NLV Financial Corporation and Subsidiaries

Financial Statements
As of and for the Years Ended
December 31, 2013 and 2012

NLV Financial Corporation and Subsidiaries
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December 31, 2013 and 2012

Independent Auditor's Report

To the Board of Directors and Stockholder of
NLV Financial Corporation:

We have audited the accompanying consolidated financial statements of NLV Financial Corporation (the "Company") and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive income, of changes in stockholder's equity and of cash flows for each of the three years in the period ended December 31, 2013.

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.

Auditor's 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 at December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

February 24, 2014

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NLV Financial Corporation and Subsidiaries
Consolidated Balance Sheets
As of December 31, 2013, and 2012

(in thousands)	2013	2012
Assets:		
Cash and investments:		
Available-for-sale debt securities	**$ 15,469,157**	$ 15,697,945
Available-for-sale equity securities	**90,534**	87,117
Trading equity securities	**18,860**	17,317
Mortgage loans	**2,261,133**	2,076,062
Policy loans	**786,971**	767,330
Real estate investments	**46,839**	49,958
Derivatives	**874,586**	372,741
Other invested assets	**341,605**	343,550
Short term investments	**345,300**	282,871
Cash and restricted cash	**325,071**	188,667
Total cash and investments	**20,560,056**	19,883,558
Deferred policy acquisition costs	**927,742**	546,864
Accrued investment income	**177,539**	177,890
Premiums and fees receivable	**21,889**	21,809
Federal income tax recoverable	**6,682**	4,185
Amounts recoverable from reinsurers	**135,780**	163,829
Present value of future profits of insurance acquired	**17,163**	21,580
Property and equipment, net	**119,608**	94,600
Corporate owned life insurance	**236,326**	227,694
Other assets	**115,096**	117,658
Separate account assets	**774,181**	688,503
Total assets	**$ 23,092,062**	$ 21,948,170
Liabilities:		
Policy liabilities:		
Policy benefit liabilities	**$ 4,598,741**	$ 4,681,430
Policyholder account liabilities	**13,246,553**	12,191,323
Policyholders' deposits	**73,198**	69,927
Policy claims payable	**72,329**	53,612
Policyholders' dividends	**170,893**	336,956
Total policy liabilities	**18,161,714**	17,333,248
Amounts payable to reinsurers	**22,376**	11,775
Derivatives	**529,695**	168,230
Other liabilities and accrued expenses	**494,062**	394,894
Pension and other post-retirement benefit obligations	**164,160**	227,277
Deferred income taxes	**203,114**	292,159
Debt	**487,967**	487,935
Separate account liabilities	**774,181**	688,503
Total liabilities	**$ 20,837,269**	$ 19,604,021
Stockholder's Equity:		
Class A common stock, 2,000 shares authorized, no shares issued and outstanding	**$ -**	$ -
Class B common stock, par value of $0.01, 1,001 shares authorized, 100 shares issued and outstanding	**-**	-
Preferred stock, 500 shares authorized, no shares issued and outstanding	**-**	-
Retained earnings	**1,992,921**	1,850,476
Accumulated other comprehensive income	**261,872**	493,673
Total stockholder's equity	**$ 2,254,793**	$ 2,344,149
Total liabilities and stockholder's equity	**$ 23,092,062**	$ 21,948,170

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, 2013, 2012, and 2011

(in thousands)	2013	2012	2011
Revenues:			
Insurance premiums	**$ 256,567**	$ 276,743	$ 297,726
Policy and contract charges	**346,338**	305,657	276,758
Mutual fund commissions and fee income	**109,839**	121,545	127,039
Net investment income	**1,285,875**	1,048,336	871,630
Net realized investment (losses) gains	**(4,743)**	(7,312)	8,047
Change in value of trading equity securities	**2,360**	730	(389)
Other income	**15,194**	16,937	16,995
Total revenues	**2,011,430**	1,762,636	1,597,806
Benefits and Expenses:			
Increase (decrease) in policy liabilities	**(11,834)**	32,447	29,690
Policy benefits	**457,809**	410,064	428,412
Policyholders' dividends and dividend obligations	**79,424**	94,980	101,847
Interest credited to policyholder account liabilities	**743,522**	492,962	351,797
Operating expenses	**243,260**	219,122	207,527
Interest expense	**41,610**	41,702	41,633
Policy acquisition expenses and amortization of present value of future profits, net	**269,997**	307,405	266,725
Total benefits and expenses	**1,823,788**	1,598,682	1,427,631
Income before income taxes	**187,642**	163,954	170,175
Income tax expense	**45,197**	39,353	47,795
Net income	**$ 142,445**	$ 124,601	$ 122,380
Other comprehensive income, net of tax:			
Unrealized (losses) gains on available-for-sale securities	**(267,301)**	200,237	129,355
Cash flow hedge on debt issuance	**34**	34	34
Change in funded status of retirement plans	**35,466**	(13,504)	(19,837)
Other comprehensive income	**(231,801)**	186,767	109,552
Comprehensive income	**$ (89,356)**	$ 311,368	$ 231,932

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, 2013, 2012, and 2011

	Class A Common Stock	Class B Common Stock	Preferred Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total
(in thousands)						
January 1, 2011	–	–	–	$ 1,603,495	$ 197,354	$ 1,800,849
Net income	–	–	–	122,380	–	122,380
Other comprehensive income	–	–	–	–	109,552	109,552
Total comprehensive income						231,932
December 31, 2011	–	–	–	1,725,875	306,906	2,032,781
Net income	–	–	–	124,601	–	124,601
Other comprehensive income	–	–	–	–	186,767	186,767
Total comprehensive income						311,368
December 31, 2012	–	–	–	**1,850,476**	**493,673**	**2,344,149**
Net income	–	–	–	**142,445**	–	**142,445**
Other comprehensive income	–	–	–	–	**(231,801)**	**(231,801)**
Total comprehensive income						**(89,356)**
December 31, 2013	**$ –**	**$ –**	**$ –**	**$ 1,992,921**	**$ 261,872**	**$ 2,254,793**

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

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
December 31, 2013, 2012, and 2011

(in thousands)	2013	2012	2011
Cash Flows from Operating Activities:			
Net income	**$ 142,445**	$ 124,601	$ 122,380
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for deferred income taxes	**35,770**	20,837	50,398
Interest credited to policyholder account liabilities	**743,522**	492,962	351,797
Amortization of deferred policy acquisition costs	**170,741**	213,162	165,188
Policy and contract charges	**(346,338)**	(305,657)	(276,758)
Net realized investment losses (gains)	**4,743**	7,312	(8,047)
Net option (gains) losses	**(334,341)**	(113,333)	37,534
Change on corporate owned life insurance policies	**(8,632)**	(9,331)	(7,124)
Amortization of present value of future profits of insurance acquired	**4,416**	4,910	4,990
Depreciation	**14,108**	13,034	11,188
Allowance for doubtful mortgages	**(11,385)**	1,020	3,070
Other	**6,220**	(1,468)	(6,778)
Changes in assets and liabilities:			
Accrued investment income	**351**	(5,173)	(5,019)
Deferred policy acquisition costs	**(259,080)**	(240,045)	(198,030)
Policy liabilities	**1,399**	44,815	37,001
Other assets and liabilities	**(639)**	(353)	(23,983)
Net cash provided by operating activities	**163,300**	247,293	257,807
Cash Flows from Investing Activities:			
Proceeds from sales, maturities and repayments of investments	**2,326,530**	2,169,532	3,162,281
Cost of investments acquired	**(2,951,453)**	(3,101,806)	(4,141,108)
Property and equipment additions	**(41,051)**	(34,261)	(20,969)
Cost of corporate owned life insurance acquired	**-**	-	(50,472)
Change in policy loans	**(19,641)**	(17,720)	(13,772)
Change in short term investments	**(62,429)**	(91,996)	166,995
Change in short term broker collateral	**155,903**	49,630	(90,770)
Other	**(296)**	(1,371)	(10,554)
Net cash used by investing activities	**(592,437)**	(1,027,992)	(998,369)
Cash Flows from Financing Activities:			
Policyholders' deposits	**1,565,731**	1,600,019	1,445,747
Policyholders' withdrawals	**(972,223)**	(851,954)	(805,850)
Advance from Federal Home Loan Bank	**-**	-	100,000
Change in other deposits	**(27,967)**	22,997	(10,195)
Net cash provided by financing activities	**565,541**	771,062	729,702
Net Decrease in Cash	**136,404**	(9,637)	(10,860)
Cash and Restricted Cash:			
Beginning of year	**188,667**	198,304	209,164
End of year	**$ 325,071**	$ 188,667	$ 198,304
Supplemental disclosure of cash flow information:			
Interest paid	**$ 41,744**	$ 41,837	$ 41,768
Income taxes paid	**$ 11,924**	$ 175	$ 28,492

NOTE 1 – NATURE OF OPERATIONS

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 900 people, primarily concentrated in Montpelier, Vermont and Addison, Texas. Between 1996 and 1999, National Life purchased all of the voting stock of Life Insurance Company of the Southwest ("LSW"), a Texas domiciled stock life insurer and the sole subsidiary of National Life. National Life, together with LSW, make 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. All of National Life's outstanding shares are currently held by its parent, NLVF, which is a wholly-owned subsidiary of National Life Holding Company ("NLHC"), the mutual holding company. Policyholders and contract owners 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. For additional information, see Note 11. Under the terms of the reorganization, NLHC must always hold a majority of the voting shares of NLVF.

The Company's insurance operations principally develop and distribute individual life insurance and annuity products. The Company markets this diverse product portfolio to small business owners, professionals, and other middle to upper income individuals. The Company provides financial solutions in the form of estate, business succession and retirement planning, deferred compensation and other key executive benefit planning, and asset management services. Insurance and annuity products are primarily distributed through a number of general agencies and branch offices in major metropolitan areas and a system of marketing general agents and independent marketing organizations throughout the United States of America. The Company has in excess of 642,000 policyholders[1] and through its subsidiary, National Life, is licensed to do business in all 50 states and the District of Columbia. About 27% of the Company's total collected premiums and deposits are from residents of the states of California and New York.

Through Sentinel Asset Management, Inc. ("SAMI") and its subsidiaries, the Company also distributes and provides investment advisory and administrative services to the Sentinel Group Funds, Inc. ("Sentinel Funds"). The Sentinel Funds' $6.9 billion of net assets represent fourteen mutual funds managed on behalf of approximately 144,000 individual, corporate, and institutional shareholders worldwide.

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 ("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

(1) The reference to "policyholder" or "policy" throughout this document includes both life insurance and annuity contract owners.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of Estimates (continued)

and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant 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 contracts; policy liabilities; valuation of investments and derivative instruments; embedded derivatives; evaluation of other-than-temporary impairments on available-for-sale securities; 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 consolidated financial statements.

Subsequent Events

The Company has evaluated events subsequent to December 31, 2013 and through the consolidated financial statement issuance date of February 24, 2014. The Company has not evaluated subsequent events after the issuance date for presentation in these consolidated financial statements.

Cash and Restricted Cash

At December 31, 2013 and 2012, the Company had restricted cash of $293.2 million and $137.3 million, respectively, related to broker collateral on the Company's derivative investments.

Investments

The Company's investment portfolio consists primarily of available-for-sale ("AFS") debt and equity securities. These securities are reported at fair value on the Consolidated Balance Sheets. Changes in the fair values of available-for-sale debt and equity securities are reflected in other comprehensive income ("OCI") after adjustments for related deferred policy acquisition costs, present value of future profits of insurance acquired, policyholder dividend obligations, loss reserve recognition, and deferred income taxes. 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 that 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.

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

Recognition and Presentation of Other-Than-Temporary Impairments (continued)
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 realized capital 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 realized capital 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 realized capital 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 securitized 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.

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 that 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.

For those equity securities where the decline in the fair values is deemed to be other-than-temporary, a charge is recorded in net realized capital losses equal to the difference between the fair value and cost basis of the security. The primary factors considered in evaluating whether an other-than-temporary impairment exists for an equity security include, but are not limited to: (a) the length of time and extent to which the fair value has been less than the cost of the security, (b) changes in the financial condition, credit rating and near-term prospects of the issuer, (c) whether there has been a reduction or elimination of dividends, (d) the intent and ability of the Company to hold the investment until an anticipated recovery, and (e) losses from the security that were recorded subsequent to the reporting period.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition and Presentation of Other-Than-Temporary Impairments (continued)
Based on this evaluation the Company concluded $10.3 million, $19.5 million, and $22.8 million of unrealized losses on available-for-sale securities were other-than-temporarily impaired due to credit-related losses for the years ended December 31, 2013, 2012 and 2011, respectively. The Company's remaining unrealized losses on available-for-sale securities of $206.0 million and $45.3 million were considered to be temporary as of December 31, 2013 and 2012, respectively.

Trading Equity Securities
Trading equity securities are reported at fair value. Realized and unrealized gains (losses) on trading equity securities are included in change in fair value of trading equity securities within the Consolidated Statements of Comprehensive Income.

Mortgage Loans
Mortgage loans on real estate are carried at amortized cost less a valuation allowance for probable losses on unidentified loans. The evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. These assumptions require the use of significant management judgment and include the probability and timing of borrower default and loss frequency and severity estimates. Changes in the valuation allowance are recognized through net investment income. In 2013 the Company revised the methodology around the calculation of the allowance to reflect probable credit losses within the mortgage portfolio and as a result the valuation allowance decreased by $12.1 million. For the years ended December 31, 2012 and 2011, the Company increased the reserve for valuation allowances by $1.0 million and $3.1 million, respectively. The total valuation allowance as of December 31, 2013 and 2012 was $2.5 million and $14.6 million, respectively.

For mortgage loans that are deemed impaired, an impairment loss is recognized through realized 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. The Company recognized mortgage loan impairments of $5.5 million, $3.7 million, and $2.0 million as of December 31, 2013, 2012, and 2011, respectively.

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

Real Estate
Real estate investments held for investment purposes are reported at depreciated cost. Real estate acquired in satisfaction of debt is generally held for investment and is transferred to real estate at the lower of cost or fair value. In establishing real estate reserves, the Company considers, among other things, the fair value of the real estate compared to depreciated cost. The Company recognized real estate impairments of $4.7 million and $1.3 million as of December 31, 2013 and 2012, respectively, through realized investment gains and losses. In 2011, no real estate impairments were recognized.

Limited Partnerships
Investments in limited partnerships are included in other invested assets. Partnerships for which the Company does not have significant influence over the limited partnership are carried at fair value. The Company obtains the fair value of these investments generally from net asset value information provided by the general partner or manager of the limited partnership, the financial statements of which generally are

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Limited Partnerships (continued)

audited annually. Other-than-temporary impairments are recorded in net realized investment gains and losses if the present value of future earnings is projected to be less than the carrying value of the investment. Changes in the fair value of these limited partnerships are included in change in unrealized gains and losses on available-for-sale securities, net of related deferred income taxes, within other 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.

Investments in limited partnerships over which the Company does not have significant influence are reviewed quarterly to determine if a decline in fair value is other-than-temporary in nature. The selection of partnership investments to review for other than temporary declines is qualitative and quantitative in nature and based on many factors including the severity and duration of the decline as well as qualitative information about the underlying investments. If a decline in fair value of a limited partnership is determined to be other-than-temporary, the value of the investment is reduced to its fair value, which becomes its new cost basis, through current period earnings. To determine fair value, the Company, among other things, reviews the underlying assets of the fund or partnership to determine what the realizable value is expected to be, which requires significant management judgment. The Company recognized impairments on limited partnerships of $3.6 million, $2.1 million and $1.9 million as of December 31, 2013, 2012, and 2011, respectively, through realized gains and losses.

Derivatives

Derivatives include long options, short options, swaptions, and futures contracts which are carried at fair value. The fair values of derivatives are based on publicly available data and when that data is not available, the Company uses independent broker pricing quotes. Changes in fair value are reflected in the Consolidated Statements of Comprehensive Income as a component of net investment income.

Affordable Housing Tax Credits

Investments in affordable housing tax credit limited partnerships are included in other invested assets and are amortized using the cost method within net investment income. The associated tax credits are included as an offset to income tax expense. For additional information, see Note 8.

Realized Gains and Losses

Realized investment (losses) gains are recognized using the specific identification method and are reported as net realized investment (losses) gains. Realized investment (losses) gains are included in the adjustment for related deferred policy acquisition costs, present value of future profits of insurance acquired, policyholder dividend obligations, and income taxes.

Short Term Investments

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

Federal Home Loan Bank

National Life is a member of the Federal Home Loan Bank of Boston ("FHLB") which provides National Life with access to a secured asset-based borrowing capacity of $1.66 billion. The membership and any advances require an investment in the common stock of FHLB. The Company received an advance from FHLB in 2011 for $100 million, which is considered operating leverage and included in policyholder account liabilities. The proceeds have been invested in a discrete pool of fixed income assets. The advance was provided to National Life in two tranches of $75 million and $25 million, which mature in 2015 and 2016, respectively. Interest accrues on these blocks at a rate of 1.88% and 2.24% with total interest of $2.0 million in 2013 and 2012, respectively. The Company posted collateral of $272.3 million as of December 31, 2013 of which $111.2 million was the required collateral level for the outstanding advances. The Company had an

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Federal Home Loan Bank (continued)

investment in the common stock of FHLB of $10.7 million and $10.6 million as of December 31, 2013 and 2012, respectively.

Policy Acquisition Expenses

Commissions and other costs that are directly related to the successful acquisition of new or renewal insurance contracts are generally 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. Future gross profits may be revised due to changes in projected investment rates, mortality assumptions, expenses, contract lapses, withdrawals, and surrenders. Deferred policy acquisition costs for these products are adjusted for related unrealized (losses) gains on available-for-sale debt and equity securities (after deducting any related policyholder dividend obligations) through OCI, net of related deferred income taxes.

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

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 investment returns, policyholder dividend scales, interest crediting rates, mortality, persistency, and administrative expenses. The effect on DAC of the update of the actuarial assumptions for both 2013 and 2012 are shown below (amounts in millions):

	Impact on DAC Balance	
	2013	2012
Dividend scale change	**(1.3)**	$ 31.1
Investment income margins	**(1.5)**	(28.4)
Surrender rates	**(1.1)**	(14.9)
Mortality rates	**-**	(3.4)
Model refinements	**7.2**	4.7
Persistency	**(1.6)**	2.6
Other assumption changes	**(0.3)**	1.1
	$ 1.4	$ (7.2)

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 incentives to the extent they are in excess of expected policy benefits and interest credits provided in renewal years. These incentives are amortized based on the underlying gross profits of the products, with amortization adjusted periodically to reflect actual experience. The components of the sales inducement asset ("SIA") are shown below (amounts in millions), and are included in DAC:

	SIA	
	2013	2012
Beginning of year	**$ 40.5**	$ 41.3
Deferral	**12.2**	19.3
Amortization, net	**(6.3)**	(20.1)
End of year	**$ 46.4**	$ 40.5

For internal replacements 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.

Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are reviewed for impairment in accordance with ASC 350 on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The assessment for impairment begins with a qualitative determination of factors that could indicate that an impairment is more likely than not to exist. If it is deemed that an impairment is more likely than not to exist then a quantitative assessment is completed. The quantitative impairment testing is performed using the fair value approach, which requires the use of estimates and judgment, at the reporting unit or intangible asset level. The determination of a reporting unit's fair value is based on management's best estimate, which generally considers a discounted cash flow analysis as well as market-based earnings and revenue multiples of the unit's peer companies. If the carrying value of a reporting unit or intangible asset exceeds its fair value, an impairment is recognized as a charge against income equal to the excess of the carrying value of goodwill or intangible asset over its fair value. The goodwill and intangible balances represent the Company's acquisition of partnership interests and other mutual funds to enhance its asset management business. The goodwill and intangible balance was $53.0 million, consisting of $45.7 million of intangibles and $7.3 million of goodwill, at both December 31, 2013 and 2012. For further information on goodwill and other intangible assets see Note 10.

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, 2013 and 2012:

	December 31, 2013		
	Cost	**Accum Dep**	**Carrying Value**
Software	**$ 143.4**	**$ (73.5)**	**$ 69.9**
Equipment	**24.7**	**(18.4)**	**6.3**
Furniture	**23.0**	**(19.1)**	**3.9**
Renovations	**10.3**	**(1.1)**	**9.2**
Home office	**82.9**	**(52.6)**	**30.3**
	$ 284.3	**$ (164.7)**	**$ 119.6**

	December 31, 2012		
	Cost	Accum Dep	Carrying Value
Software	$ 112.8	$ (62.8)	$ 50.0
Equipment	20.7	(16.5)	4.2
Furniture	23.8	(20.5)	3.3
Renovations	6.4	(0.6)	5.8
Home office	82.1	(50.8)	31.3
	$ 245.8	$ (151.2)	$ 94.6

Corporate Owned Life Insurance

The Company holds life insurance contracts on certain members of management and other key individuals. The total cash surrender value of these Corporate Owned Life Insurance ("COLI") contracts was $236.3 million and $227.7 million at December 31, 2013 and 2012, respectively. Approximately 56% of the total

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Corporate Owned Life Insurance (continued)

COLI cash surrender value was held at declared interest, with the remainder held in segregated variable separate account funds at both December 31, 2013 and 2012.

COLI income includes the net change in cash surrender value and any benefits received. COLI income was $8.7 million, $9.3 million, and $7.1 million in 2013, 2012, and 2011, respectively, and is included in other income in the Consolidated Statements of Comprehensive 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, 2013 and 2012, the Company had a receivable from agents of $24.3 million and $20.2 million, respectively, which is included in other assets on the Consolidated Balance Sheets. These numbers are reported net of an accrued valuation allowance where it is deemed that amounts may not be collectible. The allowance on the receivable was $7.3 million and $4.3 million as of December 31, 2013 and 2012.

Separate Accounts

The Company maintains separate account assets, which are reported at fair value. Investments in separate accounts that pertain to variable products are directed by the policyholder and are segregated from other investments and investment gains and losses accrue directly to the policyholder who assumes the investment risk.

Separate account liabilities are reported in amounts consistent with separate account assets. Separate account liabilities are legally insulated from the general account liabilities of the insurance enterprise and all investment performance net of contract fees and assessments is passed through to the individual policyholder. Minimum guarantees related to separate account policies are included in policy liabilities. Separate account results relating to policyholders' interests are excluded from the Company's consolidated operations.

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 5.35% and 5.65% as of December 31, 2013 and 2012, 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 life insurance (universal life products) and investment-type annuities represent amounts that inure to the benefit of the policyholders before surrender charges. Policyholder account balances for indexed life insurance and annuity liabilities consist of a combination of underlying account value and embedded derivative values. The underlying account value is primarily based on the initial deposit plus any interest credited. The embedded derivative component is based on the fair value of the contract's expected participation in future increases in the S&P 500 or Russell 2000 indexes. 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, the level and limits on contract participation in any future increases in the S&P 500 or Russell 2000 indexes, and an explicit risk margin for variance of policyholder behavior along with the associated 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 1.0% to 4.5%. The guaranteed minimum interest rates for the Company's fixed interest rate universal life insurance policies range from 2.0% to 4.5%. These guaranteed minimum rates are before deduction for any policy administration fees or mortality charges.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

Reserves are established, as appropriate, for separate account product guarantees. The most significant of these relates to a guaranteed minimum death benefit 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, which increases the risk profile of this benefit. Partial withdrawals from policies issued after November 1, 2003, will use the pro-rata method. Policyholder partial withdrawals to date have not been significant. 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 reflected in policyholder benefits.

In 2013, the Company updated certain actuarial assumptions including lapse and surrender rates, earned rates, and persistency in various blocks of business which resulted in an $8.8 million increase in policy liabilities.

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. As a result of the current interest rates used in the projections, the Company recorded reserves of $5.3 million and $1.2mm as of December 31, 2013 and 2012, respectively. The Company also tests reserves for adequacy assuming that all of the unrealized gains (losses) are realized and posts shadow reserves for any deficiency. As of December 31, 2013 and 2012, the Company accrued shadow loss reserves of $14.9 million and $22.0 million, respectively.

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 Company accrued sales inducement liabilities of $6.3 million at December 31, 2013 and released liabilities of $1.5 million at December 31, 2012. The Company recorded a net decrease for interest, amortization and unlocking of $2.9 million during 2013, and a net decrease of $2.3 million during 2012. Sales inducement liabilities were $26.5 million and $23.0 million at December 31, 2013 and 2012, respectively.

Reinsurance

The Company reinsures certain risks assumed in the normal course of business to other companies. 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. 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.

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 and National Life's overall operating results. The dividend scale is approved annually by the Board of Directors.

Policyholder Deposits

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

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recognition of Insurance Revenues and Related Expenses

Premiums from traditional life and 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 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

Financial Instruments
In February 2013, the FASB issued ASU 2013-03, *Financial Instruments (Topic 825): Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities*, which clarified the scope and applicability of a particular disclosure to nonpublic entities that resulted from the issuance of ASU 2011-04*, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments clarify that the requirement to disclose "the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)" does not apply to nonpublic entities for items that are not measured at fair value in the statement of financial position but for which fair value is disclosed. The amendments in this Update affect nonpublic entities that have total assets of $100 million or more or that have one or more derivative instruments. The amendment was effective upon issuance.

Not Yet Adopted
Comprehensive Income
In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* with the objective to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. Nonpublic entities are required to comply with all the requirements of the amendments for annual reporting periods. For interim reporting periods, nonpublic entities are not required to report the effects of reclassifications on net income but are required to report information about the amounts reclassified out of accumulated other comprehensive income by component for each reporting period. For nonpublic entities,

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS

Comprehensive Income (continued)

the amendments are effective prospectively for annual reporting periods beginning after December 15, 2013. Early adoption is permitted.

Income Taxes

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.* The objective of the amendments is to eliminate the diversity in practice in the presentation of unrecognized tax benefits and applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

Affordable Housing Tax Credits

On January 15, 2014 the FASB issued *ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects (QAHP) (ASC 323).* The new guidance eases the requirements for an investor to elect to account for its investment in a QAHP using the effective yield method. Prior to the issuance of the new guidance, investors had to have a letter of credit guaranteeing the availability of the tax credit allocable to the investor, had to demonstrate that the projected yield based solely on the cash flows from the guaranteed tax credits was positive and had to be a limited partner in the QAHP for both legal and tax purposes. Under the new guidance, the letter of credit requirement has been eliminated and instead, the investor must simply be able to demonstrate that the tax credit allocable to the investor will be available. Investments in QAHP not meeting the criteria in the new guidance would be accounted for under the equity method or the cost method. The election to use the effective yield method is considered an accounting policy decision that should be applied consistently to all QAHP investments. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2014. The guidance should be applied retrospectively, with early adoption permitted. The Company holds an investment in a QAHP which is accounted for under the equity method and is still in the process of assessing the potential effect of option.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES

The following financial instruments are carried at fair value in the Company's Consolidated Financial Statements: AFS fixed maturity and equity securities, trading securities, short-term investments, limited partnerships, freestanding and embedded derivatives, and separate account assets.

The following section applies the fair value hierarchy and disclosure requirements for the Company's financial instruments that are carried at fair value. The fair value hierarchy prioritizes the inputs to the valuation techniques used to measure fair value into three broad Levels (Level 1, 2 or 3):

- **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, investments in publicly traded mutual funds with quoted market prices, and listed derivatives. Separate account assets classified within this level principally include mutual funds.
- **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, certain municipal bonds, certain mortgage-backed securities ("MBSs") and certain asset-backed securities ("ABSs"), certain corporate debt, certain private placement investments, certain preferred stocks, and certain derivatives, including options and credit default swaps. Generally, the Company considers bonds 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 certain private placement investments, certain preferred stocks, certain limited partnerships, and 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. The Company's fixed maturities included in Level 3 are classified as such as they are primarily priced by independent brokers and/or within illiquid markets. 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 valuation methodologies used to determine the fair values of assets and liabilities under the "exit price" notion, reflect market-participant objectives and are based on the application of the fair value hierarchy that prioritizes relevant observable market inputs over unobservable inputs. 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. For investments in vehicles where the Company has a limited ownership interest ("limited partnerships") that do not have a readily determinable fair value, the Company estimates fair value of its ownership interest at net asset value ("NAV") or its equivalent, based on information provided by the general partner or investment manager.

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

Valuation Techniques

Available-for-Sale 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 three primary sources of information: 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 discounted at an market rate. 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.

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. 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. Certain internal matrix priced securities, primarily consisting of certain private placement securities, are also classified as Level 3 due to significant non-observable inputs.

US Government securities - 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 - 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 in Level 2 of the fair value hierarchy.

Corporate bonds - as well as MBS and ABS securities are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads. 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; in instances where significant inputs are unobservable, they are categorized in Level 3 of the fair value hierarchy.

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

Equity securities including non-trading preferred stocks - 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 in Level 1, for common stocks, and Level 2, for preferred stocks.

Trading equity securities - Fair values of exchange traded equity securities are based on unadjusted quoted market prices from pricing services as well as primary and secondary brokers/dealers. Trading equities are categorized into Level 1 of the fair value hierarchy.

Derivative Contracts - Fair values of futures are based on quoted prices. These prices are readily and regularly available in an active market. Therefore, these securities are categorized as Level 1 of the fair value hierarchy.

OTC derivative contracts - Such instruments held by the Company include options, swaptions, 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 of the fair value hierarchy. The remaining instruments are classified as Level 1 as all of the inputs used to determine the value are observable.

Equity Indexed Embedded Derivatives - The fair value of the embedded policy derivatives contained in equity-indexed annuity and life contracts 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, taking into account assumptions for future equity indexed credited rates in light of market conditions and policyholder behavior assumptions. The fair value incorporates an explicit risk margin for variance of policyholder behavior and the impact the Company's own credit rating would have in the view of a market participant. Given significant unobservable inputs used to value these financial instruments, they are included in Level 3.

Limited 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. Since these valuations have significant unobservable inputs, they are generally categorized as Level 3 in the fair value hierarchy.

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

Presented here is the fair value of all assets and liabilities subject to fair value determination at December 31, 2013 as well as the expanded fair value disclosures required by ASC 820 (in thousands):

Assets	Level 1	Level 2	Level 3	Not Presented at Fair Value	Total
AFS debt and equity securities:					
U.S. government obligations	$ 10,932	$ -	$ -	$ -	$ 10,932
Government agencies, authorities and subdivisions	-	89,539	-	-	89,539
Corporates	-	8,802,219	1,145	-	8,803,364
Private placements	-	1,522,644	-	-	1,522,644
Mortgage-backed securities	-	5,042,678	-	-	5,042,678
Total AFS debt securities	10,932	15,457,080	1,145	-	15,469,157
Preferred stock	-	6,241	-	-	6,241
Common stock	84,288	-	5	-	84,293
Total AFS equity securities	84,288	6,241	5	-	90,534
Total AFS debt and equity securities	95,220	15,463,321	1,150	-	15,559,691
Trading equity securities	18,860	-	-	-	18,860
Derivatives	1,059	873,527	-	-	874,586
Other invested assets	5,545	-	193,287	142,773	341,605
Short term investments	300,845	44,455	-	-	345,300
Separate account assets	709,065 [1]	55,028 [1]	10,088	-	774,181
Total assets subject to fair value disclosure	$ 1,130,594	$ 16,436,331	$ 204,525	$ 142,773	$ 17,914,223

Liabilities	Level 1	Level 2	Level 3	Not Presented at Fair Value	Total
Policyholder account liabilities	-	-	$ 1,673,028 [2]	-	$ 1,673,028
Derivatives	-	529,695	-	-	529,695
Total liabilities subject to fair value disclosure	$ -	$ 529,695	$ 1,673,028	$ -	$ 2,202,723

1. Separate account assets are measured at fair value. Investment performance related to separate account assets is fully offset by corresponding amounts credited to contract holders whose liability is reflected within separate account liabilities. Separate account liabilities are set equal to the fair value of separate account assets as prescribed by *ASC 944-80: Financial Services – Insurance – Separate Accounts*. Separate account assets are principally comprised of public registered mutual funds, trading equities and certain MBS.

2. 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, 2013, were to change by approximately 100 basis points, the fair value of the embedded derivative would change significantly with an offset to the deferred policy acquisition costs.

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

The table below summarizes the reconciliation of the beginning and ending balances and related changes for the year ended December 31, 2013 for fair value measurements for which significant unobservable inputs were used in determining each instrument's fair value (in thousands):

Assets	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
Corporates	$ 33,375	$ -	$ 388	$ -	$ -	$ (4,637)	$ -	$ -	$ (27,981)	$ 1,145	$ -
Private placements	19,275	-	-	-	-	(5,190)	-	-	(14,085)	-	-
Common stock	5	-	-	-	-	-	-	-	-	5	-
Total AFS debt and equity securities	52,655	-	388	-	-	(9,827)	-	-	(42,066)	1,150	-
Other invested assets	178,120	(3,591)	1,574	40,647	-	(23,463)	-	-	-	193,287	(3,591)
Separate account assets	-	-	-	10,088	-	-	-	-	-	10,088	-
Total invested assets	$ 230,775	$ (3,591)	$ 1,962	$ 50,735	$ -	$ (33,290)	$ -	$ -	$ (42,066)	$ 204,525	$ (3,591)
Liabilities											
Policyholder account liabilities	$ 1,332,807	$ 331,224	$ -	$ -	$ -	$ -	$ 8,997	$ -	$ -	1,673,028	-
Total liabilities	$ 1,332,807	$ 331,224	$ -	$ -	$ -	$ -	$ 8,997	$ -	$ -	$ 1,673,028	$ -

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

2. Includes changes in market value of certain instruments.

During 2013, there were no significant transfers between fair value levels 1 and 2. In 2013, certain corporate bonds and private placements were valued using inputs that were determined to be more observable, as such the bonds moved from level 3 to level 2.

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

Presented here is the fair value of all assets and liabilities subject to fair value determination at December 31, 2012 as well as the expanded fair value disclosures required by ASC 820 (in thousands):

Assets	**Level 1**	**Level 2**	**Level 3**	**Not Presented at Fair Value**	**Total**
AFS debt and equity securities:					
U.S. government obligations	$ 11,454	$ -	$ -	$ -	$ 11,454
Government agencies, authorities and subdivisions	-	98,245	-	-	98,245
Corporates	-	8,929,350	33,375	-	8,962,725
Private placements	-	1,435,680	19,275	-	1,454,955
Mortgage-backed securities	-	5,170,566	-	-	5,170,566
Total AFS debt securities	11,454	15,633,841	52,650	-	15,697,945
Preferred stock	-	7,303	-	-	7,303
Common stock	79,809	-	5	-	79,814
Total AFS equity securities	79,809	7,303	5	-	87,117
Total AFS debt and equity securities	91,263	15,641,144	52,655	-	15,785,062
Trading equity securities	17,317	-	-	-	17,317
Derivatives	792	371,949	-	-	372,741
Other invested assets	4,269	1,316	178,120	159,845	343,550
Short term investments	119,133	163,738	-	-	282,871
Separate account assets	623,640 [1]	64,863 [1]	-	-	688,503
Total assets subject to fair value disclosure	$ 856,414	$ 16,243,010	$ 230,775	$ 159,845	$ 17,490,044

Liabilities	Level 1	Level 2	Level 3	Not Presented at Fair Value	Total
Policyholder account liabilities	-	-	$ 1,332,807 [2]	-	$ 1,332,807
Derivatives	-	168,230	-	-	168,230
Total liabilities subject to fair value disclosure	$ -	$ 168,230	$ 1,332,807	$ -	$ 1,501,037

1. Separate account assets are measured at fair value. Investment performance related to separate account assets is fully offset by corresponding amounts credited to contract holders whose liability is reflected within separate account liabilities. Separate account liabilities are set equal to the fair value of separate account assets as prescribed by *ASC 944-80: Financial Services – Insurance – Separate Accounts*. Separate account assets are principally comprised of public registered mutual funds, trading equities and certain MBS.

2. 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, 2012, were to change by approximately 100 basis points, the fair value of the embedded derivative would change significantly with an offset to the deferred policy acquisition costs.

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

The table below summarizes the reconciliation of the beginning and ending balances and related changes for the year ended December 31, 2012 for fair value measurements for which significant unobservable inputs were used in determining each instrument's fair value (in thousands):

Assets	Beginning Balance	Net Investment Gains/Loss In Earnings (realized and unrealized) 1	Unrealized in OCI2	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
Corporates	$ 37,444	$ (60)	$ 237	$ -	$ -	$ (4,246)	$ -	$ -	$ -	$ 33,375	$ (60)
Private placements	19,948	-	(218)	-	-	(455)	-	-	-	19,275	-
Preferred stock	121	-	-	-	-	(121)	-	-	-	-	-
Common stock	5	-	-	-	-	-	-	-	-	5	-
Total AFS debt and equity securities	57,518	(60)	19	-	-	(4,822)	-	-	-	52,655	(60)
Other invested assets	170,223	(2,068)	11,392	36,153	-	(35,280)	-	-	(2,300)	178,120	(2,068)
Total invested assets	$ 227,741	$ (2,128)	$ 11,411	$ 36,153	$ -	$ (40,102)	$ -	$ -	$ (2,300)	$ 230,775	$ (2,128)
Liabilities											
Policyholder account liabilities	$ 1,044,150	$ 311,193	$ -	$ -	$ -	$ -	$ (22,536)	$ -	$ -	$ 1,332,807	$ 311,193
Total liabilities	$ 1,044,150	$ 311,193	$ -	$ -	$ -	$ -	$ (22,536)	$ -	$ -	$ 1,332,807	$ 311,193

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

2. Includes changes in market value of certain instruments.

During 2012, there were no significant transfers between fair value levels 1 and 2.

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

Fair Value of Financial Instruments

The carrying values and fair values of financial instruments as of December 31, 2013 and 2012 were as follows (in thousands):

	2013		2012	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Short term investments	**345,300**	**345,300**	282,871	282,871
Available-for-sale debt securities	**15,469,157**	**15,469,157**	15,697,945	15,697,945
Available-for-sale equity securities	**90,534**	**90,534**	87,117	87,117
Trading equity securities	**18,860**	**18,860**	17,317	17,317
Mortgage loans	**2,261,133**	**2,384,561**	2,076,062	2,223,022
Policy loans	**786,971**	**907,259**	767,330	909,727
Options purchased	**870,599**	**870,599**	371,948	371,948
Options written	**(529,664)**	**(529,664)**	(167,733)	(167,733)
Swaptions purchased	**2,928**	**2,928**	-	-
Futures purchased	**1,059**	**1,059**	793	793
Credit default swaps	**(31)**	**(31)**	(497)	(497)
Separate account assets	**774,181**	**774,181**	688,503	688,503
Investment product liabilities	**11,065,776**	**11,209,604**	10,349,706	10,463,325
Debt	**487,967**	**551,319**	487,935	583,107

For short term investments, carrying value approximates fair value.

Mortgage loan fair values are determined using the average of discounted cash flows for the portfolio using current market rates and average durations.

For variable rate policy loans the unpaid balance approximates fair value. Fixed rate policy loan fair values are determined based on discounted cash flows using the current variable policy loan rate (including appropriate provisions for mortality and repayments).

Investment product liabilities include flexible premium annuities, single premium deferred annuities, and supplementary contracts not involving life contingencies. Investment product fair values are determined using the average of discounted cash flows under different scenarios of future interest rates of A-rated corporate bonds and related changes in premium persistency and surrenders.

Debt fair values are determined using quoted values determined through discounted cash flows derived from current interest rates adjusted for the Company's credit rating.

NOTE 5 - INVESTMENTS

Available-for-Sale Debt and Equity Securities

The amortized cost and the fair values of AFS debt securities and the cost for AFS equity securities at December 31, 2013 are as follows (in thousands):

2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AFS debt and equity securities:				
U.S. government obligations	$ 10,326	$ 654	$ 48	$ 10,932
Government agencies, authorities and subdivisions	82,976	6,563	-	89,539
Corporate:				
Communications	712,297	64,185	4,843	771,639
Consumer & retail	2,003,015	150,684	18,494	2,135,205
Financial institutions	1,776,514	196,527	9,227	1,963,814
Industrial and chemicals	1,849,222	140,879	31,020	1,959,081
REITS	418,481	15,491	8,760	425,212
Transportation	198,768	22,560	1,504	219,824
Utilities	1,235,714	103,660	10,785	1,328,589
Total corporate	8,194,011	693,986	84,633	8,803,364
Private placements	1,473,575	71,804	22,735	1,522,644
Mortgage-backed securities	4,866,440	272,641	96,403	5,042,678
Total AFS debt securities	$ 14,627,328	$ 1,045,648	$ 203,819	$ 15,469,157
Preferred stocks	8,282	-	2,041	6,241
Common stocks	69,929	14,477	113	84,293
Total AFS equity securities	$ 78,211	$ 14,477	$ 2,154	$ 90,534
Total AFS debt and equity securities	$ 14,705,539	$ 1,060,125	$ 205,973	$ 15,559,691

NOTE 5 - INVESTMENTS (continued)

Available-for-Sale Debt and Equity Securities (continued)

The amortized cost and the fair values of AFS debt securities and the cost for AFS equity securities at December 31, 2012 are as follows (in thousands):

2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AFS debt and equity securities:				
U.S. government obligations	$ 10,239	$ 1,215	$ -	$ 11,454
Government agencies, authorities and subdivisions	84,207	14,039	2	98,244
Corporate:				
Communications	724,300	109,201	-	833,501
Consumer & retail	1,976,707	264,670	3,097	2,238,280
Financial institutions	1,781,139	267,331	5,669	2,042,801
Industrial and chemicals	1,671,546	229,648	6,340	1,894,854
REITS	297,463	25,897	178	323,182
Transportation	205,574	33,787	119	239,242
Utilities	1,215,871	176,094	1,101	1,390,864
Total corporate	7,872,600	1,106,628	16,504	8,962,724
Private placements	1,333,446	123,995	2,486	1,454,955
Mortgage-backed securities	4,677,379	517,218	24,029	5,170,568
Total AFS debt securities	$ 13,977,871	$ 1,763,095	$ 43,021	$ 15,697,945
Preferred stocks	8,282	-	979	7,303
Common stocks	71,239	9,863	1,288	79,814
Total AFS equity securities	$ 79,521	$ 9,863	$ 2,267	$ 87,117
Total AFS debt and equity securities	$ 14,057,392	$ 1,772,958	$ 45,288	$ 15,785,062

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt and Equity Securities (continued)

Unrealized gains (losses) on available-for-sale debt and equity securities included as a component of accumulated other comprehensive income and changes therein for the years ended December 31 were as follows (in thousands):

	2013	2012	2011
Net unrealized (losses) gains on AFS securities	**$ (873,517)**	$ 489,285	$ 436,701
Net unrealized gains on separate accounts	**1,277**	618	12
Net unrealized gains on other invested assets	**1,572**	11,381	1,122
Related deferred policy acquisition costs	**292,539**	(139,637)	(135,298)
Related loss reserve	**7,121**	(21,975)	-
Related deferred income taxes	**143,931**	(108,066)	(69,655)
Related policyholder dividend obligation	**159,776**	(30,912)	(103,527)
Increase in net unrealized (losses) gains	**(267,301)**	200,694	129,355
Balance, beginning of year	**567,215**	366,521	237,166
Balance, end of year	**$ 299,914**	$ 567,215	$ 366,521

	2013	2012
Balance, end of year includes:		
Net unrealized gains on available-for-sale securities	**$ 854,153**	$ 1,727,670
Net unrealized gains on separate accounts	**5,545**	4,268
Net unrealized gains on other invested assets	**21,627**	20,055
Related deferred policy acquisition costs	**(265,994)**	(558,533)
Related loss reserve	**(14,854)**	(21,975)
Related deferred income taxes	**(161,493)**	(305,424)
Related policyholder dividend obligation	**(139,070)**	(298,846)
Balance, end of year	**$ 299,914**	$ 567,215

Net other comprehensive income related to unrealized (losses) gains on available-for-sale securities for 2013, 2012, and 2011 of ($267.3) million, $200.7 million, and $129.4 million, respectively, is presented net of reclassifications to net income for net realized gains during the period of $19.0 million, $4.8 million, and $0.1 million and net of tax and deferred acquisition cost offsets of $12.3 million, $3.2 million, and $0.1 million, respectively.

The amortized cost and fair values of debt securities by contractual maturity at December 31, 2013, 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.

Maturity Schedule
(in thousands)

	Amortized cost	Fair Value
Due in one year or less	**$ 543,544**	**$ 556,857**
Due after one yr through 5 yrs	**2,937,175**	**3,237,284**
Due after 5 yrs through 10 yrs	**4,644,614**	**4,800,404**
Due after ten years	**1,635,554**	**1,831,933**
Mortgage-backed securities	**4,866,441**	**5,042,679**
Total	**$ 14,627,328**	**$ 15,469,157**

Available-for-Sale Debt and Equity Securities (continued)

The Company determines the cost of investments sold based on average cost. Proceeds from sales of available-for-sale debt and equity securities for the years ended December 31, 2013, 2012, and 2011 were $270.2 million, $461.8 million, and $1,891.3 million, respectively. Gross realized gains on sales of available-for-sale debt securities for the years ended December 31, 2013, 2012, and 2011 were $16.1 million, $15.8 million, and $43.4 million, respectively. Gross realized losses on sales of available-for-sale debt securities for the years ended December 31, 2013, 2012, and 2011 were $2.3 million, $1.3 million, and $11.1 million, respectively. Gross realized gains on available-for-sale equity securities for the years ended December 31, 2013, 2012, and 2011 were $4.8 million, $0.8 million, and $2.0 million, respectively. Gross realized losses on available-for-sale equity securities for the years ended December 31, 2013, 2012, and 2011 were $0.1 million, $0.1 million, and $0 million, respectively.

The Company recognized $13.9 million, $21.5 million, and $24.7 million in realized losses for the years ended December 31, 2013, 2012, and 2011, respectively, resulting from other-than-temporary declines in the fair value of individual debt and equity securities held. Factors considered in determining whether declines in the fair value of securities are other-than temporary include 1) the significance of the decline, 2) the Company's ability and intent not to sell prior to recovery, 3) the time period during which there has been a significant decline in value, and 4) fundamental analysis of the liquidity, business prospects, and overall financial condition of NLVF. Based upon these factors, securities that have indications of potential impairment are subject to intensive review. Where such analysis results in a conclusion that declines in fair values are other-than-temporary, the security is written down to fair value.

The Company recognized $9.7 million, $19.4 million and $19.4 million in other-than-temporary impairments for the years ended December 31, 2013, 2012, 2011, respectively, related to debt securities. The Company selects debt securities to review for other-than-temporary declines based on qualitative and quantitative criteria including, but not limited to severity and duration of the decline, issuer specific credit information and industry information. For corporate bonds, the Company evaluates issuer specific credit, credit spreads of similar securities and overall market spreads to evaluate whether a decline in fair value is other than temporary in nature. Once a determination is made that a decline is other-than-temporary in nature, the Company assesses what portion of that decline is credit related and what is attributable to other market conditions. To make this determination the company considers the severity of the decline, duration of the decline and credit spreads of similar securities.

For asset-backed securities selected for review, the Company compares its cost to expected cash flows discounted at the effective interest rate implicit in the security at the date of acquisition. The discounted cash flows is determined by a discount model. The expected cash flows input into the model are determined by reviewing underlying collateral and assessing default and delinquency rates of the assets that are backing the investment as compared to the subordination of tranches that we hold. If it is determined that the discounted cash flow is lower that our cost, an impairment for the difference between the discounted cash flows and the Company's cost basis is recognized.

The Company recognized $0.6 million, $0 million, $3.4 million in other-than-temporary impairments for the years ended December 31, 2013, 2012 and 2011 related to common and preferred equity securities. The Company selects common and preferred equity securities to review for other-than-temporary declines based on qualitative and quantitative criteria including, but not limited to severity and duration of the decline, issuer specific credit information and industry information.

The Company recognized $3.6 million, $2.1 million and $1.9 million in other-than-temporary impairments for the years ended December 31, 2013, 2012 and 2011 related to limited partnership investments. The Company selects limited partnerships to review for other-than-temporary declines based on qualitative and quantitative criteria including, but not limited to severity and duration of the decline, specific credit information and industry information of the underlying investments. The limited partnerships selected for review are then assessed to determine if the decline is other-than-temporary in nature using management's judgment on the nature of the partnerships and the outlook of the underlying investments of the partnership. If it is deemed that a portion of

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt and Equity Securities (continued)

the decline is other-than-temporary in nature, the difference between the cost basis of the partnership and the net realizable value as determined by management's estimate is recognized as an other-than-temporary impairment.

Investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, were as follows (in thousands):

2013	Less than 12 months		12 months or more		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Government agencies, authorities and subdivisions	$ 1,633	$ 48	$ -	$ -	$ 1,633	$ 48
Corporate:						
Communications	114,884	4,843	-	-	114,884	4,843
Consumer & retail	414,471	16,785	16,043	1,709	430,514	18,494
Financial institutions	211,952	9,045	15,812	182	227,764	9,227
Industrial and chemicals	500,754	25,393	46,569	5,627	547,323	31,020
REITS	175,721	8,760	-	-	175,721	8,760
Transportation	14,430	896	5,602	608	20,032	1,504
Utilities	214,593	9,520	13,064	1,265	227,657	10,785
Total corporate	1,646,805	75,242	97,090	9,391	1,743,895	84,633
Private placements	480,422	20,870	18,627	1,865	499,049	22,735
Mortgage-backed securities	1,616,301	79,002	74,255	17,401	1,690,556	96,403
Subtotal debt securities	3,745,161	175,162	189,972	28,657	3,935,133	203,819
Preferred stock	-	-	6,241	2,041	6,241	2,041
Common stock	2,600	61	238	52	2,838	113
Total securities	$ 3,747,761	$ 175,223	$ 196,451	$ 30,750	$ 3,944,212	$ 205,973

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt and Equity Securities (continued)

2012	Less than 12 months		12 months or more		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government agencies, authorities and subdivisions	$ 476	$ 2	$ -	$ -	$ 476	$ 2
Corporate:						
Communications	-	-	-	-	-	-
Consumer & retail	52,303	1,578	15,192	1,519	67,495	3,097
Financial institutions	25,682	1,243	61,177	4,426	86,859	5,669
Industrial and chemicals	105,544	2,124	22,210	4,216	127,754	6,340
REITS	18,122	161	1,983	17	20,105	178
Transportation	6,106	119	-	-	6,106	119
Utilities	58,922	579	2,436	522	61,358	1,101
Total corporate	266,679	5,804	102,998	10,700	369,677	16,504
Private placements	47,375	2,437	9,951	49	57,326	2,486
Mortgage-backed securities	99,338	4,422	27,599	19,607	126,937	24,029
Subtotal debt securities	413,868	12,665	140,548	30,356	554,416	43,021
Preferred stock	-	-	7,303	979	7,303	979
Common stock	7,769	619	1,599	669	9,368	1,288
Total securities	$ 421,637	$ 13,284	$ 149,450	$ 32,004	$ 571,087	$ 45,288

NOTE 5 – INVESTMENTS (continued)

Available-for-Sale Debt and Equity Securities (continued)

Of the $175.2 million total unrealized losses on debt securities in the less than 12 months category, $75.2 million total unrealized losses are in the corporate bond portfolio. The unrealized losses are concentrated in the consumer and retail, industrial and chemical and utilities categories. In 2013, the Barclays US Corporate Investment Grade Index, an investment grade corporate bond index tightened by approximately 28 basis points from 139 basis points at the beginning of the year to 111 basis points at the end of the year. Over the same time period, the Barclays US Corporate High Yield Index tightened by approximately 141 basis points from a beginning level of 569 basis points to a year end level of 428. Despite the overall favorable credit environment in 2013, the group holds and monitors some individual credits that experienced adverse price action during this timeframe.

The debt securities in an unrealized loss position for less than 12 months also include $79.0 million of mortgage-backed securities. Of this amount, $77.9 million is attributable to the Residential Mortgage Backed Securities ("RMBS"). CMBS spreads tightened 2 bps in 2013 from 132 bps to 130 bps according to the Barclays US CMBS Index. The group's losses in CMBS are limited to a few structures where we continue to monitor the fundamentals closely.

Of the $28.7 million unrealized losses on debt securities in the more than 12 months category, $9.4 million was in the corporate bond portfolio. The unrealized losses are concentrated in the industrial and chemical, consumer & retail, and utilities sectors. Based on the 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 bonds at December 31, 2013 are temporary.

The debt securities in an unrealized loss position for 12 months or more are attributable to $17.4 million of mortgage-backed securities of which $11.5 million are attributable to the Commercial Mortgage Backed Securities ("CMBS") and $5.9 million are attributable to RMBS. The Company has no intention 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. At that time, the Company will record OTTI as appropriate.

Trading Equity Securities

These securities represent investments by the Company in the Sentinel Funds. SAMI has a contract with the Sentinel Funds ("Funds"), renewed annually, to manage the assets of the Funds. For the years ended December 31, 2013, 2012, and 2011 the equity securities held in the trading category recorded $1.3 million, $1.2 million, and $0.6 million, respectively, of net investment income. The cost of trading securities held at December 31, 2013 and 2012 was $16.8 million and $16.4 million respectively.

The total return on these 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):

	2013	2012
Geographic Region		
New England	**3.4%**	2.5%
Middle Atlantic	**4.0**	3.9
East North Central	**19.4**	18.6
West North Central	**4.9**	5.2
South Atlantic	**22.6**	22.1
East South Central	**5.5**	6.1
West South Central	**14.0**	15.0
Mountain	**10.0**	9.6
Pacific	**16.2**	17.0
Total	**100.0%**	100.0%
Property Type		
Apartment	**18.2%**	14.0%
Retail	**22.7**	22.2
Office Building	**37.7**	41.1
Industrial	**16.1**	18.0
Hotel/Motel	**0.4**	0.4
Other Commercial	**4.9**	4.3
Total	**100.0%**	100.0%
Mortgage loans	**$2,261,133**	$2,076,062
Real estate	**46,839**	49,958
Total mortgage loans and real estate	**$2,307,972**	$2,126,020

NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

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, commonly expressed as a percentage, compares the amount of the loan to the fair value of the underlying property collateralizing the loan. The following tables summarize the credit quality of the Company's commercial mortgage loan portfolio based on loan-to-value and debt service coverage ratios:

Debt Service Coverage Ratios as of December 31, 2013
(amounts in millions)

LTV Range	Greater than 2.0x	1.5x to 2.0x	1.25x to 1.5x	1.0x to 1.25x	Less than 1.0x	Total Carrying Value
< 50%	**$ 179.1**	**$ 129.4**	**$ 36.3**	**$ 5.2**	**$ 0.6**	**$ 350.6**
50% - 60%	**121.5**	**267.4**	**33.0**	**34.5**	**7.8**	**464.2**
60% - 70%	**85.4**	**511.9**	**137.3**	**47.2**	**14.5**	**796.3**
70% - 80%	**40.8**	**135.6**	**109.1**	**58.0**	**37.0**	**380.5**
80% - 90%	**-**	**32.2**	**33.9**	**44.8**	**38.1**	**149.0**
> 90%	**2.0**	**14.7**	**28.8**	**17.5**	**60.0**	**123.0**
Total	**$ 428.8**	**$ 1,091.2**	**$ 378.4**	**$ 207.2**	**$ 158.0**	**$ 2,263.6**

Debt Service Coverage Ratios as of December 31, 2012
(amounts in millions)

LTV Range	Greater than 2.0x	1.5x to 2.0x	1.25x to 1.5x	1.0x to 1.25x	Less than 1.0x	Total Carrying Value
< 50%	$ 113.9	$ 136.3	$ 22.0	$ 3.4	$ 5.5	$ 281.1
50% - 60%	139.5	210.2	114.2	18.9	14.5	497.3
60% - 70%	34.9	391.6	132.3	38.6	14.3	611.7
70% - 80%	9.1	126.5	138.4	53.6	42.5	370.1
80% - 90%	2.5	4.0	47.4	48.4	37.4	139.7
> 90%	-	14.2	22.8	64.7	89.0	190.7
Total	$ 299.9	$ 882.8	$ 477.1	$ 227.6	$ 203.2	$ 2,090.6

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

	2013	2012
Commercial loans	**$ 2,271,603**	$ 2,094,757
Related valuation allowances	**$ (2,504)**	(14,556)
Impaired loans	**$ (7,966)**	(4,139)
Total	**$ 2,261,133**	$ 2,076,062

	2013	2012	2011
Impaired loans:			
Average total investment	**$ 19,044**	$ 18,106	$ 23,537
Interest income recognized	**1,078**	780	234
Interest received	**1,220**	520	259
Unpaid principal balance	**22,768**	15,319	20,892

NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

The Company reviewed loans where there were indicators of potential impairments based on certain criteria, including macro-economic factors and loan specific indicators in accordance with accounting guidance. As a result of this review a loan valuation allowance was established for $2.5 million and $14.6 million, with the change in valuation allowance recorded in net investment income for the years ended December 31, 2013 and 2012, respectively.

Activity in the valuation allowances for mortgage loans for the years ended December 31 was as follows (in thousands):

	2013	2012	2011
Changes to previously established valuation allowances	**$ (12,052)**	$ 1,020	$ 3,070
Balance, beginning of year	**14,556**	13,536	10,466
Balance, end of year	**$ 2,504**	$ 14,556	$ 13,536

Mortgage Loans Modified in a Troubled Debt Restructuring

The Company has a high quality, well performing, commercial mortgage loan portfolio. For a small portion of the portfolio, classified as troubled debt restructuring, the Company grants concessions related to the borrowers' financial difficulties. Generally, the types of concessions include: reduction of the contractual interest rate, extension of the maturity date at an interest rate lower than current market interest rates and/or 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, 2013, the Company had 5 mortgage loans with aggregate impairments of $1.8 million which were modified during the period in a troubled debt restructuring.

During the previous twelve months, the Company had no mortgage loans modified in a troubled debt restructuring with a subsequent payment default at December 31, 2013. Payment default is determined in the same manner as delinquency status – when interest and principal payments are 60 days past due.

NOTE 5 – INVESTMENTS (continued)

Net Investment Income

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

	2013	2012	2011
Debt securities interest	**$ 766,757**	$ 773,313	$ 757,254
Equity securities dividends	**5,329**	4,225	3,265
Mortgage loan interest	**130,576**	122,749	109,954
Policy loan interest	**40,010**	40,266	40,970
Real estate income	**6,750**	7,841	5,354
Options	**334,341**	113,333	(37,534)
Other investment income	**11,020**	7,727	12,579
Gross investment income	**1,294,783**	1,069,454	891,842
Less: investment expenses	**(20,960)**	(20,098)	(17,142)
Less: valuation allowance on mortgage loans	**12,052**	(1,020)	(3,070)
Net investment income	**$ 1,285,875**	$ 1,048,336	$ 871,630

Other investment income includes income distributions from unconsolidated partnership investments and the amortization of investments in affordable housing credits.

The following summarizes the components of net realized investment (losses) gains, including other than temporary impairments, by investment category for the years ended December 31 (in thousands):

	2013	2012	2011
Debt securities	**$ 5,248**	$ (2,844)	$ 14,101
Equity securities	**5,109**	751	(878)
Mortgage loans	**(5,598)**	(4,188)	(3,501)
Partnerships	**(3,595)**	(2,068)	(1,922)
Other invested assets	**(1,478)**	285	243
Real estate	**(4,429)**	752	4
Total	**$ (4,743)**	$ (7,312)	$ 8,047

Derivatives

The Company purchases OTC options and exchange-traded futures on the S&P 500 and Russell 2000 indexes to hedge obligations relating to indexed products. These instruments and their related indexed embedded derivative obligations do not qualify for hedge accounting and, therefore, changes in their fair value are included within net investment income in the Consolidated Statements of Comprehensive Income. Call options purchased are included in derivatives on the consolidated balance sheet and are carried at fair value. Call options written are included in the derivatives liability and carried at fair value. Credit default swaps were purchased to hedge existing market exposure.

The Company purchases options only from highly rated counterparties. However, in the event a counterparty fails 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 $293.2 million as of December 31, 2013. The Company utilizes a scale based on credit rating of the counterparty to determine the appropriate amount of counterparty risk. As of December 31, 2013, there was no derivative counterparty exposure that exceeded $26.1 million net of collateral.

NOTE 5 – INVESTMENTS (continued)

Derivatives (continued)

Indexed annuity and life contracts are included in policyholder account liabilities and consist of a combination of underlying host contract and embedded derivative values. The embedded derivative component is based on the fair value of the contracts' expected participation in future increases in the S&P 500 or Russell 2000 indexes. 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, and the level and limits on contract participation in any future increases in the S&P 500 or Russell 2000 indexes. The Company incorporated two additional requirements in determining the fair value of a financial liability: (1) reflection of the reporting company's nonperformance risk and (2) reflection of a risk margin. The Company did not elect hedge accounting for any of those transactions and, therefore changes in their fair value are included in the Consolidated Statements of Comprehensive Income.

The embedded derivative value was $1,673.0 million and $1,332.8 million at December 31, 2013 and 2012 respectively.

The Company credits interest on policyholder account liabilities based on S&P 500 and Russell 2000 index performance at participation rates and with certain caps on returns. These participation rates and caps are set each policy year. The Company economically hedges this annual exposure at the time the participation rates and caps are set by purchasing S&P 500 and Russell 2000 index based derivatives in an amount that approximates the obligation of the company to credit interest at the end of the year with adjustments for lapse assumptions. Since the options 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. Since these movements are so closely correlated, there has not been any significant hedging ineffectiveness in the years ended December 31, 2013 and 2012.

The net notional amount of options purchased, options written, and those embedded in policy liabilities, all related to equity indexed products for the current policy year, is essentially nil. The notional amounts and the fair market value of options, futures, and credit default swaps at December 31 were as follows (in thousands):

	2013		**2012**	
	Notional	**Fair Market Value**	**Notional**	**Fair Market Value**
Options purchased	**$ 6,720,780**	**$ 870,599**	$ 5,748,500	$ 371,948
Options written	**(6,089,880)**	**(529,664)**	5,295,500	(167,733)
Swaptions purchased	**500,000**	**2,928**	-	-
Futures purchased	**4,875**	**1,059**	13,020	793
Credit Default Swaps	**5,000**	**(31)**	15,000	(497)
Net fair market value		**$ 344,891**		$ 204,511

NOTE 6 – REINSURANCE

The Company reinsures certain risks assumed in the normal course of business. For individual life products sold on or after August 16, 2004, the Company generally retains no more than $2.0 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 $1.0 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 $3.0 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 primarily 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% on the other modified coinsurance reserves held by the Company. All other rights and responsibilities outlined in the reinsurance agreements between the Company and UNUM remain in force.

Other income on the Consolidated Statements of Comprehensive Income includes income of $4.5 million, $5.7 million, and $5.9 million for 2013, 2012, and 2011, respectively, related to the Company's disability income reinsurance. Such income is primarily offset by expenses incurred by the Company related to this block of business. Reserve transfers and interest payments under modified coinsurance agreements are included in the Consolidated Statements of Comprehensive Income as a component of increase in policy liabilities expense.

NOTE 6 – REINSURANCE (continued)

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

	2013	2012	2011
Insurance premiums:			
Direct	**$ 317,441**	$ 340,293	$ 361,226
Reinsurance assumed	**1,052**	929	844
Reinsurance ceded	**(61,926)**	(64,480)	(64,344)
Total insurance premiums	**$ 256,567**	$ 276,743	$ 297,726
Increase in policy liabilities:			
Direct	**$ (45,627)**	$ 15,391	$ (10,854)
Reinsurance assumed	**(54)**	1	1
Reinsurance ceded	**33,847**	17,055	40,542
Total increase in policy liabilities	**$ (11,834)**	$ 32,447	$ 29,690
Policy benefits:			
Direct	**$ 532,348**	$ 481,973	$ 498,676
Reinsurance assumed	**133**	539	(44)
Reinsurance ceded	**(74,672)**	(72,448)	(70,219)
Total policy benefits	**$ 457,809**	$ 410,064	$ 428,412
Policyholders' dividends:			
Direct	**$ 79,967**	$ 95,700	$ 102,976
Reinsurance ceded	**(543)**	(721)	(1,129)
Total policyholders' dividends	**$ 79,424**	$ 94,980	$ 101,847

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, 2013 and 2012 was with Swiss Re for $64.6 million and $64.0 million, respectively.

Total life insurance in force as of December 31, 2013 and 2012 was approximately $75.0 billion and $68.5 billion, respectively.

NOTE 7 – DEFERRED POLICY ACQUISITION COSTS AND PRESENT VALUE OF FUTURE PROFITS OF INSURANCE ACQUIRED

The table below reflects the changes in the deferred policy acquisition costs asset.

(in thousands)	2013	2012	2011
Balance, beginning of year	**$ 546,864**	$ 659,618	$ 762,074
Acquisition costs deferred during the year	**259,080**	240,045	198,030
Amortization during the year	**(170,741)**	(213,162)	(165,188)
Adjustment through other comprehensive income during the year	**292,539**	(139,637)	(135,298)
Balance, end of year	**$ 927,742**	$ 546,864	$ 659,618

The Company holds PVFP attributable to two purchased blocks of insurance, the first attributed to an indirect purchase of a two-thirds ownership interest in LSW in February 1996, the second attributed to the indirect purchase of the remaining third ownership interest in July 1999. Amortization of PVFP was $4.4 million, $4.9 million, and $5.0 million for the years ended December 31, 2013, 2012, and 2011, respectively.

Projected amortization of PVFP during the next five years is as follows (in thousands):

Year	Projected Amortization
2014	$3,900
2015	3,500
2016	3,100
2017	2,800
2018	2,600

NOTE 8 – FEDERAL INCOME TAXES

The Company files income tax returns in the U.S. federal and certain state jurisdictions. During 2012, the IRS completed its examination of the Company's 2008 consolidated federal income tax return. The Company is awaiting Joint Committee approval of the examination results. The Company is no longer subject to U.S federal, state, and local income tax examinations by tax authorities for years prior to 2008.

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):

	2013		2012		2011	
	Amount	**Rate**	Amount	Rate	Amount	Rate
Current	**$ 9,427**		$ 18,516		$ (2,603)	
Deferred	**35,770**		20,837		50,398	
Total income tax expense	**$ 45,197**		$ 39,353		$ 47,795	
Expected income taxes	**$ 65,675**	**35.0%**	$ 57,384	35.0%	$ 59,561	35.0%
Dividends received deduction	**(1,840)**	**(1.0)**	(1,889)	(1.1)	(1,823)	(1.1)
Affordable housing tax credit	**(15,232)**	**(8.1)**	(11,975)	(7.3)	(7,924)	(4.7)
Corporate owned life insurance	**(3,230)**	**(1.7)**	(3,631)	(2.2)	(2,493)	(1.5)
Other, net	**(176)**	**(0.1)**	(536)	(0.4)	474	0.4
Total income tax expense	**$ 45,197**		$ 39,353		$ 47,795	
Effective federal income tax rate		**24.1%**		24.0%		28.1%

The Company paid $10.0 million, received $1.1 million and paid $28.5 million in federal income taxes during 2013, 2012, and 2011, respectively.

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

	2013	2012
Balance, beginning of year	**$ 9,657**	$ 20,174
Additions/(reductions) based on tax positions related to current year	**(1,166)**	(1,166)
Additions/(reductions) based on tax positions related to prior years	**-**	(522)
Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	**-**	(7,770)
Settlements	**-**	(1,059)
Balance, end of year	**$ 8,491**	$9,657

Total unrecognized tax benefits were $9.1 million at December 31, 2013, including $0.6 million that would impact net income if recognized. The company does not expect any significant change in liability for federal income tax loss contingencies within the next twelve months.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. During the years ended December 31, 2013, 2012, and 2011, the Company has recognized approximately $0.1 million in expense and $1.3 million in benefits and $0.1 million in expense, respectively, related to interest and penalties. The Company had approximately $0.6 million and $0.4 million accrued for interest and penalties at December 31, 2013 and 2012, respectively.

NOTE 8 – FEDERAL INCOME TAXES (continued)

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

	2013	2012
Deferred income tax assets:		
Policy liabilities	**$ 323,541**	$ 363,591
Pension and other employee benefits	**57,395**	76,678
Debt/Equity Securities	**-**	-
Net UCL AFS Debt/Equity Securities	**-**	-
Other invested assets	**1,810**	7,113
Loss carryforwards	**4,047**	9,298
Accrued Expenses	**-**	-
Other	**3,737**	3,495
Total deferred income tax assets	**390,530**	460,175
Deferred income tax liabilities:		
Deferred policy acquisition costs	**236,883**	108,148
Debt/Equity Securities	**28,191**	16,499
Net UCL AFS Debt/Equity Securities	**298,953**	604,684
PV Future Profits	**6,007**	7,553
Property and Equipment	**23,610**	15,450
Other	**-**	-
Total deferred income tax liabilities	**593,644**	752,334
Total net deferred income tax assets (liabilities)	**$ (203,114)**	$ (292,159)

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, 2013 or 2012.

At December 31, 2013, the Company has federal operating loss carryforwards related to the non-life insurance companies of $11.6 million which expire in 2032.

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 non-contributory qualified defined benefit plan for fulltime employees of the general agents. 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 was no benefit increase after December 31, 2003 for current participants. These pension plans are separately funded. Plan assets are primarily bonds and common stocks held in a Company separate account and funds invested in a general account group annuity contract issued by National Life. None of the securities held in the Company's separate account were issued by the Company, but some investments are advised by an affiliate.

The Company also sponsors other pension plans, including a non-contributory defined benefit plan for National Life career general agents contracted prior to July 1, 2001 that provides benefits based on years of service and sales levels 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 post-retirement plans that provide medical and life insurance benefits to certain retired employees, agency staff, agents and general agents. Spouses of participants and dependents generally qualify for the medical coverage and dental plans. Substantially all employees who began service prior to July 1, 2001 may be eligible for medical and life insurance retiree benefits if they are employed until retirement age and meet certain minimum service requirements while working for the Company. Substantially all employees beginning service prior to January 1, 2005 may be eligible for life insurance retiree benefits if they reach retirement age and meet certain minimum service requirements while working for the Company.

Medical coverage is contributory, with retiree contributions adjusted annually, and contain cost sharing features such as deductibles and copayments. These post-retirement 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.

NOTE 9 – BENEFIT PLANS (continued)

Information with respect to the defined benefit plans at December 31 was as follows (in thousands):

	Pension Benefits			Other Benefits		
	2013	2012	2011	**2013**	2012	2011
Change in benefit obligation:						
Benefit obligation, beginning of year	**$ 374,259**	$ 319,208	$ 291,378	**$ 29,935**	$ 38,300	$ 33,967
Service cost for benefits earned during the period	**7,013**	6,749	5,859	**382**	1,042	828
Interest cost on benefit obligation	**13,783**	13,887	15,485	**1,091**	1,671	1,810
Plan participants' contributions	**–**	–	–	**976**	994	881
Actuarial (gains)/ losses	**(24,945)**	53,893	23,820	**(3,484)**	(8,739)	3,818
Curtailment	**–**	–	–	**–**	–	–
Benefits paid	**(20,737)**	(19,478)	(17,334)	**(2,443)**	(3,333)	(3,004)
Benefit obligation, end of year	**349,373**	374,259	319,208	**26,457**	29,935	38,300
Change in plan assets:						
Plan assets, beginning of year	**208,014**	175,371	165,990	**–**	–	–
Actual income on plan assets	**32,431**	17,216	5,368	**–**	–	–
Employer contributions	**24,189**	34,905	21,347	**2,443**	2,339	2,123
Plan participants' contributions	**–**	–	–	**976**	994	881
Benefits paid	**(20,737)**	(19,478)	(17,334)	**(2,443)**	(3,333)	(3,004)
Plan assets, end of year	**243,897**	208,014	175,371	**–**	–	–
Funded Status	**$ (105,476)**	$ (166,245)	$ (143,837)	**$ (26,457)**	$ (29,935)	$ (38,300)

	Pension Benefits			Other Benefits		
	2013	2012	2011	**2013**	2012	2011
Amounts recognized in the Consolidated Balance Sheets:						
Pension and other post-retirement benefit obligations liability	**$ 41,605**	$ 48,491	$ 55,602	**$ 33,528**	$ 36,391	$ 35,946
Accumulated other comprehensive income	**63,871**	117,754	88,235	**(7,071)**	(6,456)	2,354
Net amount recognized	**$ 105,476**	$ 166,245	$ 143,837	**$ 26,457**	$ 29,935	$ 38,300
Pension and other post-retirement benefit obligations liability	**$ (105,476)**	$ (166,245)	$ (143,837)	**$ (26,457)**	$ (29,935)	$ (38,300)
Amounts recognized in accumulated other comprehensive income consists of:						
Net actuarial loss	**$ 63,871**	$ 117,859	$ 88,340	**$ 2,987**	$ 6,617	$ 3,417
Net prior service costs (benefits)	**-**	(105)	(105)	**(10,058)**	(13,073)	(1,063)
	$ 63,871	$ 117,754	$ 88,235	**$ (7,071)**	$ (6,456)	$ 2,354

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 obligation 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 (in thousands):

	2013	2012	2011
Total Accumulated Benefit Obligation	$ 335,384	$ 359,497	$ 306,715
Plans with ABO in excess of plan assets:			
ABO	335,384	359,497	306,715
Fair value of plan assets (1)	243,999	207,767	175,949
Plans with PBO in excess of plan assets:			
PBO	349,373	374,259	319,208
Fair value of plan assets (1)	243,999	207,767	175,949

(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 were as follows (in thousands):

	Pension Benefits			**Other Benefits**		
	2013	2012	2011	**2013**	2012	2011
Service cost for benefits earned during the period	**$ 7,013**	$ 6,749	$ 5,859	**$ 382**	$ 1,042	$ 828
Interest cost on benefit obligation	**13,783**	13,887	15,485	**1,091**	1,671	1,810
Expected (income) on plan assets	**(14,566)**	(12,379)	(11,691)	**–**	–	–
Net amortization of actuarial losses (gains)	**11,175**	7,212	3,901	**1,121**	256	(207)
Amortization of prior service costs (benefits) and plan amendments	**(38)**	(67)	(67)	**(3,014)**	(185)	(185)
Net periodic benefit cost (included in operating expenses)	**$ 17,367**	$ 15,402	$ 13,487	**$ (420)**	$ 2,784	$ 2,246

NOTE 9 – BENEFIT PLANS (continued)

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

	Pension Benefits			Other Benefits		
	2013	2012	2011	**2013**	2012	2011
Net gain (loss)	**$ 42,746**	$ (36,664)	$ (30,143)	**$ 1,279**	$ (3,456)	$ 4,602
Prior service (cost) benefit	**-**	-	-	**-**	12,195	-
Amortization of (gain) loss	**11,175**	7,212	3,901	**1,121**	256	(207)
Amortization of prior service cost (benefits)	**(38)**	(67)	(67)	**(3,014)**	(185)	(185)
Total recognized in other comprehensive income	**$ 53,883**	$ (29,519)	$ (26,309)	**$ (615)**	$ 8,810	$ 4,210

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 $5.1 million and $3.0 million, respectively.

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

	Pension Benefits			Other Benefits		
	2013	2012	2011	**2013**	2012	2011
Discount rate	**4.80%**	3.80%	4.50%	**4.80%**	3.80%	4.50%
Rate of increase in future compensation levels	**3.0% - 5.0%**	3.0% - 5.0%	3.0% - 5.0%			

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

	Pension Benefits			Other Benefits		
	2013	2012	2011	**2013**	2012	2011
Discount rate	**3.80%**	4.50%	5.50%	**3.80%**	4.50%	5.50%
Rate of increase in future compensation levels	**3.0% - 5.0%**	3.0% - 5.0%	3.0% - 6.5%			
Expected long term return on plan assets	**7.00%**	7.00%	7.00%			

NOTE 9 – BENEFIT PLANS (continued)

Included in the pension and other post-retirement benefit obligations liability as reported on the balance sheets are deferred compensation and employee disability liabilities of $32.2 million and $31.1 million as of December 31, 2013 and 2012, respectively. Effective January 1, 2013, the cost sharing arrangements associated with the other post-retirement employee benefits were amended. This created a $12.2 million benefit which is included as a prior service cost benefit in other comprehensive income and resulted in a decrease in the other post-retirement benefit liability.

Assumed health care cost trend rates (HCCTR) at December 31, 2013:

Weighted average health care cost trend rate assumed for next year	9.29%
Rate to which the cost trend rate is assumed to decline	5%
Year that the rate reaches the ultimate trend rate	2023

Increasing the assumed HCCTR by one percentage point in each year would increase the accumulated post-retirement benefit obligation ("APBO") by about $0.9 million. Decreasing the assumed HCCTR by one percentage point in each year would reduce the APBO by about $0.8 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, 2013**	December 31, 2012
Bonds	**20%**	26%
Common stocks	**61%**	57%
Group annuity contract and other	**19%**	17%
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 40%-70% equities, 30%-50% bonds and 0 – 10% alternative investments when measured at fair value.

The Company's expected future long-term rate of return of 7.0% 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.

NOTE 9 – BENEFIT PLANS (continued)

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

			2013		2012
Common stocks – unaffiliated	Consumer Discretionary	**$**	**13,074**		13,360
	Consumer Staples		**5,484**		7,095
	Energy		**6,689**		7,825
	Equity Funds (1)		**49,900**		22,814
	Financials		**23,096**		11,339
	Health Care		**11,699**		14,126
	Industrial		**12,551**		15,149
	Information Technology		**19,821**		21,335
	Materials		**3,643**		4,433
	Telecommunication Services		**1,301**		1,024
	Utilities		**601**		738
	Total common stocks		**147,857**		119,238
Long term bonds	US Government		**33,554**		42,919
	Automotive		**682**		553
	Chemicals		**2,056**		2,099
	Consumer Products		**523**		-
	Distributors		**113**		-
	Food and Beverage		**1,903**		2,078
	Home Construction		**130**		-
	Independent		**3,047**		1,046
	Integrated		**-**		1,093
	Media		**129**		-
	Metals and Mining		**274**		-
	Insurance- Property and Casualty		**494**		-
	Packaging		**508**		541
	Refining		**2,036**		2,233
	Technology		**433**		-
	Wireless		**1,851**		2,039
	Total long term bonds		**47,733**		54,601
Short term investments	Money Market Funds - Banking		**29,660**		23,490
	US Government		**7,000**		8,000
	US Treasury		**-**		2,000
	Total short term investments		**36,660**		33,490
Partnerships			**10,088**		-
Cash			**1,362**		391
Group annuity			**299**		47
	Total Investments (2)	**$**	**243,999**	$	207,767

(1) Consists of investments advised by the Company's subsidiary SAMI.

(2) The difference to total plan assets shown of $243,897 for 2013 and $208,014 for 2012 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 and are included on the hierarchy in Note 4.

The valuation techniques used for the plan assets are:

Government obligations - U.S. government obligations consists primarily of FNMA and GNMA mortgage-backed securities and U.S treasuries. 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. The fair value of 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.

NOTE 9 – BENEFIT PLANS (continued)

Common stock - Fair values of common stocks are based on unadjusted quoted market prices from pricing services as well as primary and secondary brokers/dealers. Common stocks are categorized into Level 1 of the fair value hierarchy.

Corporate bonds - Corporate bonds are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads. These securities are categorized in Level 2 of the fair value hierarchy.

Short term investments - Short term investments consist of mutual funds invested in money market and government agencies. Short term investments in money market funds are categorized in Level 1 of the hierarchy, whereas short term investments in government agencies, which are not traded daily, are categorized in Level 2 of the hierarchy.

General investment account - This category consists of an investment in a National Life 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 are as follows (in thousands):

2013 Fair Value				**Not Presented**	
Assets	**Level 1**	**Level 2**	**Level 3**	**at Fair Value**	**Total**
Common Stock	147,958	-	-	-	147,958
Corporate	-	14,179	-	-	14,179
Partnerships	-	-	10,088	-	10,088
Mortgage backed securities	-	33,849	-	-	33,849
Cash	1,362	-	-	-	1,362
Short term investments	29,660	7,000	-	-	36,660
Group annuity	-	299	-	-	299
Total Assets	$ 178,980	$ 55,327	$ 10,088	$ -	$ 244,395
Liabilities					
Total Liabilities	-	-	-	502	502
Total Plan Assets	$ 178,980	$ 55,327	$ 10,088	$ 502	$ 244,897

2012 Fair Value				**Not Presented**	
Assets	**Level 1**	**Level 2**	**Level 3**	**at Fair Value**	**Total**
Common Stock	$ 119,327	$ -	$ -	$ -	$ 119,327
Corporate	-	11,682	-	-	11,682
Mortgage backed securities	-	43,180	-	-	43,180
Cash	391	-	-	-	391
Short term investments	23,490	10,000			33,490
Group annuity	-	51	-	-	51
Total Assets	$ 143,208	$ 64,913	$ -	$ -	$ 208,121
Liabilities					
Total Liabilities	-	-	-	107	107
Total Plan Assets	$ 143,208	$ 64,913	$ -	$ (107)	$ 208,014

During 2013 and 2012, there were no significant transfers between fair value levels 1 and 2. In 2013, there were no transfers in or out of level 3.

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, 2013, 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
2014	$23,341	$2,103	$45
2015	20,659	2,002	48
2016	21,606	2,057	51
2017	22,192	2,117	52
2018	22,899	2,103	51
2019-2023	131,567	9,881	226

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 2014 into its separately funded defined benefit pension plans is approximately $15 million.

The Company provides employee 401(k) plans for its employees. Under the Company's 401(k) pension 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.

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.

Under the Company's 401(k) plan for agency employees, eligible agency employees receive a matching contribution of 100% of their elective deferrals up to 4% of compensation. The Company provides non-qualified defined contribution deferred compensation plans for certain employees, agents, general agents and independent directors.

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 (several of which are sponsored by the Company's subsidiary, SAMI). 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 – GOODWILL AND OTHER INTANGIBLES

The Company had goodwill of $7.3 million and intangible assets of $45.7 million at December 31, 2013. In 2013 and 2012, there were no impairments or other reductions recorded.

	December 31, 2013			December 31, 2012		
	(Amounts in millions)			*(Amounts in millions)*		
	Gross	**Accumulated Impairments**	**Carrying Value**	Gross	Accumulated Impairments	Carrying Value
Goodwill	**$ 7.7**	**$ (0.4)**	**$ 7.3**	$ 7.7	$ (0.4)	$ 7.3
Intangibles - Non-amortizing	**47.2**	**(1.5)**	**45.7**	47.2	(1.5)	45.7
Total	**$ 54.9**	**$ (1.9)**	**$ 53.0**	$ 54.9	$ (1.9)	$ 53.0

NOTE 11 – DEBT

Debt consists of the following (in thousands):

	2013	2012
7.5% Senior Notes:	**$ 199,334**	$ 199,302
$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:	**68,014**	68,014
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 milllion of the senior note. Interest paid to the subsidiary is eliminated in consolidation.		
Note Payable:	**20,619**	20,619
$20.6 million, callable at par on May 15, 2010, and maturing on May 15, 2033. The note is unsecured and subordinate to all current and future obligations. The interest rate floats based on LIBOR and resets quarterly.		
10.5% Surplus Notes:	**200,000**	200,000
$200 million, maturing September 15, 2039, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of National Life.		
Total debt	**$ 487,967**	$ 487,935

Interest paid on the 7.5% senior notes was $15.0 million in 2013, 2012, and 2011. Interest paid on the 6.5% senior notes was $4.9 million in 2013, 2012 and 2011. Interest paid on the $20.6 million note payable was $0.9 million in 2013 and $1.0 million in 2012 and 2011. Interest recognized on the 10.5% surplus note was $21.0 million in 2013, 2012, and 2011.

National Life has a secured asset-based borrowing capacity of $1.66 billion with FHLB. For additional information see Note 2.

NOTE 12 – 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), which is pending before the U.S. District Court for the Central District of California (the "Court") and captioned Walker, et al. v. Life Ins. Co. of the Southwest. Plaintiffs assert claims under the California Unfair Competition Law and for fraudulent concealment, alleging that LSW 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. Plaintiffs seek a variety of alternative forms of relief, including actual and punitive damages or rescission, injunctive relief, and an award of attorneys' fees. The Company denies engaging in any misconduct, and believes it has meritorious defenses to the claims asserted in Walker. On November 9, 2012, the Court certified a class of all Provider and Paragon policyholders who purchased their policies in California on or after September 24, 2006 and a sub-class of those who received an illustration on or before the date they submitted a policy application. On November 26, 2012, LSW filed a petition with the U.S. Court of Appeals for the Ninth Circuit seeking an interlocutory appeal of the class certification order. On February 27, 2013, LSW's petition for permission to appeal the District Court's certification order was denied. On May 20, 2013, the parties appeared before the Court for a show cause hearing regarding why the Court should not decertify the illustration subclass. On May 28, 2013, the Court issued a ruling decertifying the illustration subclass on predominance grounds. On or about August 19, 2013, notice was sent to potential class members advising them of the remaining certified claims and the November 19, 2013 deadline to opt out of the class. On September 10, 2013, Plaintiffs filed a motion for Reconsideration and Leave to Amend the operative Complaint. LSW opposed the motion and, also on September 10, 2013 filed, a Motion to Decertify the remaining class claims. On November 1, 2013, the Court denied both motions. Fact and Expert Discovery is now closed. Currently, a jury trial of the matter is scheduled to commence April 8, 2014. At this time, the Company is unable to predict the outcome or a range of possible outcomes for this matter.

The Company currently leases rights to the use of certain data processing hardware and software from Dell, Plano, Texas. The Company extended its agreement with Dell around certain hardware through July 31, 2016. The Company also extended its mainframe lease through January 31, 2017. The following is a schedule of future minimum lease payments as of December 31, 2013 (in thousands).

Year	Contract Obligation
2014	12,635
2015	11,556
2016	9,288
2017	504
Total minimum payments	$ 33,983

The Company has a multi-year contract for information systems application and infrastructure services from NTT Data, Boston, Massachusetts. The contract became effective on February 1, 2004 and expires April 30, 2014. The Company's remaining obligation under the contract as of December 31, 2013 (in thousands):

NOTE 12 – COMMITMENTS AND CONTINGENCIES (continued)

Year	Contract Obligation
2014	12,777
Total minimum payments	$ 12,777

Rental expense paid under the above referenced operating leases with Dell and NTT was $36.3 million, $31.6 million, and $29.0 million for the years ended December 31, 2013, 2012, and 2011, respectively. The rental expense paid includes the minimum rental commitment and any variable expenses related to project work performed during the year.

The Company signed a multi-year contract with I-Pipeline which became effective January 1, 2013 through December 31, 2017. The contract provides new business support through electronic application. The Company's outstanding commitment under the contract as of December 31, 2013 (in thousands):

Year	Contract Obligation
2014	1,500
2015	1,500
2016	1,500
2017	1,500
Total minimum payments	$ 6,000

Unfunded Commitments – The Company had unfunded mortgage loan, partnerships, and private placement commitments of $68.7 million, $129.9 million, and $67.5 million, respectively, at December 31, 2013. 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 13 – 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 policyholders of participating policies in force at December 31, 1998, and includes traditional dividend paying life insurance policies, certain participating term insurance policies, dividend paying flex premium annuities, and other related liabilities. The Closed Block's primary purpose is to protect the policy dividend expectations related to these policies. 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. Based on current projections, Closed Block assets are sufficient to meet all future obligations. 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 2013, 2012, and 2011, due to unfavorable experience there was no policyholder dividend obligation recorded through earnings. Similarly, unrealized gains on Closed Block investments may

NOTE 13 – NATIONAL LIFE CLOSED BLOCK (continued)

increase the policyholder dividend obligation liability. Unrealized gains in the Closed Block generated a policyholder dividend obligation through accumulated other comprehensive income of $139.1 million, $298.8 million, and $267.9 million at December 31, 2013, 2012 and 2011, respectively. These gains and their related policyholder dividend obligation and income tax offsets are included in other comprehensive income. The total policyholder dividend obligation at December 31, 2013 and 2012 was $139.1 million and $298.8 million, respectively.

Summarized financial information for the Closed Block effects included in the consolidated financial statements as of December 31, 2013 and 2012, and for the three years ended December 31, 2013, 2012 and 2011 is as follows (in thousands):

	2013	2012
Liabilities:		
Policy liabilities and accruals	**$ 3,594,767**	$ 3,830,072
Other liabilities	**–**	411
Total liabilities	**$ 3,594,767**	$ 3,830,483
Assets:		
Cash	**$ 4,818**	$ 2,560
Short term investments	**43,000**	4,800
Available-for-sale debt and equity securities	**2,540,830**	2,770,596
Mortgage loans	**228,215**	244,039
Policy loans	**444,968**	458,031
Accrued investment income	**36,137**	38,010
Premiums and fees receivable	**6,772**	7,730
Other assets	**48,352**	51,890
Total assets	**$ 3,353,092**	$ 3,577,656
Excess of reported liabilities over assets	**$ 241,675**	$ 252,827
Closed block accumulated other comprehensive loss	**–**	–
Unrealized loss and liabilities	**$ 241,675**	$ 252,827

NOTE 13 – NATIONAL LIFE CLOSED BLOCK (continued)

	2013	2012	2011
Revenues:			
Premiums and other income	**$ 146,121**	$ 169,072	$ 186,045
Net investment income	**169,674**	177,161	182,950
Net investment (loss) gain	**(500)**	1,765	2,035
Total revenues	**$ 315,295**	$ 347,998	$ 371,030
Benefits and Expenses:			
Decrease in policy liabilities	**(69,023)**	(33,182)	(28,794)
Policy benefits	**280,967**	259,757	275,486
Policyholders' dividends	**70,126**	86,910	94,293
Interest credited to policyholder account liabilities	**8,505**	10,151	8,941
Operating expenses	**6,059**	5,995	7,164
Commission expenses	**1,399**	1,552	1,626
Total benefits and expenses	**$ 298,033**	$ 331,183	$ 358,716
Pre-tax results of operations	**17,262**	16,815	12,314
Income taxes	**6,110**	5,928	4,357
Closed block results of operations	**$ 11,152**	$ 10,887	$ 7,957
Other comprehensive income:			
Unrealized loss	**–**	–	–
Total closed block comprehensive income	**$ 11,152**	$ 10,887	$ 7,957
Excess of reported closed block liabilities over closed block assets:			
Beginning of year	**252,827**	263,714	271,671
Closed block comprehensive income	**11,152**	10,887	7,957
End of year	**$ 241,675**	$ 252,827	$ 263,714

Amortized cost of bonds held by the Closed Block at December 31, 2013 and 2012 were $2,401.8 million and $2,471.7 million, respectively.

Participating insurance in force within the Closed Block at December 31, 2013 and 2012 was $7.2 billion and $7.9 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 14 – STATUTORY INFORMATION AND RESTRICTIONS

The Company's insurance operations, domiciled in the states of Vermont for National Life and Texas for 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. The Company's insurance operations do not have any permitted practices.

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 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 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. In 2013, LSW paid a $25 million dividend to National Life and National Life paid a $25 million dividend to NLVF. In 2012, LSW paid a $30 million dividend to National Life and National Life paid a $30 million dividend to NLVF. In 2011, there was no dividend paid by National Life to NLVF. The dividends were eliminated in consolidation. Dividends declared by National Life in excess of the lesser 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.

The New York Department of Financial Services recognizes only statutory accounting practices for determining and reporting the financial condition and results of operations of an insurance company and for determining solvency under the New York Insurance Law. No consideration is given by the New York Department of Financial Services to financial statements prepared in accordance with U.S. GAAP in making such determinations.

National Life's statutory surplus was $1,413.1 million and $1,287.1 million at December 31, 2013 and 2012, respectively. Statutory net income was $88.5 million, $64.6 million, and $25.9 million in 2013, 2012, and 2011, respectively.

Pursuant to certain statutory requirements, as of December 31, 2013, National Life and LSW had securities on deposit with a statutory carrying value of $7.0 million and $3.4 million, respectively, in insurance department special deposit accounts.

NOTE 15 – PARTICIPATING LIFE INSURANCE

Participating life insurance in force was 35.0% and 38.9% of the face value of total insurance in force at December 31, 2013 and 2012, respectively. The premiums on participating life insurance policies were 23.1%, 30.8%, and 34.5% of total individual life insurance premiums in 2013, 2012, and 2011, respectively.