing models, as well as interest rates. Government agency securities are valued based on market observable yield curves, interest rates, and spreads. Municipal bonds and government agency securities are generally categorized as Level 2.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Valuation Techniques (continued)

Corporates - Corporate bonds as well as ABS are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads and are generally categorized as Level 2.

Private placements - Fair values of private placement securities are determined using industry accepted models based on observable spreads. These securities are generally categorized in Level 2 of the fair value hierarchy. However, in instances where significant inputs are unobservable, they are categorized as Level 3.

Mortgage backed securities - The fair value of the MBS are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads and are generally categorized as Level 2.

Included in the pricing of ABS, commercial mortgage-backed securities ("CMBS"), and residential mortgage-backed securities ("RMBS") are estimates of the rate of future prepayments of principal over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. Actual prepayment experience may vary from these estimates. RMBS consist primarily of FNMA and GNMA mortgage-backed securities.

Equity securities - The fair value of equity securities is based on unadjusted quoted market prices from a third party pricing service as well as primary and secondary broker quotes. These securities are generally categorized as Level 1 for common stocks and Level 2 for preferred stocks. Equity securities that are valued using NAV as a practical expedient are not categorized in the fair value hierarchy.

Trading debt securities - Fair values of exchange traded debt securities are based on unadjusted quoted market prices from pricing services as well as primary and secondary brokers/dealers. Trading debt securities are generally categorized as Level 2 of the fair value hierarchy.

Derivatives - Derivative instruments held by the Company include options, swaptions, interest rate swaps and futures contracts. Fair value of these over the counter ("OTC") derivative products is calculated using models such as the Black-Scholes option-pricing model, which uses pricing inputs observed from actively quoted markets, and is widely accepted by the financial services industry. The majority of the Company's OTC derivative products use this and other pricing models, and are categorized as Level 2. Fair values of futures are based on quoted prices which are observable and readily and regularly available in an active market. Therefore, futures are categorized as Level 1.

Other invested assets - Investments in limited partnerships are included in other invested assets. Limited partnerships do not have a readily determinable fair value, and as such, the Company values them at its pro-rata share of the limited partnership's NAV, or its equivalent. Investments in limited partnerships are not categorized in the fair value hierarchy. Also included in other invested assets are U.S. Treasuries held as restricted collateral, which are categorized as Level 1.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Valuation Techniques (continued)

Separate account assets - Separate account assets include assets supporting our variable products which are carried at fair value and categorized as Level 1. Separate account assets also include the assets of the Company's separately funded pension plans, which are primarily comprised of bonds. See Note 9 for additional information on the fair value hierarchy and valuation techniques for these pension plan assets. Separate account assets that are valued using NAV as a practical expedient are not categorized in the fair value hierarchy.

Policyholder account liabilities - Embedded derivatives contained in equity-indexed annuity and life contracts are included in policyholder account liabilities at fair value. The fair value of these derivatives is 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, using assumptions about market conditions and policyholder behavior. The fair value measurement incorporates an explicit risk margin for policyholder behavior and for the impact the Company's own credit or nonperformance risk would have in the view of a market participant. Given the significant unobservable inputs used to value embedded derivatives, they are included in Level 3.

Amounts payable to reinsurers – Modco embedded derivatives are carried at fair value and included in amounts payable to reinsurers. The fair value of modco embedded derivatives is measured at an amount equal to the unrealized gains (losses) of trading debt securities held in a segregated custody account in support of modified coinsurance arrangements. Accordingly, such modco embedded derivatives are categorized on a basis consistent with the related trading debt securities.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Financial Instruments Measured at Fair Value on a Recurring Basis

Presented below is the fair value of all assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 (in thousands):

Assets	**Level 1**	**Level 2**	**Level 3**	**Total**
AFS debt securities:				
U.S. government obligations	$ 287,738	$ —	$ —	$ 287,738
Government agencies, authorities and subdivisions	—	2,035,245	—	2,035,245
Corporates	—	15,552,267	225,859	15,778,126
Private placements	—	2,193,794	142,454	2,336,248
Mortgage-backed securities	—	3,262,742	—	3,262,742
Total AFS debt securities	287,738	23,044,048	368,313	23,700,099
Trading debt securities	—	135,619	1,011	136,630
Equity securities [2]	4,794	23,319	—	28,113
Derivative assets	13,295	1,395,775	—	1,409,070
Other invested assets [2]	162,789	—	—	162,789
Separate account assets [2]	15,011	332,193	—	347,204
Amounts recoverable from reinsurers	—	—	3,941	3,941
Total assets subject to fair value disclosure [2]	$ 483,627	$ 24,930,954	$ 373,265	$ 25,787,846

Liabilities	**Level 1**	**Level 2**	**Level 3**	**Total**
Policyholder account liabilities [1]	$ —	$ —	$ 2,417,948	$ 2,417,948
Amounts payable to reinsurers	—	4,556	—	4,556
Derivative liabilities	—	881,670	—	881,670
Total liabilities subject to fair value disclosure	$ —	$ 886,226	$ 2,417,948	$ 3,304,174

1. The most sensitive assumption in determining policy liabilities for indexed annuities is the rate used to discount the excess projected contract values. This discount rate reflects the Company's nonperformance risk. If the discount rates used to discount the excess projected contract values at December 31, 2019 were to change by approximately 100 basis points, the fair value of the embedded derivative would change significantly, partially offset by a change to deferred policy acquisition costs.
2. In accordance with Topic 820, certain investments that are measured at fair value using NAV (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. See Financial Instruments Measured Using NAV, below.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Financial Instruments Measured at Fair Value on a Recurring Basis (continued)

The table below summarizes the reconciliation of the beginning and ending balances and related changes for the year ended December 31, 2019 for fair value measurements for which significant unobservable inputs were used in determining each instrument's fair value (in thousands):

	Beginning Balance	Net Investment Gains/Loss In Earnings (realized and unrealized) [1]	Unrealized in OCI[2]	Purchases	Issuances	Sales	Settlements	Transfer In to Level 3	Transfer Out of Level 3	Ending Balance	Net Investment Gains/Losses In Earnings for Assets and Liabilities Still Held at the Ending Date
Assets											
Government agencies, authorities and subdivisions	$ 12,282	$ 276	$ (153)	$ —	$ —	$ (12,405)	$ —	$ —	$ —	$ —	$ —
Corporates	267,880	27	14,311	27,389	—	(49,385)	—	(34,363)	—	225,859	—
Private placements	—	9	(5)	122,510	—	(30)	—	19,970	—	142,454	—
Trading debt securities	—	17	—	994	—	—	—	—	—	1,011	—
Amounts recoverable from reinsurers	1,571	(1,241)	—	—	—	—	3,611	—	—	3,941	—
Total assets	$ 281,733	$ (912)	$ 14,153	$ 150,893	$ —	$ (61,820)	$ 3,611	$ (14,393)	$ —	$ 373,265	$ —
Liabilities											
Policyholder account liabilities	$ 1,970,049	$ 435,998	$ —	$ —	$ —	$ —	$ 11,901	$ —	$ —	$ 2,417,948	$ —
Total liabilities	$ 1,970,049	$ 435,998	$ —	$ —	$ —	$ —	$ 11,901	$ —	$ —	$ 2,417,948	$ —

1. Includes (losses) gains on sales of financial instruments, changes in fair value of certain instruments, and other-than-temporary impairments.
2. Includes changes in fair value of certain instruments.

Presented below is the fair value of all assets and liabilities subject to fair value determination as of December 31, 2018 (in thousands):

Assets	Level 1	Level 2	Level 3	Total
AFS debt securities:				
U.S. government obligations	$ 247,898	$ —	$ —	$ 247,898
Government agencies, authorities and subdivisions	—	1,853,843	12,282	1,866,125
Corporates	—	13,082,124	267,880	13,350,004
Private placements	—	1,667,507	—	1,667,507
Mortgage-backed securities	—	2,991,183	—	2,991,183
Total AFS debt securities	247,898	19,594,657	280,162	20,122,717
Trading debt securities	—	19,082	—	19,082
Equity securities (2)	7,147	22,133	—	29,280
Derivative assets	7,133	224,041	—	231,174
Other invested assets (2)	35,150	—	—	35,150
Separate account assets (2)	1,708	301,729	—	303,437
Amounts recoverable from reinsurers	—	—	1,571	1,571
Total assets subject to fair value disclosure (2)	$ 299,036	$ 20,161,642	$ 281,733	$ 20,742,411

Liabilities	Level 1	Level 2	Level 3	Total
Policyholder account liabilities (1)	$ —	$ —	$ 1,970,049	$ 1,970,049
Amounts payable to reinsurers	—	98	—	98
Derivative liabilities	—	102,391	—	102,391
Total liabilities subject to fair value disclosure	$ —	$ 102,489	$ 1,970,049	$ 2,072,538

1. The most sensitive assumption in determining policy liabilities for indexed annuities is the rate used to discount the excess projected contract values. This discount rate reflects the Company's nonperformance risk. If the discount rates used to discount the excess projected contract values at December 31, 2018 were to change by approximately 100 basis points, the fair value of the embedded derivative would change significantly with an offset to deferred policy acquisition costs.
2. In accordance with Topic 820, certain investments that are measured at fair value using NAV (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. See Financial Instruments Measured Using NAV, below.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Financial Instruments Measured at Fair Value on a Recurring Basis (continued)

The table below summarizes the reconciliation of the beginning and ending balances and related changes for the year ended December 31, 2018 for fair value measurements for which significant unobservable inputs were used in determining each instrument's fair value (in thousands):

	Beginning Balance	Net Investment Gains/Loss In Earnings (realized and unrealized) [1]	Unrealized in OCI[2]	Purchases	Issuances	Sales	Settlements	Transfer In to Level 3	Transfer Out of Level 3	Ending Balance	Net Investment Gains/Losses In Earnings for Assets and Liabilities Still Held at the Ending Date
Assets											
Government agencies, authorities and subdivisions	$ —	$ 131	$ 128	$ —	$ —	$ (1,226)	$ —	$ 13,249	$ —	$ 12,282	$ —
Corporates	—	(46)	(2,914)	249,641	—	(621)	—	21,820	—	267,880	—
Amounts recoverable from reinsurers	—	(1,119)	—	—	—	—	2,690	—	—	1,571	—
Total assets	$ —	$ (1,034)	$ (2,786)	$ 249,641	$ —	$ (1,847)	$ 2,690	$ 35,069	$ —	$ 281,733	$ —
Liabilities											
Policyholder account liabilities	$ 2,057,471	$ (56,542)	$ —	$ —	$ —	$ —	$ (30,880)	$ —	$ —	$ 1,970,049	$ —
Total liabilities	$ 2,057,471	$ (56,542)	$ —	$ —	$ —	$ —	$ (30,880)	$ —	$ —	$ 1,970,049	$ —

1. Includes (losses) gains on sales of financial instruments, changes in fair value of certain instruments, and other-than-temporary impairments.
2. Includes changes in fair value of certain instruments.

Financial Instruments Measured Using NAV

Presented below are investments that are measured using NAV as a practical expedient as of December 31, 2019 and 2018 (in thousands):

Assets	**Fair Value as of December 31, 2019**	**Fair Value as of December 31, 2018**	**Unfunded Commitments as of December 31, 2019**	**Redemption Frequency (If Currently Eligible)**	**Redemption Notice Period**
		(in thousands)			
Equity securities	**$ 34,769**	$ 26,080	**$ —**	Not applicable	Not applicable
Other invested assets	**825,435**	659,545	**513,701**	Not applicable	Not applicable
Short term investments	**161,450**	264,750	**—**	Not applicable	Not applicable
Separate account assets	**534,588**	466,326	**13,834**	Not applicable or Quarterly	Not applicable or 70 days
Total	**$ 1,556,242**	$ 1,416,701	**$ 527,535**		

NLV Financial Corporation and Subsidiaries
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NOTE 5 – INVESTMENTS

Available-for-Sale Debt Securities

The amortized cost and the fair values of AFS debt securities at December 31, 2019 and December 31, 2018 were as follows (in thousands):

At December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AFS debt securities:				
U.S. government obligations	**$ 255,218**	**$ 32,527**	**$ 7**	**$ 287,738**
Government agencies, authorities and subdivisions	**1,828,796**	**207,274**	**825**	**2,035,245**
Corporates:				
Asset-backed securities	**2,384,085**	**23,392**	**9,543**	**2,397,934**
Communications	**932,860**	**105,899**	**414**	**1,038,345**
Consumer & retail	**3,838,542**	**375,412**	**16,292**	**4,197,662**
Financial institutions	**2,676,450**	**301,185**	**962**	**2,976,673**
Industrial and chemicals	**1,868,333**	**186,683**	**3,761**	**2,051,255**
REITS	**516,131**	**27,832**	**6,533**	**537,430**
Transportation	**485,562**	**43,068**	**348**	**528,282**
Utilities	**1,893,086**	**165,949**	**8,490**	**2,050,545**
Total corporates	**14,595,049**	**1,229,420**	**46,343**	**15,778,126**
Private placements	**2,226,350**	**115,897**	**5,999**	**2,336,248**
Mortgage-backed securities	**3,106,562**	**162,373**	**6,193**	**3,262,742**
Total AFS debt securities	**$ 22,011,975**	**$ 1,747,491**	**$ 59,367**	**$ 23,700,099**

Available-for-Sale Debt Securities

At December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AFS debt securities:				
U.S. government obligations	$ 236,473	$ 11,583	$ 158	$ 247,898
Government agencies, authorities and subdivisions	1,843,645	51,708	29,228	1,866,125
Corporates:				
Asset-backed securities	1,605,742	6,955	18,935	1,593,762
Communications	964,589	26,511	35,140	955,960
Consumer & retail	3,872,828	57,226	174,743	3,755,311
Financial institutions	2,576,541	98,154	59,743	2,614,952
Industrial and chemicals	1,921,856	50,076	66,781	1,905,151
REITS	555,964	3,605	12,716	546,853
Transportation	437,765	10,294	12,965	435,094
Utilities	1,547,371	42,230	46,680	1,542,921
Total corporates	13,482,656	295,051	427,703	13,350,004
Private placements	1,691,088	20,749	44,330	1,667,507
Mortgage-backed securities	2,957,954	78,890	45,661	2,991,183
Total AFS debt securities	$ 20,211,816	$ 457,981	$ 547,080	$ 20,122,717

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt Securities (continued)

Unrealized gains (losses) included as a component of accumulated other comprehensive income as of December 31, 2019 and 2018 and changes therein included in other comprehensive income for the years ended December 31, 2019 and 2018 were as follows (in thousands):

	2019	2018
Balance, beginning of year	**$ 21,857**	$ 495,202
Net unrealized gains (losses) on AFS securities [1]	**1,816,498**	(1,137,106)
Net unrealized gains (losses) on separate accounts	**2,446**	(319)
Net unrealized (losses) gains on other invested assets	**(59,470)**	21,852
Deferred policy acquisition costs	**(463,650)**	296,886
Loss reserve	**(6,406)**	4,027
Reserves	**(150,927)**	101,654
Deferred income taxes [1]	**(203,914)**	125,819
Effect of ASU 2016-01 [1]	**(45,804)**	—
Policyholder dividend obligation	**(167,475)**	113,842
Increase (decrease) in net unrealized gains (losses)	**721,298**	(473,345)
Balance, end of year	**$ 743,155**	$ 21,857

	2019	2018
Balance, end of year includes:		
Net unrealized gains (losses) on AFS securities [1]	**$ 1,683,275**	$ (75,242)
Net unrealized gains on separate accounts	**10,674**	8,228
Net unrealized (losses) gains on other invested assets	**(295)**	59,175
Deferred policy acquisition costs	**(410,271)**	53,379
Loss reserve	**(10,700)**	(4,294)
Reserves	**(127,547)**	23,380
Deferred income taxes	**(197,548)**	(5,811)
Policyholder dividend obligation	**(204,433)**	(36,958)
Total	**$ 743,155**	$ 21,857

1. In accordance with ASU 2016-01, Financial Instruments—Overall (Topic 825), the classification of trading and AFS for equity securities was removed and changes in fair value are no longer classified as AOCI.

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt Securities (continued)

The amortized cost and fair values of debt securities by contractual maturity at December 31, 2019, are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized cost	Fair Value
Due in one year or less	**$ 375,193**	**$ 380,556**
Due after one year through 5 years	**3,435,744**	**3,580,533**
Due after 5 years through 10 years	**3,505,137**	**3,745,130**
Due after ten years	**11,589,339**	**12,731,138**
Mortgage-backed securities	**3,106,562**	**3,262,742**
Total	**$ 22,011,975**	**$ 23,700,099**

The Company determines the cost of investments sold based on average cost. The proceeds and gross realized gains (losses) on debt securities are shown below (in millions):

	2019	2018
Proceeds on debt securities	**$ 836.3**	$ 339.9
Gross realized gains on debt securities	**20.8**	1.6
Gross realized losses on debt securities	**(5.3)**	(4.3)

The Company recognized realized losses resulting from other-than-temporary declines in the fair value of debt securities of $30.9 million and $8.1 million in 2019 and 2018, respectively.

See Note 2 for additional information on the factors considered in determining whether declines in the fair value of investments are other-than-temporary.

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NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt Securities (continued)

Gross unrealized losses and investment fair values, aggregated by investment category, industry sector, and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2019 were as follows (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of securities						
U.S. government obligations	$ —	$ —	$ 2,640	$ 7	$ 2,640	$ 7
Government agencies, authorities and subdivisions	39,403	825	—	—	39,403	825
Corporates:						
Asset-backed securities	562,364	4,836	405,923	4,707	968,287	9,543
Communications	36,342	414	—	—	36,342	414
Consumer & retail	191,017	5,046	142,618	11,246	333,635	16,292
Financial institutions	40,994	362	19,400	600	60,394	962
Industrial and chemicals	108,484	1,642	46,349	2,119	154,833	3,761
REITS	1,280	30	19,297	6,503	20,577	6,533
Transportation	18,285	348	—	—	18,285	348
Utilities	136,416	1,934	44,904	6,556	181,320	8,490
Total corporates	1,095,182	14,612	678,491	31,731	1,773,673	46,343
Private placements	85,285	3,802	70,969	2,197	156,254	5,999
			132			
Mortgage-backed securities	183,629	3,259	,212	2,934	315,841	6,193
Total debt securities	$ 1,403,499	$ 22,498	$ 884,312	$ 36,869	$ 2,287,811	$ 59,367

Gross unrealized losses and investment fair values, aggregated by investment category, industry sector, and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2018 were as follows (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Description of securities						
U.S. government obligations	$ 52	$ 1	$ 7,984	$ 157	$ 8,036	$ 158
Government agencies, authorities and subdivisions	459,955	19,472	133,043	9,756	592,998	29,228
Corporates:						
Asset-backed securities	1,027,307	18,828	7,200	107	1,034,507	18,935
Communications	468,733	24,930	49,873	10,210	518,606	35,140
Consumer & retail	2,146,725	142,062	275,083	32,681	2,421,808	174,743
Financial institutions	1,231,533	52,933	125,246	6,810	1,356,779	59,743
Industrial and chemicals	970,067	58,841	91,186	7,940	1,061,253	66,781
REITS	215,933	3,971	96,326	8,745	312,259	12,716
Transportation	245,955	12,130	15,567	835	261,522	12,965
Utilities	715,111	32,336	118,416	14,344	833,527	46,680
Total corporates	7,021,364	346,031	778,897	81,672	7,800,261	427,703
Private placements	680,497	23,603	353,136	20,727	1,033,633	44,330
Mortgage-backed securities	590,123	9,897	750,277	35,764	1,340,400	45,661
Total debt securities	$ 8,751,991	$ 399,004	$ 2,023,337	$148,076	$ 10,775,328	$ 547,080

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt Securities (continued)

Based upon the Company's analysis of market factors affecting the fair value of debt securities, as well as facts and circumstances surrounding the individual securities, the Company's assessment around the probability of all contractual cash flows, and the Company's ability and intent to hold the individual securities to maturity or recovery, the Company believes that the unrealized losses on these securities at December 31, 2019 and 2018 were temporary.

The Company does not intend to sell these securities nor are there any requirements to sell these securities. The Company will continue to monitor these holdings for any underlying deterioration in future quarters that would indicate that an individual security will not recover and will record OTTI as appropriate.

Trading Debt Securities

Trading debt securities consist of fixed maturity securities held in a segregated custody account, which support a modified coinsurance arrangement that became effective in 2018. The cost of trading debt securities held at December 31, 2019 and 2018 was $136.6 million and $19.0 million, respectively.

Equity Securities

The cost equity securities held at December 31, 2019 and 2018 was $62.9 million and $55.4 million, respectively. The total return on certain equity investments is intended to offset the net appreciation or depreciation in value of certain defined contribution deferred compensation liabilities. The net change in deferred compensation liabilities is included in operating expenses.

NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate

The distributions of mortgage loans and real estate at December 31 were as follows (in thousands):

	2019	2018
Geographic Region		
New England	**6.4 %**	5.9 %
Middle Atlantic	**6.9**	6.8
East North Central	**9.5**	10.8
West North Central	**13.5**	12.4
South Atlantic	**20.1**	21.5
East South Central	**4.8**	4.8
West South Central	**10.1**	8.2
Mountain	**12.0**	13.3
Pacific	**16.7**	16.3
Total	**100.0 %**	100.0 %
Property Type		
Apartment	**21.5 %**	22.7 %
Retail	**24.3**	25.2
Office Building	**30.1**	31.5
Industrial	**18.3**	14.3
Other Commercial	**5.8**	6.3
Total	**100.0 %**	100.0 %
Mortgage loans	**3,718,391**	3,674,383
Real estate investments	**11,806**	16,210
Total mortgage loans and real estate	**$ 3,730,197**	$ 3,690,593

The Company applies a consistent and disciplined approach to evaluating and monitoring credit risk, and monitors credit quality on an ongoing basis. Quality ratings are based on internal evaluations of each loan's specific characteristics, considering a number of key inputs. The two most significant contributors to the credit quality are debt service coverage and loan-to-value ratios. The debt service coverage ratio measures the amount of property cash flow available to meet annual interest and principal payments on debt. The loan-to-value ratio ("LTV"), commonly expressed as a percentage, compares the amount of the loan to the fair value of the underlying property collateralizing the loan.

NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

The following tables summarize the credit quality of the Company's current commercial mortgage loan portfolio based on loan-to-value and debt service coverage ratios:

Debt Service Coverage Ratios as of December 31, 2019
(amounts in millions)

LTV Range	**≥ 2.0x**	**1.5x to <2.0x**	**1.25x to <1.5x**	**1.0x to <1.25x**	**<1.0x**	**Total Carrying Value**
< 50%	**708.5**	**$ 197.3**	**$ 43.7**	**$ 39.3**	**$ 15.0**	**$ 1,003.8**
50% - 60%	**963.4**	**392.3**	**50.3**	**23.3**	**7.4**	**1,436.7**
60% - 70%	**360.1**	**405.4**	**170.9**	**88.1**	**7.3**	**1,031.8**
70% - 80%	**12.6**	**79.0**	**44.2**	**9.7**	**—**	**145.5**
80% - 90%	**—**	**30.6**	**35.3**	**—**	**2.5**	**68.4**
> 90%	**—**	**3.7**	**11.2**	**7.4**	**10.6**	**32.9**
Total	**$ 2,044.6**	**$ 1,108.3**	**$ 355.6**	**$ 167.8**	**$ 42.8**	**$ 3,719.1**

Debt Service Coverage Ratios as of December 31, 2018
(amounts in millions)

LTV Range	≥ 2.0x	1.5x to <2.0x	1.25x to <1.5x	1.0x to <1.25x	<1.0x	Total Carrying Value
< 50%	674.6	$ 278.0	$ 28.1	$ 17.7	$ —	$ 998.4
50% - 60%	952.7	427.5	58.8	14.9	—	1,453.9
60% - 70%	280.3	365.7	103.8	15.0	—	764.8
70% - 80%	77.6	93.0	83.3	16.7	7.6	278.2
80% - 90%	40.2	20.0	49.5	2.3	0.8	112.8
> 90%	18.8	10.9	2.9	23.1	12.0	67.7
Total	$ 2,044.2	$ 1,195.1	$ 326.4	$ 89.7	$ 20.4	$ 3,675.8

The difference between the total carrying value reflected in the tables above and the carrying value reflected in the Consolidated Balance Sheets is due to the related valuation allowance which is a general valuation allowance not attributable to any one mortgage and the market value adjustment on the hedge.

Mortgage loans and related valuation allowances at December 31, 2019 and 2018 were as follows (in thousands):

	2019	**2018**
Commercial loans	**$ 3,720,613**	$ 3,679,204
Valuation allowance	**(1,300)**	(1,100)
Impaired loans	**(1,512)**	(3,335)
Market value adjustment on hedge	**590**	(386)
Total	**$ 3,718,391**	$ 3,674,383

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NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

The table below includes additional disclosures for impaired loans as of December 31, 2019 and 2018 (in thousands):

	2019	2018
Impaired loans:		
Average total investment	**$ 9,086**	$ 12,946
Interest income recognized	**201**	548
Interest received	**186**	533
Unpaid principal balance	**5,226**	12,946

The Company recognized mortgage loan impairments of $1.0 million 2018. No mortgage loan impairments were recognized in 2019.

The Company recognized real estate impairments of $0.8 million in 2018. No real estate impairments were recognized in 2019.

Activity in the valuation allowance for mortgage loans for the years ended December 31, 2019 and 2018 was as follows (in thousands):

	2019	2018
Balance, beginning of year	**$ 1,100**	$ 1,713
Changes to previously established valuation allowance	**200**	(613)
Balance, end of year	**$ 1,300**	$ 1,100

Mortgage Loans Modified in a Troubled Debt Restructuring

For a small portion of the Company's commercial mortgage loan portfolio classified as troubled debt restructuring, the Company grants concessions related to the borrowers' financial difficulties. Generally, the types of concessions include: 1) reduction of the contractual interest rate, 2) extension of the maturity date at an interest rate lower than current market interest rates and/or 3) a reduction of accrued interest. The Company considers the amount, timing and extent of the concession granted in determining any impairment or changes in the specific valuation allowance recorded in connection with the troubled debt restructuring. Through the portfolio monitoring process, the Company may have recorded a specific valuation allowance prior to the quarter when the loan was modified in a troubled debt restructuring. Accordingly, the carrying value (after specific valuation allowance) before and after modification through a troubled debt restructuring may not change significantly.

At December 31, 2019 and 2018, no loans were modified during the period in a troubled debt restructuring. Payment default is determined in the same manner as delinquency status, which is when interest and principal payments are 90 days past due.

NOTE 5 – INVESTMENTS (continued)

Other Invested Assets

Other invested assets included the following as of December 31, 2019 and 2018 (in thousands):

	2019	2018
Limited partnerships	**$ 814,760**	$ 651,316
Affordable housing tax credits	**130,038**	157,332
Non-cash broker collateral	**162,789**	35,150
FHLB common stock	**93,581**	79,682
Other	**35,266**	8,922
Other invested assets	**$ 1,236,434**	$ 932,402

Variable Interest Entities

The table below includes certain information regarding VIEs in which the Company held a variable interest as of December 31, 2019 and 2018 (in thousands).

	2019		2018	
Investment Type	**Total VIE Assets (1)**	**Maximum Exposure to Loss (2)**	Total VIE Assets (1)	Maximum Exposure to Loss (2)
Investment in notes	**$ 138,888**	**$ 138,888**	$ 17,116	$ 17,116
Other invested assets	**18,629**	**2,271**	33,483	1,005

1. Represents assets of the VIEs which the Company does not have the right to make use of to satisfy its own obligations.
2. Represents the Company's investments in these entities, plus any accrued receivables due from these entities.

Net Investment Income

The components of net investment income for the years ended December 31, 2019 and 2018 were as follows (in thousands):

	2019	2018
Debt securities interest	**$ 980,809**	$ 895,800
Equity securities dividends	**5,954**	5,849
Mortgage loan interest	**168,170**	155,535
Policy loan interest	**44,644**	43,109
Real estate income	**3,342**	8,564
Derivative income (loss)	**483,036**	(166,236)
Partnership income	**86,536**	66,997
Other investment income	**2,954**	6,044
Gross investment income	**1,775,445**	1,015,662
Less: investment expenses	**(34,586)**	(34,872)
Net investment income	**$ 1,740,859**	$ 980,790

NOTE 5 – INVESTMENTS (continued)

Net Gains and (Losses)

The following summarizes the components of net gains and (losses), including other-than-temporary impairments, by asset category for the years ended December 31, 2019 and 2018 (in thousands):

	2019	2018
Debt securities	**$ (11,494)**	$ (6,187)
Equity securities	**6,760**	(3,599)
Mortgage loans	**(787)**	(627)
Partnerships	**(19,449)**	(9,531)
Other invested assets	**(5,756)**	857
Real estate	**(102)**	(405)
Embedded derivative	**(4,556)**	(98)
Debt retirement	**(688)**	(3,890)
Impairment of software	**(2,786)**	—
Total	**$ (38,858)**	$ (23,480)

Derivatives

The Company enters into interest rate swaps to reduce market risks from changes in interest rates. These swaps are used to hedge changes in fair value of certain bond and mortgage investments. The Company has designated interest rate swaps as fair value hedges. The interest rate swaps are used to convert fixed rate assets to floating rate. The Company recognizes gains and losses on the swaps along with the related hedged items within net investment income on the Consolidated Statements of Comprehensive Income. Ineffectiveness recognized through net investment income in the years ended December 31, 2019 and 2018 was $1.0 million and $0.7 million respectively.

The Company credits interest on policyholder account liabilities for certain of its products based on the performance of certain indexes (which include but are not limited to the S&P 500, Russell 2000, or MSCI Emerging Markets), subject to contractual participation rates and caps on returns. These participation rates and caps are set each policy anniversary. The Company economically hedges the exposure for the next policy year, at the time the participation rates and caps are set, by entering into over-the-counter (OTC) options and exchange-traded futures contracts on the underlying indexes in an amount that approximates the obligation of the Company to credit interest at the policy anniversary, with adjustments for lapse assumptions. These derivative instruments do not qualify for hedge accounting and, therefore, changes in their fair value are included within net investment income. Call options purchased are included in derivatives assets at fair value. Call options written are included in derivatives liabilities and are carried at fair value. Since the derivatives purchased are based on the same indexes that the crediting rates are based upon, they substantially offset the market risk associated with the crediting rate in the policy year being hedged.

Under U.S. GAAP, indexed annuity and life contracts reported in policyholder account liabilities include embedded derivatives, which reflect the fair value of the Company's future obligations related to interest crediting that is based on the performance of certain indexes, as specified in the respective contracts. The embedded derivative liabilities were $2.42 billion and $1.97 billion at December 31, 2019 and 2018, respectively.

NOTE 5 – INVESTMENTS (continued)

Derivatives (continued)

The Company purchases options only from highly rated counterparties. However, in the event a counterparty failed to perform, the Company's loss would be equal to the fair value of the net options held from that counterparty. The Company held collateral from counterparties as secured OTC call options to mitigate a portion of this risk in the amount of $469.2 million and $83.9 million as of December 31, 2019 and 2018, respectively. The Company utilizes a scale based on credit rating of the counterparty to determine the appropriate amount of counterparty risk. As of December 31, 2019, there was no derivative counterparty exposure that exceeded $19.8 million, net of collateral.

The Company has embedded derivatives related to reinsurance contracts that are accounted for on a modified coinsurance basis. An embedded derivative exists because the arrangement exposes the reinsurer to third party credit risk. The embedded derivative is included in amounts recoverable from/payable to reinsurers, with changes in the fair value of the embedded derivative reported in net gains and (losses).

The notional amounts and the fair value of derivatives at December 31, 2019 and 2018, excluding embedded derivatives, were as follows (in thousands):

		2019		2018		Primary Underlying
		Notional	**Fair Value**	**Notional**	**Fair Value**	**Risk Exposure**
Options purchased		**$ 11,962,530**	**1,382,967**	$ 10,034,550	$ 198,071	Equity market
Options written		**(10,663,430)**	**(876,635)**	(9,113,170)	(102,391)	Equity market
Swaptions purchased		**200,000**	**122**	200,000	676	Interest rates
Interest rate swaps	(1)	**255,454**	**7,651**	597,425	25,294	Interest rates
Futures purchased		**30,748**	**13,295**	82,195	7,133	Equity market
Net fair market value			**$ 527,400**		$ 128,783	

1. Interest rates swaps are reflected net of cash margin collateral of $12.6 million and $9.9 million as of December 31, 2019 and 2018, respectively, in the Consolidated Balance Sheets.

NOTE 6 – REINSURANCE

The Company reinsures certain risks assumed in the normal course of business. Effective in March 2018, for certain indexed universal life products, the Company may retain up to $4 million of risk on an individual life. For other individual life products sold on or after August 16, 2004, the Company generally retains no more than $2 million of risk on any person (excluding accidental death benefits and dividend additions). For individual life products sold after 2001 but prior to August 16, 2004, the Company generally retains no more than $1 million of risk on any person (excluding accidental death benefits and dividend additions). On individual life business issued prior to 2002, the Company generally retains no more than $3 million of risk (excluding accidental death benefits and dividend additions). Reinsurance for life products is ceded under yearly renewable term, coinsurance, and modified coinsurance agreements with various reinsurers.

Disability income products are reinsured under coinsurance and modified coinsurance agreements primarily with Unum Provident Corporation ("UNUM"). Under the terms of the agreements, the Company has agreed to pay UNUM an interest rate of 9.5% on the reserves of original modified coinsurance block and 7.0% on the other modified coinsurance reserves held by the Company.

Other income includes $4.0 million and $5.1 million in 2019 and 2018, respectively, related to the Company's disability income reinsurance. Such income is largely offset by expenses incurred by the Company related to this block of business. Reserve transfers and interest payments under modified coinsurance agreements are

NOTE 6 – REINSURANCE (continued)

included in the Consolidated Statements of Comprehensive Income as a component of decrease in policy liabilities expense.

Effective October 1, 2018, new issuances of certain of our indexed annuity products are subject to a quota share modified coinsurance arrangement with an unaffiliated reinsurer. The quota share ceded is currently 50% and may be adjusted for future sales. As the ceding company we retain the reserves, as well as the assets backing those reserves, and the reinsurer shares proportionally in all financial terms of the reinsured policies based on their respective percentage of the risk.

The Company has entered into reinsurance agreements to cede statutory reserves for certain term and universal life products, that are subject to statutory reserve requirements resulting from the NAIC Model Regulation “Valuation of Life Insurance Policies” (Regulation XXX) and NAIC Actuarial Guideline 38 (Guideline AXXX), to an unaffiliated reinsurer. Under U.S. GAAP, these reinsurance transactions are subject to deposit accounting with a reinsurance risk charge which will be recorded in interest expense. Effective December 31, 2018, the Company entered into an agreement to cede approximately $59.7 million of statutory reserves for certain term products.

The effects of reinsurance for the years ended December 31, 2019 and 2018 were as follows (in thousands).

	2019	2018
Insurance premiums:		
Direct	**$ 280,944**	$ 269,087
Reinsurance assumed	**835**	839
Reinsurance ceded	**(48,523)**	(52,685)
Total insurance premiums	**$ 233,256**	$ 217,241
Decrease in policy liabilities:		
Direct	**$ (62,282)**	$ (143,848)
Reinsurance assumed	**—**	—
Reinsurance ceded	**49,587**	60,086
Total decrease in policy liabilities	**$ (12,695)**	$ (83,762)
Policy benefits:		
Direct	**$ 555,476**	$ 624,326
Reinsurance assumed	**—**	—
Reinsurance ceded	**(68,535)**	(87,513)
Total policy benefits	**$ 486,941**	$ 536,813
Policyholders’ dividends:		
Direct	**$ 46,759**	$ 40,427
Reinsurance ceded	**(260)**	(203)
Total policyholders’ dividends	**$ 46,499**	$ 40,224

The Company remains liable in the event any reinsurer is unable to meet its assumed obligations. The Company regularly evaluates the financial condition of its reinsurers and concentrations of credit risk of reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. The Company’s largest reserve credit as of December 31, 2019 and 2018 was with Hannover Life Reinsurance Company of America for $515.5 million and $479.4 million, respectively. Total life insurance in force subject to reinsurance as of December 31, 2019 and 2018 was approximately $ 173.3 billion and $142.3 billion, respectively.

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NOTE 6 – REINSURANCE (continued)

The Company assumes a small amount of reinsurance from other companies. These reinsurance arrangements provide for greater diversification of business, allow management to control exposure to potential losses, and provide additional capacity for growth.

NOTE 7 – DEFERRED POLICY ACQUISITION COSTS

The table below reflects the changes in the deferred policy acquisition costs asset for the years ended December 31, 2019 and 2018.

(in thousands)	2019	2018
Balance, beginning of year	**$ 2,093,111**	$ 1,539,129
Acquisition costs deferred	**595,010**	507,138
Amortization	**(367,769)**	(250,042)
Adjustment through other comprehensive income	**(463,651)**	296,886
Balance, end of year	**$ 1,856,701**	$ 2,093,111

The components of the sales inducement asset ("SIA") are shown below (amounts in millions):

	SIA	
	2019	2018
Beginning of year	**$ 149.7**	$ 123.1
Deferral	**37.5**	34.8
Amortization and assumption changes, net	**(19.3)**	(8.2)
End of year	**$ 167.8**	$ 149.7

NOTE 8 – FEDERAL INCOME TAXES

The Company files income tax returns in the U.S. federal and certain state jurisdictions. The Company is no longer subject to U.S federal, state, and local income tax examinations by tax authorities for years prior to 2010, 2014, and 2015. The Company's 2010 through 2013 consolidated federal income tax returns are under examination by the IRS.

The components of federal income taxes and a reconciliation of the expected and actual federal income taxes and income tax rates for the years ended December 31 were as follows (in thousands):

	2019		2018	
	Amount	**Rate**	Amount	Rate
Current	**$ 89,641**		$ (7,980)	
Deferred	**(33,140)**		31,540	
Total income tax expense	**$ 56,501**		$ 23,560	
Expected income taxes	**$ 58,809**	**21.0%**	$ 36,459	21%
Dividends received deduction	**(841)**	**(0.3)**	(410)	(0.2)
Affordable housing tax credits	**(27,125)**	**(9.7)**	(28,421)	(16.4)
Corporate owned life insurance	**(2,914)**	**(1.0)**	(2,968)	(1.7)
Enacted change in tax rate	**634**	**0.2**	(6,169)	(3.6)
State income taxes	**3,128**	**1.1**	936	0.5
Other, net	**2,809**	**1.0**	(359)	(0.1)
Total without amortization	**$ 34,500**		$ (932)	
Effective rate without amortization		**12.3%**		-0.5%
Affordable housing tax credit amortization	**$ 22,001**	**7.9**	$ 24,492	14.1
Total income tax expense	**$ 56,501**		$ 23,560	
Effective federal income tax rate		**20.2%**		13.6%

The Company received $7.4 million and paid $47.7 million in federal income taxes during 2019 and 2018, respectively.

A reconciliation of the beginning to ending amount of unrecognized tax benefits is as follows (in thousands):

	2019	2018
Balance, beginning of year	**$ 6,469**	$ 7,817
Reductions based on tax positions related to current year	**(1,348)**	(1,348)
Balance, end of year	**$ 5,121**	$ 6,469

Total unrecognized tax benefits, including interest and penalties, were $9.9 million at December 31, 2019, including $7.9 million that would impact net income if recognized. It is reasonably possible that the amount of the Company's unrecognized tax benefits could change within the next twelve months due to the settlement of outstanding audit issues with the IRS. Accordingly, the Company believes it is reasonably possible that its existing unrecognized tax benefits may be reduced by an amount up to $9.9 million within the next twelve months.

NOTE 8 – FEDERAL INCOME TAXES (continued)

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. During the years ended December 31, 2019 and 2018, the Company recognized approximately $0.7 million in expense related to interest and penalties. The Company had approximately $4.8 million and $4.0 million accrued for interest and penalties at December 31, 2019 and 2018, respectively.

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

	2019	2018
Deferred income tax assets:		
Policy liabilities	**$ 403,668**	$ 222,525
Pension and other employee benefits	**42,252**	37,830
Loss carryforwards	**847**	26,605
Tax credits	**—**	9,312
Net UCL AFS debt/equity securities	**—**	6,370
Other	**—**	—
Total deferred income tax assets	**446,767**	302,642
Deferred income tax liabilities:		
Deferred policy acquisition costs	**278,785**	348,326
Debt/equity securities	**13,982**	11,760
Other invested assets	**25,284**	12,127
Net UCG AFS debt/equity securities	**363,218**	—
Property and equipment	**22,759**	20,378
Other	**410**	1,304
Total deferred income tax liabilities	**704,438**	393,895
Total net deferred income tax liabilities	**$ 257,671**	$ 91,253

Management believes it is more likely than not that the Company will realize the benefit of deferred tax assets. Therefore, no valuation allowance was recorded as of December 31, 2019 or 2018.

At December 31, 2019, the Company had $4.0 million federal operating loss carryforwards with no expiration date and no tax credit carryforwards.

NOTE 9 – BENEFIT PLANS

The Company sponsors a qualified defined benefit pension plan covering substantially all employees. The plan is non-contributory, with benefits for National Life employees hired prior to July 1, 2001, based on an employee's retirement age, years of service, and compensation near retirement. Benefits for National Life employees hired after June 30, 2001, and other Company employees, are based on the amount credited to the employee's account each year, which is a factor of the employee's age, service, and compensation, increased at a specified rate of interest. 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 National Life. None of the securities held in the Company's separate account were issued by the Company.

The Company sponsors other pension plans, including a non-contributory defined benefit plan for National Life 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 postemployment 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.

NOTE 9 – BENEFIT PLANS (continued)

Information with respect to the defined benefit plans as of and for the years ended December 31, 2019 and 2018 was as follows (in thousands):

	Pension Benefits		Other Benefits	
	2019	2018	**2019**	2018
Change in benefit obligation:				
Benefit obligation, beginning of year	**$ 431,145**	$ 457,354	**$ 25,086**	$ 26,709
Service cost for benefits earned during the period	**8,391**	8,450	**241**	238
Interest cost on benefit obligation	**17,428**	16,416	**984**	921
Plan participants' contributions	**—**	—	**—**	1,166
Actuarial losses (gains)	**68,834**	(23,380)	**19**	(1,475)
Settlement/curtailment	**(13,645)**	(2,605)	**—**	—
Plan amendment	**—**	12	**1,204**	—
Benefits paid	**(23,857)**	(25,102)	**(2,415)**	(2,473)
Benefit obligation, end of year	**488,296**	431,145	**25,119**	25,086
Change in plan assets:				
Plan assets, beginning of year	**346,949**	326,670	**—**	—
Actual (losses) income on plan assets	**64,592**	(10,393)	**—**	—
Employer contributions	**22,888**	58,379	**1,211**	1,306
Settlement/curtailment	**(13,645)**	(2,605)	**—**	—
Plan participants' contributions	**—**	—	**1,204**	1,167
Benefits paid	**(23,857)**	(25,102)	**(2,415)**	(2,473)
Plan assets, end of year	**396,927**	346,949	—	—
Funded Status	**$ (91,369)**	$ (84,196)	**$ (25,119)**	$ (25,086)

	Pension Benefits		Other Benefits	
	2019	2018	**2019**	2018
Amounts recognized in the Consolidated Balance Sheets as of December 31,:				
Pension and other post-retirement benefit obligations liability	**$ (43,032)**	$ (43,598)	**$ 23,427**	$ 23,533
Accumulated other comprehensive income	**134,401**	127,794	**1,692**	1,553
Net amount recognized	**$ 91,369**	$ 84,196	**$ 25,119**	$ 25,086
Pension and other post-retirement benefit obligations liability	**$ (91,369)**	$ (84,196)	**$ (25,119)**	$ (25,086)
Amounts recognized in accumulated other comprehensive income consists of:				
Net actuarial loss	**$ 134,301**	$ 127,680	**$ 1,692**	$ 1,553
Net prior service cost	**100**	114	**—**	—
	$ 134,401	$ 127,794	**$ 1,692**	$ 1,553

NOTE 9 – BENEFIT PLANS (continued)

The total accumulated benefit obligation ("ABO"), the accumulated benefit obligation and fair value of plan assets for the Company's pension plans with accumulated benefit obligations in excess of plan assets, and the projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets as of the measurement date was as follows as of December 31, 2019 and 2018 (in thousands):

	2019	2018
Total Accumulated Benefit Obligation	**$ 447,934**	$ 407,651
Plans with ABO in excess of plan assets:		
ABO	**447,934**	407,651
Fair value of plan assets (1)	**396,897**	346,971
Plans with PBO in excess of plan assets:		
PBO	**488,296**	431,145
Fair value of plan assets (1)	**396,897**	346,971

(1) The difference to total plan assets shown on the prior page is due to accrual for income and liabilities that are not carried at fair value.

The components of net periodic benefit cost for the years ended December 31, 2019 and 2018 were as follows (in thousands):

	Pension Benefits		**Other Benefits**	
	2019	2018	**2019**	2018
Service cost for benefits earned during the period	**$ 8,391**	$ 8,450	**$ 241**	$ 238
Interest cost on benefit obligation	**17,428**	16,416	**983**	921
Expected income on plan assets	**(17,816)**	(21,083)	—	—
Net amortization of actuarial losses (gains)	**10,356**	10,610	**(119)**	144
Settlement/curtailment	**5,081**	896	**—**	—
Amortization of prior service benefits and plan amendments	**14**	14	**—**	—
Net periodic benefit cost (included in operating expenses)	**$ 23,454**	$ 15,303	**$ 1,105**	$ 1,303

Other changes in plan assets and benefit obligations recognized in other comprehensive income (in thousands):

	Pension Benefits		**Other Benefits**	
	2019	2018	**2019**	2018
Net gain (loss)	**$ (22,058)**	$ (8,095)	**$ (19)**	$ 1,475
Prior service cost	**—**	(12)	**—**	—
Amortization of loss	**10,356**	10,610	**(119)**	144
Amortization of prior service cost (benefits)	**14**	14	**—**	—
Recognition of settlement loss	**5,081**	896	**—**	—
Total recognized in other comprehensive income	**$ (6,607)**	$ 3,413	**$ (138)**	$ 1,619

Over the next year, the estimated amount of amortization from accumulated other comprehensive income into net periodic benefit cost related to net actuarial losses and prior service benefit is $9.4 million and $14 thousand, respectively.

NOTE 9 – BENEFIT PLANS (continued)

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

	Pension Benefits		Other Benefits	
	2019	2018	**2019**	2018
Discount rate	**3.35%**	4.25%	**3.35%**	4.25%
Rate of increase in future compensation levels	**4.0% - 5.0%**	3.0% - 5.0%		

The weighted-average assumptions used to determine net periodic benefit cost:

	Pension Benefits		Other Benefits	
	2019	2018	**2019**	2018
Discount rate	**4.25%**	3.65%	**4.25%**	3.65%
Rate of increase in future compensation levels	**3.0% - 5.0%**	3.0% - 5.0%		
Expected long term return on plan assets	**5.30%**	6.50%		

Included in the pension and other post-retirement benefit obligations liability as reported on the Consolidated Balance Sheets are deferred compensation and employee disability liabilities of $49.3 million and $40.1 million as of December 31, 2019 and 2018, respectively.

Assumed health care cost trend rates (“HCCTR”) at December 31, 2019:

Weighted average health care cost trend rate assumed for next year	6.43%
Rate to which the cost trend rate is assumed to decline	5%
Year that the rate reaches the ultimate trend rate	2026

Increasing the assumed HCCTR by one percentage point in each year would increase the accumulated post-retirement benefit obligation (“APBO”) by about $0.1 million and would increase service and interest costs by less than $0.1 million. Decreasing the assumed HCCTR by one percentage point in each year would reduce the APBO by approximately $0.1 million and would reduce service and interest costs by less than $0.1 million.

The Company uses the straight-line method of amortization for prior service cost and unrecognized gains and losses.

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

Plan Asset Category	**December 31, 2019**	December 31, 2018
Fixed income	**90%**	94%
Equities	**0%**	0%
Group annuity contract and other	**10%**	6%
Total	**100%**	100%

The primary objective is to maximize long-term total return within the investment policy and guidelines. The Company’s investment policy for the plan assets associated with the separately funded plans is to maintain a target allocation of approximately 90%-100% fixed income and 0–10% alternative investments when measured at fair value.

The Company’s expected future long-term rate of return of 5.30% is based upon the combination of current asset mix of equities and fixed income, the Company’s historical and projected experience, and on long-term projections by investment research organizations.

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NOTE 9 – BENEFIT PLANS (continued)

The concentrations of credit risk associated with the plan assets are shown in the table below (in thousands):

		2019	2018
Fixed income	Aerospace/Defense	**$ 10,598**	$ 9,284
	Airlines	**692**	688
	Automotive	**2,451**	3,109
	Banking	**39,133**	31,681
	Cable	**6,603**	5,431
	Chemicals	**3,636**	3,264
	Consumer products	**13,412**	7,930
	Food and Beverage	**13,243**	12,052
	Government agency	**25,593**	29,021
	Health Care	**10,628**	9,189
	Housing	**10,946**	10,110
	Insurance - Health	**3,812**	3,294
	Insurance - Property and Casualty	**18,192**	15,518
	Insurance - Life	**5,441**	4,496
	Independent	**2,919**	2,480
	Integrated	**4,687**	3,977
	Local authorities	**10,896**	10,082
	Machine Construction	**2,846**	5,690
	Manufacturing	**3,003**	3,546
	Media	**5,914**	5,078
	Metals/Mining	**10,197**	8,555
	Midstream	**3,128**	3,001
	Pharmaceuticals	**16,267**	13,923
	Railroads	**16,509**	14,027
	Real Estate Investment Trusts	**3,970**	3,367
	Retailers	**9,021**	12,584
	Technology	**23,123**	19,192
	Transportation	**10,808**	9,596
	Utilities	**33,088**	31,143
	Wireless	**3,387**	2,889
	Wirelines	**5,051**	4,429
	Bond Funds	**25,323**	22,901
	Total fixed income	**354,516**	321,527
Partnerships		**24,801**	20,721
Cash		**14,180**	1,038
Group annuity		**400**	587
	Total Investments (1)	**$ 393,897**	$ 343,873

(1) The difference to total plan assets of $396,927 in 2019 and $346,949 for 2018 shown in the changes in plan assets are accruals for income and liabilities.

The assets of the Company’s separately funded pension plans are held in the Company’s separate account.

NOTE 9 – BENEFIT PLANS (continued)

The valuation techniques used for the plan assets are:

Corporates – Corporate bonds are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads. Corporate bonds are categorized as Level 2 in the fair value hierarchy. Bond mutual funds that have a readily determinable NAV are not categorized in the fair value hierarchy.

Partnerships - Investments in limited partnerships do not have a readily determinable fair value, and, as such, the Company values them at its pro-rata share of the limited partnership's NAV, or its equivalent. Investments in limited partnerships are not categorized in the fair value hierarchy.

Group annuity - This category consists of an investment in a National Life group variable annuity contract. The contract is carried at amortized cost, which approximates fair value. These assets are categorized in Level 2 of the hierarchy.

The valuation of plan assets as of December 31, 2019 and 2018 is as follows (in thousands):

2019 Fair Value	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Corporates [(1)]	**$ —**	**$ 332,192**	**$ —**	**$ 332,192**
Cash	**14,180**	**—**	**—**	**14,180**
Group annuity	**—**	**400**	**—**	**400**
Total Plan Assets [(1)]	**$ 14,180**	**$ 332,592**	**$ —**	**$ 346,772**

2018 Fair Value	Level 1	Level 2	Level 3	Total
Assets				
Corporates [(1)]	$ —	$ 301,729	$ —	$ 301,729
Cash	1,038	—	—	1,038
Group annuity	—	587	—	587
Total Plan Assets [(1)]	$ 1,038	$ 302,316	$ —	$ 303,354

1. In accordance with Topic 820, certain investments that are measured at fair value using NAV (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. As of December 31, 2019, the fair value of these investments in corporates and partnerships were $25,323 and $24,801, respectively. As of December 31, 2018, the fair value of these investments in corporates and partnerships were $22,901 and $20,721, respectively.

NOTE 9 – BENEFIT PLANS (continued)

Projected benefit payments for defined benefit obligations, and for projected Medicare Part D reimbursements for each of the five years following December 31, 2019, and in aggregate for the five years thereafter is as follows (in thousands):

Year	Projected Pension Benefit Payments	Projected Other Benefit Payments	Projected Medicare Part D Reimbursements
2020	$ 28,033	$ 1,590	$ 51
2021	28,225	1,615	57
2022	28,102	1,648	62
2023	28,896	1,661	66
2024	31,056	1,678	69
2025-2029	152,719	7,403	401

The Company's general policy is to contribute the regulatory minimum required amount into its separately funded defined benefit pension plan. However, the Company may elect to make larger contributions subject to maximum contribution limitations. The Company's expected contribution for 2020 into its separately funded defined benefit pension plans is anticipated to be up to $0.5 million.

The Company provides employees with a 401(k) plan. Under the Company's 401(k) plan for employees, eligible employees earning less than a specified amount receive a 75% match up to 6% of an employee's salary, subject to maximum contribution guidelines. Employees earning more than the specified amount receive a 50% match up to 6% of an employee's salary, subject to maximum contribution guidelines. Additional employee voluntary contributions may be made to the plans subject to contribution guidelines. Vesting and withdrawal privilege schedules are attached to the Company's matching contributions. Effective January 1, 2016, agency employees became a part of the employee 401(k) plan with the same matching contributions as home office employees.

The Company also provides a 401(k) plan for its regular full-time agents. The Company makes an annual contribution equal to 6.1% of an agent's compensation up to the Social Security Taxable Wage Base plus 7.5% of the agent's compensation in excess of the Social Security Taxable Wage Base. In addition, the agent may elect to defer a portion of the agent's compensation, up to the legal limit on elective deferrals, and have that amount contributed to the plan. Total annual contributions cannot exceed certain limits which vary based on total agent compensation.

For all of the Company's 401(k) plans, accumulated funds may be invested in a group annuity contract issued by National Life or in mutual funds. These plans are not separately funded. Costs associated with these plans are included in operating expenses. Liabilities for these plans are included in pension and other post-retirement benefit obligations.

NOTE 10 – DEBT

Debt consists of the following (in thousands):

	2019	2018
7.5% Senior Notes:	**$ 198,281**	$ 198,158
$200 million, maturing August 2033, interest payable semiannually on February 15 and August 15. The notes are unsecured and subordinated to any existing or future indebtedness of NLVF and its subsidiaries.		
6.5% Senior Notes:	**67,475**	67,439
Original issue of $75 million, maturing March 2035, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of NLVF and its subsidiaries. In 2009, the Company's subsidiary, National Life repurchased $7.0 million of the senior notes. Interest paid to the subsidiary is eliminated in consolidation.		
10.5% Surplus Notes:	**166,304**	167,449
Original issue of $200 million, maturing September 15, 2039, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of National Life.		
5.25% Surplus Notes:	**482,620**	357,820
$500 million, maturing July 19, 2068, interest payable semiannually on January 19 and July 19. The notes are unsecured and subordinated to any existing or future indebtedness of National Life.		
Total debt	**$ 914,680**	$ 790,866

In July 2018, the Company issued surplus notes with a principal balance of $350 million 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 equal to the Three-month USD LIBOR rate plus 3.314%. The surplus notes are redeemable by the Company on or after July 19, 2048. In July 2018, National Life also completed an exchange transaction, in which it issued an additional $22.1 million of the 5.25% surplus notes in exchange for its 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 recognized in interest expense over the life of the 5.25% surplus notes. In April 2019, the Company issued an additional $128 million of the 2068 5.25% surplus notes, which brought the total of that issuance to $500 million.

In 2019 and 2018, National Life repurchased $1.2 million and $7.1 million, respectively, of the outstanding 10.5% surplus notes. Losses of $0.7 million and $3.9 million were recorded on the repurchases and included in net gains and (losses) in 2019 and 2018, respectively.

Interest paid on the 7.5% senior notes was $15.0 million in 2019 and in 2018. Interest paid on the 6.5% senior notes was $4.9 million in 2019 and 2018. Interest paid on the 10.5% surplus note was $17.7 million in 2019 and $19.8 million in 2018. Interest paid on the 5.25% surplus note was $21.0 million in 2019. No interest was paid on the 5.25% surplus note in 2018.

National Life and LSW have secured asset-based borrowing capacity of $1.4 billion with FHLB Boston and $4.2 billion with FHLB Dallas, respectively. For additional information on FHLB, see Note 2.

NOTE 11 – COMMITMENTS AND CONTINGENCIES

The Company is subject, in the ordinary course of business, to claims, litigation, arbitration proceedings, and governmental examinations. Although the Company is not aware of any actions, proceedings or allegations that reasonably should give rise to a material adverse impact to the Company’s financial position or liquidity, the outcome of any particular matter cannot be foreseen with certainty. It is the opinion of management that the ultimate resolution of these matters will not materially impact the Company’s financial condition.

The Company is also involved in class action or putative class action litigation. On September 24, 2010, three individuals (including two former policyholders and one now former policyholder) brought a putative class action against LSW concerning their purchases of indexed universal life insurance policies sold in California (SecurePlus Provider and SecurePlus Paragon), before the U.S. District Court for the Central District of California and captioned Walker, et al. v. Life Ins. Co. of the Southwest. Plaintiffs asserted claims under the California Unfair Competition Law and for fraudulent concealment, alleging that the Company and independent agents did not sufficiently and/or appropriately disclose, in illustrations and otherwise, certain features of the policies, including the amount and duration of certain charges and fees set forth in the policies themselves, the method by which policy values are calculated under the policies, and the potential tax treatment for policy loans under certain circumstances. A jury trial on the fraudulent concealment claims was held in April 2014 and resulted in a defense verdict. No liability was found and no damages awarded. In an Order dated April 14, 2015, U.S. District Court Judge James V. Selna found in favor of the Company as to all remaining claims. On May 29, 2015, plaintiffs filed a notice of appeal from the final judgment with the United States Court of Appeals for the Ninth Circuit. The US Court of Appeals for the Ninth Circuit issued its decision on March 3, 2017. The Ninth Circuit affirmed the defense verdict on all of the claims that went to trial finding that Plaintiffs had failed to prove the merits of any of their claims. The Ninth Circuit reversed the District Court's conclusion that Plaintiffs could not bring an unlawfulness claim under California's Unfair Competition Law for alleged violations of California's Illustration Statute, and remanded that claim back to the District Court for further proceedings (including an analysis of whether any class action could be maintained as to that claim). The appellants (Walker, et al) then filed a petition for rehearing with the Ninth Circuit. That petition for rehearing was denied. Following the remand to the United States District Court, the plaintiffs filed a Third Amended Complaint which included the previously dismissed claims alleging violations of the California Illustration Statute. The Company filed a motion for summary judgment and Plaintiffs filed a cross motion for partial summary judgment on these claims. The motions were heard on December 11, 2017 and the Court issued its opinion on December 22, 2017. The Court granted and denied the cross motions for summary judgment with respect to certain claims under the California Unfair Competition Law that had previously been dismissed by the Court. The Company answered the Third Amended Complaint on January 22, 2018. On June 15, 2018, the Court granted Plaintiffs leave to file a Fourth Amended Complaint which among other things added two additional named Plaintiffs. Plaintiffs filed their Fourth Amended Complaint on June 22, 2018 and LSW answered on June 29, 2018. On May 11, 2018, Plaintiffs filed a motion for class certification and LSW opposed on June 1, 2018. After a hearing on July 28, 2018, the Court granted class certification as to certain of the remanded claims on July 31, 2018. Both parties were granted permission to appeal the class certification ruling on February 26, 2019. Briefing was completed on October 28, 2019. Oral argument took place on February 10, 2020, and the appeal remains pending decision by the Ninth Circuit U.S. Court of Appeals. The Company intends to continue to contest the matter vigorously.

The Company has a multi-year contract with NTT Data, Inc. which expires June 30, 2024. The contract provides data processing, information systems application and infrastructure services from NTT Data. The Company paid $33.9 million and $38.2 million under this contract in 2019 and 2018, respectively. The expense paid includes a base amount and variable expenses related to project work performed during the year.

The Company has a multi-year contract with I-Pipeline which expires December 31, 2020. The contract provides new business support through electronic applications. The Company paid $4.3 million and $2.8 million under this contract in 2019 and 2018, respectively.

NOTE 11 – COMMITMENTS AND CONTINGENCIES (continued)

The Company signed a multi-year contract with Cognizant which expires June 30, 2024. The contract provides application support, web development and Quality Assurance ("QA") services. The Company paid $15.9 million and $20.1 million under this contract in 2019 and 2018, respectively.

The Company signed a multi-year contract with SalesForce.com which expires December 31, 2020. The contract provides customer relationship management application licenses and support. The Company paid $1.3 million and $2.6 million under this contract in 2019 and 2018, respectively.

The Company has a multi-year contract with Microsoft which expires June 22, 2022. The contract provides software licenses to Microsoft end-user and data center products. The Company paid $5.4 million and $3.0 million under this contract in 2019 and 2018, respectively.

LSW is a party to an amended lease agreement with Gaedeke Holdings IX, LLC for office facilities in Addison, Texas. The expiration date of this agreement is August 31, 2029. Rental expense incurred under this agreement was $1.3 million and $1.4 million in 2019 and 2018, respectively.

The following is a schedule of future minimum rental payments pursuant to the amended lease as described above (in thousands):

Year	Contract Obligation
2020	2,871
2021	2,937
2022	2,933
2023	2,989
2024	3,074
Thereafter	14,071
Total minimum payments	$ 28,875

The Company had unfunded mortgage loan, partnership, and AFS debt security commitments of $50.7 million, $513.7 million, and $155.0 million, respectively, at December 31, 2019. Partnership commitments may be called by the partnership during the commitment period (on average two to five years) to fund the purchase of new investments and partnership expenses. Once the commitment period expires, the Company is under no obligation to fund the remaining unfunded commitment but may elect to do so.

NOTE 12 – NATIONAL LIFE CLOSED BLOCK

National Life established and began operating the Closed Block on January 1, 1999. The Closed Block was established pursuant to regulatory requirements as part of the reorganization into a mutual holding company corporate structure. The Closed Block was established for the benefit of holders of certain of National Life's individual participating life insurance and annuity policies in force at December 31, 1998. The Closed Block is designed to give reasonable assurance to holders of policies in the Closed Block that assets will be available to provide for payment of policy benefits, including the continuation of dividends throughout the life of such policies based upon the 1998 dividend scale if the experience underlying such dividend scale (including portfolio interest rates) continues as it was in 1998, and for appropriate adjustment in such dividend scale if the experience changes. The Closed Block is expected to remain in effect until all policies within the Closed Block are no longer in force. Assets assigned to the Closed Block at January 1, 1999, together with projected future premiums and investment returns, are reasonably expected to be sufficient to pay out all future Closed Block policy benefits, expenses, and taxes. Such benefits include dividends paid out under the current dividend scale, adjusted to reflect future changes in the underlying experience. The assets and liabilities allocated to the Closed Block are recorded in the Company's financial statements on the same basis as other similar assets and liabilities. National Life remains contingently liable for all contractual benefits and expenses of the Closed Block.

If actual cumulative Closed Block earnings are greater than expected cumulative earnings, only the expected earnings will be recognized in net income of the Company. Actual cumulative earnings in excess of expected earnings represent undistributed earnings attributable to Closed Block policyholders.

These excess earnings are recorded as a policyholder dividend obligation (included in policyholders' dividend liability) to be paid to Closed Block policyholders unless offset by future results that are less than expected. If actual cumulative performance is less favorable than expected, only actual earnings will be recognized in income. In 2019 and 2018, the Company recorded increases in policyholder dividend obligation of $12.4 million and $5.2 million respectively. Unrealized gains in the Closed Block generated a policyholder dividend obligation through accumulated other comprehensive income of $204.4 million and $37.0 million at December 31, 2019 and 2018, respectively. The total policyholder dividend obligation at December 31, 2019 and 2018 was $216.9 million and $42.2 million, respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2019

NOTE 12 – NATIONAL LIFE CLOSED BLOCK (continued)

Summarized financial information for the Closed Block effects included in the consolidated financial statements as of December 31, 2019 and 2018, and for the two years ended December 31, 2019 and 2018 is as follows (in thousands):

	2019	2018
Liabilities:		
Policy liabilities and accruals	**$ 3,037,576**	$ 2,966,311
Other liabilities	**327**	256
Total liabilities	**$ 3,037,903**	$ 2,966,567
Assets:		
Cash	**$ 5,071**	$ 2,343
Short term investments	**11,400**	—
Available-for-sale debt securities	**2,319,061**	2,175,885
Mortgage loans	**126,847**	162,053
Policy loans	**336,389**	367,221
Accrued investment income	**29,474**	30,546
Premiums and fees receivable	**5,367**	5,742
Other assets	**5,705**	13,785
Total assets	**$ 2,839,314**	$ 2,757,575
Excess of reported liabilities over assets	**$ 198,589**	$ 208,992

	2019	2018
Revenues:		
Insurance premiums and other income	**$ 76,709**	$ 87,218
Net investment income	**115,843**	120,111
Net gains	**471**	72
Total revenues	**$ 193,023**	$ 207,401
Benefits and Expenses:		
Decrease in policy liabilities	**(86,150)**	(94,084)
Policy benefits	**215,801**	245,145
Policyholders' dividends and dividend obligations	**38,904**	31,083
Interest credited to policyholder account liabilities	**6,380**	6,565
Operating expenses	**4,114**	4,571
Commission expenses	**805**	929
Total benefits and expenses	**$ 179,854**	$ 194,209
Pre-tax results of operations	**13,169**	13,192
Income tax expense (benefit)	**2,766**	(3,400)
Closed Block results of operations	**$ 10,403**	$ 16,592
Excess of reported Closed Block liabilities over Closed Block assets:		
Beginning of year	**208,992**	225,584
Closed Block results of operations	**10,403**	16,592
End of year	**$ 198,589**	$ 208,992

NOTE 12 – NATIONAL LIFE CLOSED BLOCK (continued)

Amortized cost of available for sale debt securities held by the Closed Block was $2.1 billion at December 31, 2019 and 2018.

Participating insurance in force within the Closed Block at December 31, 2019 and 2018 was $5.1 billion and $5.5 billion, respectively.

Many expenses related to Closed Block policies and operations, including amortization of policy acquisition costs, are charged to operations outside the Closed Block; accordingly, the contribution from the Closed Block presented above does not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside the Closed Block are therefore disproportionate to the actual business outside the Closed Block.

NOTE 13 – STATUTORY INFORMATION AND RESTRICTIONS

The Company's insurance operations, domiciled in the states of Vermont (National Life, Catamount Reinsurance Company, and Longhorn Reinsurance Company) and Texas (LSW), prepare statutory financial statements in accordance with statutory accounting principles ("SAP") prescribed or permitted by the insurance departments of the states of domicile. Prescribed statutory accounting principles include the Accounting Practices and Procedures Manual of the National Association of Insurance Commissioners ("NAIC") as well as state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Permitted statutory accounting practices include practices not prescribed by the domiciliary state, but allowed by the domiciliary state regulatory authority. National Life and LSW do not have any permitted practices. Catamount and Longhorn have permitted practices approved by the State of Vermont.

LSW paid no dividends to National Life in 2019 or 2018. National Life paid a $188 million and $35 million cash dividend to NLVF in 2019 and 2018, respectively. In 2019, National Life's ownership of Longhorn Reinsurance Company was transferred as a dividend to NLVF. For U.S. GAAP, the dividends were eliminated in consolidation. Dividends declared by National Life in excess of the greater of ten percent of statutory surplus or statutory net gain from operations require pre-approval by the Commissioner of the Vermont Department of Financial Regulation.

In 2019 and 2018, there was a capital contribution of $75 million and $180 million, respectively, from National Life to LSW.

National Life's statutory surplus was $2.29 billion (unaudited) and $2.13 billion (unaudited) at December 31, 2019 and 2018, respectively. Statutory net income (loss) was a net gain of $39.9 million (unaudited) and net loss of $(22.8) million (unaudited) in 2019 and 2018, respectively.

LSW's statutory surplus was $1.52 billion (unaudited) and $1.24 billion (unaudited) at December 31, 2019 and 2018, respectively. Statutory net income (loss) was a net gain of $289.2 million (unaudited) and net loss of $(193.8) million (unaudited) in 2019 and 2018, respectively.

Pursuant to certain statutory requirements, as of December 31, 2019, National Life and LSW had securities on deposit with a statutory carrying value of $7.1 million and $3.2 million, respectively, in insurance department special deposit accounts.

NOTE 14 – PARTICIPATING LIFE INSURANCE

Participating life insurance in force was 15.2% and 17.9% of the face value of total insurance in force at December 31, 2019 and 2018, respectively. The premiums on participating life insurance policies were 10.3% and 12.6% of total individual life insurance premiums in 2019 and 2018, respectively.