

NLV Financial Corporation and Subsidiaries

Financial Statements

**As of and for the Years Ended
December 31, 2015 and 2014**

NLV Financial Corporation and Subsidiaries
Index
December 31, 2015 and 2014

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Independent Auditor's Report

To the Board of Directors 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, 2015 and 2014, 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, 2015.

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 as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

February 25, 2016

NLV Financial Corporation and Subsidiaries
Consolidated Balance Sheets
As of December 31, 2015, and 2014

(in thousands)

Assets:

Cash and investments:

| | 2015 | 2014 |
|---|----------------------|----------------------|
| Available-for-sale debt securities | \$ 17,111,699 | \$ 16,879,781 |
| Available-for-sale equity securities | 60,916 | 25,938 |
| Trading equity securities | 14,505 | 14,890 |
| Mortgage loans | 2,686,711 | 2,331,749 |
| Policy loans | 823,456 | 808,598 |
| Real estate investments | 44,667 | 54,041 |
| Derivatives | 299,941 | 677,169 |
| Other invested assets | 631,439 | 511,624 |
| Short term investments | 244,043 | 270,320 |
| Cash and restricted cash | 141,168 | 258,452 |
| Total cash and investments | 22,058,545 | 21,832,562 |
| Deferred policy acquisition costs | 1,295,231 | 951,160 |
| Accrued investment income | 199,025 | 184,877 |
| Premiums and fees receivable | 19,685 | 19,422 |
| Federal income tax recoverable | - | 12,863 |
| Amounts recoverable from reinsurers | 135,208 | 126,013 |
| Present value of future profits of insurance acquired | 9,751 | 13,236 |
| Property and equipment, net | 169,978 | 144,304 |
| Corporate owned life insurance | 268,115 | 245,025 |
| Other assets | 124,930 | 116,495 |
| Separate account assets | 714,621 | 771,669 |
| Total assets | \$ 24,995,089 | \$ 24,417,626 |

Liabilities:

Policy liabilities:

| | | |
|---|----------------------|----------------------|
| Policy benefit liabilities | \$ 4,509,427 | \$ 4,572,292 |
| Policyholder account liabilities | 15,760,710 | 14,358,653 |
| Policyholders' deposits | 85,591 | 82,482 |
| Policy claims payable | 61,567 | 61,405 |
| Policyholders' dividends | 154,114 | 246,145 |
| Total policy liabilities | 20,571,409 | 19,320,977 |
| Amounts payable to reinsurers | 26,305 | 38,853 |
| Derivatives | 139,507 | 358,905 |
| Other liabilities and accrued expenses | 438,724 | 551,343 |
| Pension and other post-retirement benefit obligations | 225,680 | 252,801 |
| Deferred income taxes | 150,541 | 251,922 |
| Federal income tax payable | 576 | - |
| Debt | 457,743 | 467,381 |
| Separate account liabilities | 714,621 | 771,669 |
| Total liabilities | \$ 22,725,106 | \$ 22,013,851 |

Stockholder's Equity:

| | | |
|--|----------------------|----------------------|
| Class A common stock, 2,000 shares authorized, no shares issued and outstanding | \$ - | \$ - |
| Class B common stock, par value of \$0.01, 1,001 shares authorized, 100 shares issued and outstanding | - | - |
| Preferred stock, 500 shares authorized, no shares issued and outstanding | - | - |
| Retained earnings | 2,243,408 | 2,134,104 |
| Accumulated other comprehensive income | 26,575 | 269,671 |
| Total stockholder's equity | \$ 2,269,983 | \$ 2,403,775 |
| Total liabilities and stockholder's equity | \$ 24,995,089 | \$ 24,417,626 |

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, 2015, 2014 and 2013

(in thousands)

| | 2015 | 2014 | 2013 |
|---|---------------------|-------------------|--------------------|
| Revenues: | | | |
| Insurance premiums | \$ 227,547 | \$ 231,629 | \$ 256,567 |
| Policy and contract charges | 445,899 | 396,358 | 346,338 |
| Mutual fund commissions and fee income | 100,826 | 107,321 | 109,839 |
| Net investment income | 925,208 | 1,186,100 | 1,297,458 |
| Net realized investment (losses) gains | (8,581) | 24,685 | (4,743) |
| Change in value of trading equity securities | (1,130) | (1,029) | 2,360 |
| Other income | 16,661 | 15,359 | 15,194 |
| Total revenues | 1,706,430 | 1,960,423 | 2,023,013 |
| Benefits and Expenses: | | | |
| Decrease in policy liabilities | (1,720) | (50,994) | (11,834) |
| Policy benefits | 440,896 | 512,671 | 457,809 |
| Policyholders' dividends and dividend obligations | 64,289 | 83,413 | 79,424 |
| Interest credited to policyholder account liabilities | 427,754 | 564,687 | 743,522 |
| Operating expenses | 274,790 | 264,332 | 243,260 |
| Interest expense | 40,149 | 41,434 | 41,610 |
| Policy acquisition expenses and amortization of present value of future profits, net | 309,024 | 338,696 | 269,997 |
| Total benefits and expenses | 1,555,182 | 1,754,239 | 1,823,788 |
| Income before income taxes | 151,248 | 206,184 | 199,225 |
| Income tax expense | 41,944 | 61,866 | 56,780 |
| Net income | \$ 109,304 | \$ 144,318 | \$ 142,445 |
| Other comprehensive income, net of tax: | | | |
| Unrealized (losses) gains on available-for-sale securities | (258,047) | 83,362 | (267,301) |
| Cash flow hedge on debt issuance | 34 | 34 | 34 |
| Change in funded status of retirement plans | 14,917 | (76,077) | 35,466 |
| Total other comprehensive (loss) income | (243,096) | 7,319 | (231,801) |
| Comprehensive (loss) income | \$ (133,792) | \$ 151,637 | \$ (89,356) |

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, 2015, 2014, and 2013

| | Class A Common Stock | Class B Common Stock | Preferred Stock | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|----------------------------|----------------------------|----------------------------|--------------------|----------------------|---|--------------------|
| <i>(in thousands)</i> | | | | | | |
| December 31, 2012 | \$ - | \$ - | \$ - | \$ 1,847,341 | \$ 494,153 | \$ 2,341,494 |
| Net income | - | - | - | 142,445 | - | 142,445 |
| Other comprehensive income | - | - | - | - | (231,801) | (231,801) |
| Total comprehensive income | | | | | | (89,356) |
| December 31, 2013 | - | - | - | 1,989,786 | 262,352 | 2,252,138 |
| Net income | - | - | - | 144,318 | - | 144,318 |
| Other comprehensive income | - | - | - | - | 7,319 | 7,319 |
| Total comprehensive income | | | | | | 151,637 |
| December 31, 2014 | - | - | - | 2,134,104 | 269,671 | 2,403,775 |
| Net income | - | - | - | 109,304 | - | 109,304 |
| Other comprehensive income | - | - | - | - | (243,096) | (243,096) |
| Total comprehensive income | | | | | | (133,792) |
| December 31, 2015 | \$ - | \$ - | \$ - | \$ 2,243,408 | \$ 26,575 | \$2,269,983 |

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

NLV Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2015, 2014, and 2013

(in thousands)

| | 2015 | 2014 | 2013 |
|---|--------------------|-------------------|-------------------|
| Cash Flows from Operating Activities: | | | |
| Net income | \$ 109,304 | \$ 144,318 | \$ 142,445 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for deferred income taxes | 29,663 | 42,057 | 35,770 |
| Interest credited to policyholder account liabilities | 427,754 | 564,687 | 743,522 |
| Amortization of deferred policy acquisition costs | 202,049 | 235,482 | 170,741 |
| Policy and contract charges | (445,899) | (396,358) | (346,338) |
| Net realized investment (gains) losses | 8,581 | (24,685) | 4,743 |
| Net option (gains) losses | 79,606 | (199,619) | (334,341) |
| Change on corporate owned life insurance policies | (7,156) | (8,700) | (8,632) |
| Amortization of present value of future profits of insurance acquired | 3,485 | 3,928 | 4,416 |
| Depreciation | 24,694 | 19,996 | 14,108 |
| Other | (9,040) | (10,229) | 6,220 |
| Changes in assets and liabilities: | | | |
| Accrued investment income | (14,148) | (7,338) | 351 |
| Deferred policy acquisition costs | (318,636) | (313,010) | (259,080) |
| Policy liabilities | 67,769 | 51,488 | 1,399 |
| Other assets and liabilities | 6,973 | (42,165) | (12,024) |
| Net cash provided by operating activities | <u>164,999</u> | <u>59,852</u> | <u>163,300</u> |
| Cash Flows from Investing Activities: | | | |
| Proceeds from sales, maturities and repayments of investments | 3,272,590 | 2,805,312 | 2,326,530 |
| Cost of investments acquired | (4,613,227) | (3,715,105) | (2,951,453) |
| Property and equipment additions | (40,036) | (47,585) | (41,051) |
| Cost of corporate owned life insurance acquired | (15,934) | - | - |
| Change in policy loans | (14,858) | (21,627) | (19,641) |
| Change in short term investments | 26,277 | 74,980 | (62,429) |
| Change in short term broker collateral | (145,130) | (75,790) | 155,903 |
| Other | (33,898) | 13,981 | (296) |
| Net cash used by investing activities | <u>(1,564,216)</u> | <u>(965,834)</u> | <u>(592,437)</u> |
| Cash Flows from Financing Activities: | | | |
| Policyholders' deposits | 1,823,046 | 1,825,595 | 1,565,731 |
| Policyholders' withdrawals | (1,017,670) | (1,011,044) | (972,223) |
| Advance from Federal Home Loan Bank | 610,770 | 50,000 | - |
| Repayments to Federal Home Loan Bank | (100,000) | - | - |
| Debt retirement | (15,079) | (20,587) | - |
| Change in other deposits | (19,134) | (4,601) | (27,967) |
| Net cash provided by financing activities | <u>1,281,933</u> | <u>839,363</u> | <u>565,541</u> |
| Net Decrease in Cash | <u>(117,284)</u> | <u>(66,619)</u> | <u>136,404</u> |
| Cash and Restricted Cash: | | | |
| Beginning of year | 258,452 | 325,071 | 188,667 |
| End of year | <u>\$ 141,168</u> | <u>\$ 258,452</u> | <u>\$ 325,071</u> |
| Supplemental disclosure of cash flow information: | | | |
| Interest paid | \$ 40,421 | \$ 40,744 | \$ 41,290 |
| Income taxes (received) paid | <u>\$ (18,645)</u> | <u>\$ 11,817</u> | <u>\$ 11,924</u> |

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

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 1 – NATURE OF OPERATIONS AND STRUCTURE

NLV Financial Corporation (“NLVF”) and its subsidiaries and affiliates (collectively the “Company”) offer a broad range of financial products and services, including life insurance, annuities, mutual funds, and investment advisory and administrative services. The flagship company of the organization, National Life Insurance Company (“National Life”), was chartered in 1848. The Company employs approximately 1,040 people, primarily concentrated in Montpelier, Vermont and Addison, Texas. Life Insurance Company of the Southwest (“LSW”), a Texas domiciled stock life insurer, is a wholly owned subsidiary of National Life. National Life, together with LSW, makes up NLVF’s insurance operations.

On January 1, 1999, pursuant to a mutual holding company reorganization, National Life converted from a mutual to a stock life insurance company. 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 of National Life hold membership interests in NLHC. NLHC and its subsidiaries are collectively known as the National Life Group. NLHC has ownership of all of NLVF’s common stock class B shares outstanding. NLVF has assets and operations primarily related to the issuance of debt and as the sponsor of certain employee related benefit plans. Under the terms of the reorganization, NLHC must always hold a majority of the voting shares of NLVF.

On March 6, 2015, National Life Distribution, LLC (“NLD”) was formed as a subsidiary of LSW. In 2015, the entity is serving as a paymaster for National Life Group’s field force operations. All commission expenses continue to be incurred in the operating companies.

On August 5, 2015, Catamount Reinsurance Company (“Catamount”) was formed as a subsidiary of National Life. Catamount is a special purpose financial captive life insurance company domiciled in the state of Vermont. Catamount entered into a coinsurance with funds withheld agreement with National Life to reinsure the majority of in force Closed Block policies for statutory reporting.

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 724,000 policyholders¹ and, through its subsidiaries, is licensed to do insurance business in all 50 states and the District of Columbia². About 36% of the Company’s total collected premiums and deposits are from residents of the states of California and Texas.

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’ \$5.7 billion of net assets represent twelve mutual funds managed on behalf of approximately 105,000 individual, corporate, and institutional shareholders worldwide.

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

(2) National Life is licensed to do business in all 50 states and the District of Columbia. LSW is licensed in 49 states and the District of Columbia. Catamount Reinsurance Company is licensed to do business in Vermont only.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The Company's consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP").

The consolidated financial statements of the Company include the accounts of NLVF and its direct and indirect subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Certain reclassifications have been made to conform prior periods to the current year's presentation.

Use of Estimates

The preparation of U.S. GAAP financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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; determination of hedging effectiveness on interest rate swaps; evaluation of other-than-temporary impairments; valuations related to benefit plans; income taxes; and litigation and regulatory contingencies. Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the debt or equity markets could have a material impact on the consolidated financial statements.

Subsequent Events

The Company has evaluated events subsequent to December 31, 2015 and through the consolidated financial statement issuance date of February 25, 2016. The Company has not evaluated subsequent events after the issuance date for presentation in these consolidated financial statements.

Cash and Restricted Cash

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

At December 31, 2015 and 2014, the Company had restricted cash of \$72.4 million and \$235.1 million, respectively, related to broker collateral on the Company's derivative investments.

Short Term Investments

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

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, policyholder dividend obligations, loss reserve recognition, reserves, 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, which could be potentially impaired. These identified securities are subjected to an enhanced analysis to determine if the impairments are other-than-temporary.

A debt security is deemed to be other-than-temporarily impaired if it meets the following conditions: (1) the Company intends to sell, or it is more likely than not the Company will be required to sell, the security before a recovery in value, or (2) the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell, or it is more likely than not that the Company will be required to sell, the security before a recovery in fair value, a charge is recorded in net realized investment 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 investment 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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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 value 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.

Based on this evaluation, the Company determined that \$33.9 million, \$6.0 million, and \$10.3 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, 2015, 2014 and 2013, respectively. The Company's remaining unrealized losses on available-for-sale securities of \$370.0 million and \$93.3 million were considered to be temporary as of December 31, 2015 and 2014, 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 realized investment gains (losses). The total valuation allowance as of December 31, 2015 and 2014 was \$1.6 million and \$1.6 million, respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Mortgage Loans (continued)

For mortgage loans that are deemed impaired, an impairment loss is recognized through net realized investment gains (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 \$0.7 million, \$2.4 million and \$5.5 million as of December 31, 2015, 2014, and 2013, respectively.

Policy Loans

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

Real Estate

Real estate acquired in satisfaction of debt is classified either as held for investment or available for sale, and transferred to real estate at the lower of cost or fair value. Real estate investments held for investment purposes are reported at depreciated cost and real estate investments classified as held for sale are reported at the lower of cost or fair value, less the costs to sell, and are not depreciated. In evaluating real estate impairments, the Company considers, among other things, the fair value of the real estate compared to its carrying value. The Company recognized real estate impairments of \$1.1 million, \$0.2 million and \$4.7 million as of December 31, 2015, 2014 and 2013, respectively, through net realized investment gains (losses).

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 audited annually. Other-than-temporary impairments are recorded in net realized investment gains (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 \$1.4 million, \$5.2 million and \$3.6 million as of December 31, 2015, 2014, and 2013, respectively, through net realized investment gains (losses).

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other Invested Assets

The Company receives U.S. Treasuries as broker collateral on the Company's derivative investments. These assets are considered restricted and are included in other invested assets on the Company's Consolidated Balance Sheets. The Company held \$76.6 million and \$63.8 million in Treasury securities as broker collateral as of December 31, 2015 and 2014 respectively. The Company also receives cash as broker collateral. For additional information, see the Cash and Restricted Cash information included in Note 2.

Derivatives

Derivatives include long options, short options, swaptions, interest rate swaps, 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.

The Company designates interest rate swaps as fair value hedges when they have met the requirements to be deemed fair value hedges. The interest rate swaps are used to convert fixed rate assets to floating rate. The Company recognizes gains and losses on the swaps along with the related hedged items within net investment income on the Consolidated Statements of Comprehensive Income. For additional information, see Note 5.

Affordable Housing Tax Credits

The Company's investments in affordable housing projects are included in other invested assets and are amortized using the proportional amortization method within income tax expense in accordance with ASU 2014-01. The associated tax credits are also included as a component of income tax expense. For additional information, see Note 8.

Realized Gains and Losses

Realized investment gains (losses) are recognized using the specific identification method and are reported as net realized investment gains (losses). Realized investment gains (losses) include an adjustment for related deferred policy acquisition costs, sales inducement assets, reserves, policyholder dividend obligations, and income taxes.

Accumulated Other Comprehensive Income

The balance of and changes in each component of AOCI attributable to the Company for the years ended December 31 are as follows:

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accumulated Other Comprehensive Income (continued)

| | Unrealized gains (losses) on available-for-sale securities | Cash flow hedge on debt issuance | Change in funded status of retirement plans | Total |
|--|--|-------------------------------------|---|-------------------------|
| Balance, December 31, 2013 | \$ 299,934 | \$ (662) | \$ (36,920) | \$ 262,352 |
| Other comprehensive income before reclassifications | 104,547 | 34 | (78,912) | 25,669 |
| Amounts reclassified from AOCI | (32,592) | - | 4,361 | (28,231) |
| Income tax benefit (expense) | 11,407 | - | (1,526) | 9,881 |
| Balance, December 31, 2014 | <u>\$ 383,296</u> | <u>\$ (628)</u> | <u>\$ (112,997)</u> | <u>\$ 269,671</u> |
| Other comprehensive income before reclassifications | (258,204) | 34 | 6,611 | (251,559) |
| Amounts reclassified from AOCI | 241 | - | 12,778 | 13,019 |
| Income tax benefit (expense) | (84) | - | (4,472) | (4,556) |
| Balance, December 31, 2015 | <u>\$ 125,249</u> | <u>\$ (594)</u> | <u>\$ (98,080)</u> | <u>\$ 26,575</u> |

Reclassifications out of AOCI during the year ended December 31, 2015 were as follows:

| AOCI component | Amounts reclassified out of AOCI (1) | Affected line item in the Consolidated Statements of Comprehensive Income |
|--|---|--|
| Unrealized gains (losses) on available-for-sale securities | \$ 35,018 | Sale of securities - in net realized investment gains/(losses) |
| | <u>(35,259)</u> | Impairment expense - in net realized investment gains/(losses) |
| | \$ (241) | Total before tax |
| | <u>84</u> | Income tax expense |
| | <u>(157)</u> | Net of tax |
| Change in funded status of retirement plans (2) | \$ (12,778) | Amortization of actuarial gain/(loss) - in operating expenses |
| | <u>4,472</u> | Income tax expense |
| | <u>(8,306)</u> | Net of tax |
| Total reclassifications for the period | <u>\$ (8,463)</u> | Net of tax |

(1) Positive amounts indicate gains/benefits reclassified out of AOCI. Negative amounts indicate losses/costs reclassified out of AOCI.

(2) These AOCI components are included in the computation of net periodic pension cost (see Note 9 for additional details).

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accumulated Other Comprehensive Income (continued)

Reclassifications out of AOCI during the year ended December 31, 2014 were as follows:

| AOCI component | Amounts reclassified out of AOCI (1) | Affected line item in the Consolidated Statements of Comprehensive Income |
|--|---|--|
| Unrealized gains (losses) on available-for-sale securities | \$ 43,797 | Sale of securities - in net realized investment gains/(losses) |
| | (11,205) | Impairment expense - in net realized investment gains/(losses) |
| | \$ 32,592 | Total before tax |
| | (11,407) | Income tax expense |
| | 21,185 | Net of tax |
| Change in funded status of retirement plans (2) | \$ (4,361) | Amortization of actuarial gain/(loss) - in operating expenses |
| | 1,526 | Income tax expense |
| | (2,835) | Net of tax |
| Total reclassifications for the period | \$ 18,350 | Net of tax |

(1) Positive amounts indicate gains/benefits reclassified out of AOCI. Negative amounts indicate losses/costs reclassified out of AOCI.

(2) These AOCI components are included in the computation of net periodic pension cost (see Note 9 for additional details).

Federal Home Loan Bank

National Life is a member of the Federal Home Loan Bank of Boston (“FHLB Boston”) which provides National Life with access to a secured asset-based borrowing capacity of \$1.7 billion as of December 31, 2015. The membership and any advances require an investment in the common stock of FHLB Boston. National Life currently has outstanding advances of \$79.2 million and pledged collateral of \$86.7 million as of December 31, 2015 and \$100 million and \$126 million respectively as of December 31, 2014. National Life had an investment in the common stock of FHLB Boston of \$10.9 million at December 31, 2015 and \$10.7 million as of 2014. The common stock is redeemable with the FHLB. It is considered restricted and is reflected in Other Invested Assets at par value.

All of these advances are considered funding agreements and included in policyholder account liabilities. The proceeds from these advances have been invested into a pool of fixed income assets. Total interest expense of \$1.7 million and \$1.8 million was paid to the FHLB Boston in 2015 and 2014, respectively.

During 2015, National Life repaid advances to FHLB Boston of \$100 million.

LSW is a member of the Federal Home Loan Bank of Dallas (“FHLB Dallas”) which provides LSW with access to a secured asset-based borrowing capacity of \$4.0 billion as of December 31, 2015. The membership and any advances require an investment in the common stock of FHLB Dallas. LSW currently has outstanding advances of \$581.6 million and pledged collateral of \$594.3 million as of December 31, 2015 and \$50 million and \$52.5 million respectively as of December 31, 2014. LSW had an investment in the common stock of FHLB Dallas of \$23.6 million at December 31, 2015 and \$7.0 million as of 2014. The common stock is redeemable with the FHLB. It is considered restricted and is reflected in Other Invested Assets at par value.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Federal Home Loan Bank (continued)

All of these advances are considered funding agreements and included in policyholder account liabilities. The proceeds from these advances have been invested into a pool of fixed income assets. Total interest expense of \$0.8 million and \$0.01 million was paid to the FHLB Dallas in 2015 and 2014, respectively.

Policy Acquisition Expenses

Commissions and other costs that are related directly to the successful acquisition of new or renewal insurance contracts are eligible to be deferred. Deferred policy acquisition costs (“DAC”) for participating life insurance, universal life insurance, and annuities are amortized in relation to estimated gross profits. Amortization is adjusted retrospectively for actual experience and when estimates of future gross profits are revised. 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 gains (losses) 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 and whole life insurance and participating limited-payment and single-payment life insurance is amortized in relation to premium income using assumptions consistent with those used in computing policy benefit liabilities.

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 2015 and 2014 was a decrease to policy acquisition expenses of \$0.3 million and an increase of \$1.6 million, respectively.

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 | |
|-------------------|-----------------------|----------------|
| | 2015 | 2014 |
| Beginning of year | \$ 55.9 | \$ 46.4 |
| Deferral | 24.0 | 24.4 |
| Amortization, net | (11.4) | (14.9) |
| End of year | <u>\$ 68.5</u> | <u>\$ 55.9</u> |

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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill and Other Intangible Assets

Goodwill and other intangible assets with indefinite useful lives are reviewed for impairment in accordance with FASB ASC 350, *Intangibles – Goodwill and Other* on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The assessment for impairment begins with a qualitative determination of factors that could indicate that an impairment is more likely than not to exist. If it is 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 market-based earnings and revenue multiples of the unit's peer companies as well as a discounted cash flow analysis. 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, 2015 and 2014. 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, 2015 and 2014 (in millions):

| | December 31, 2015 | | |
|--------------------|--------------------------|---------------------------------|-----------------------|
| | Cost | Accumulated Depreciation | Carrying Value |
| Software | \$ 219.9 | \$ (104.0) | \$ 115.9 |
| Equipment | 31.7 | (23.5) | 8.2 |
| Furniture | 28.1 | (22.2) | 5.9 |
| Renovations | 11.9 | (1.8) | 10.1 |
| Home office | 87.0 | (57.1) | 29.9 |
| | \$ 378.6 | \$ (208.6) | \$ 170.0 |

| | December 31, 2014 | | |
|-------------|--------------------------|---------------------------------|-----------------------|
| | Cost | Accumulated Depreciation | Carrying Value |
| Software | \$ 178.3 | \$ (86.9) | \$ 91.4 |
| Equipment | 26.5 | (20.9) | 5.6 |
| Furniture | 27.8 | (20.4) | 7.4 |
| Renovations | 11.9 | (1.2) | 10.7 |
| Home office | 84.1 | (54.9) | 29.2 |
| | \$ 328.6 | \$ (184.3) | \$ 144.3 |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property and Equipment (continued)

Depreciation expense recognized in operating expenses was \$24.3 million, \$19.6 million, and \$16.2 million for the years ended December 31, 2015, 2014, and 2013, respectively. In 2014, the Company recognized an impairment on property and equipment for \$6.3 million as the recoverability test indicated that an impairment existed. The impairment loss is included in net realized investment gains (losses). No impairments were recognized in 2015.

Corporate Owned Life Insurance

The Company holds life insurance contracts on certain members of management and other key individuals. During 2015 the Company expanded its Corporate Owned Life Insurance (“COLI”) program with existing carriers by purchasing additional COLI of \$16.0 million. The total cash surrender value of these COLI contracts was \$268.1 million and \$245.0 million at December 31, 2015 and 2014, respectively.

COLI income includes the net change in cash surrender value and any benefits received. COLI income was \$9.4 million, \$8.7 million, and \$8.7 million in 2015, 2014, and 2013, 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, 2015 and 2014, the Company had a receivable from agents of \$33.1 million and \$24.5 million, respectively, which is included in other assets on the Consolidated Balance Sheets. These numbers are reported net of an accrued valuation allowance if it is deemed that amounts may not be collectible. The allowance on the receivable was \$7.4 million as of December 31, 2015 and 2014, respectively.

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. Those investments are segregated from other investments. Any 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 4.94% and 5.08% as of December 31, 2015 and 2014, respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

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, Russell 2000 or MSCI Emerging Markets 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, Russell 2000 or MSCI Emerging Markets 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 0.25% to 4.5%. The guaranteed minimum interest rates for the Company's fixed interest rate universal life insurance policies range from 2.0% to 5.0%. These guaranteed minimum rates are before deduction for any policy administration fees or mortality charges.

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. 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.

As part of the Company's annual actuarial assumption update, certain assumptions were revised including lapse and surrender rates, earned rates, and persistency in various blocks of business which resulted in a \$20.4 million decrease and \$7.2 million decrease in policy liabilities as of December 31, 2015 and 2014, respectively.

The Company tests reserves for any premium deficiency using best estimate assumptions. If a deficiency is found to exist, an additional reserve is typically recorded. As a result of the current interest rates used in the projections, the Company recorded reserves of \$13.8 million as of December 31, 2014. In 2015, due to changes in the mortality tables the Company increased the reserve to \$15.1 million as of December 31, 2015. 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, 2015 and 2014, the Company accrued shadow loss reserves of \$10.8 million and \$17.2 million, respectively.

The Company held a reserve on its Guaranteed Lifetime Income Rider through accumulated other comprehensive income of \$18.2 million and \$40.9 million, as of December 31, 2015 and 2014. The net impact after DAC and tax offsets was \$7.3 million and \$16.7 million. The SOP 03-1 liability was \$205.6 million and \$132.6 million as of December 31, 2015 and 2014 respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Policy Liabilities (continued)

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

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

| | SIL | |
|---|----------------|----------------|
| | <u>2015</u> | <u>2014</u> |
| Beginning of year | \$ 37.7 | \$ 26.5 |
| Additional accruals | 1.4 | 1.5 |
| Increase (decrease) due to interest, amortization and unlocking | 6.3 | 9.7 |
| End of year | <u>\$ 45.4</u> | <u>\$ 37.7</u> |

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’s and National Life’s overall operating results. The dividend scale is approved annually by the Board of Directors for the respective company.

Policyholder Deposits

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

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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

Not Yet Adopted

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The objective of the amendments in this Update is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and International Financial Reporting Standards (IFRS) that would (1) remove inconsistencies and weaknesses from revenue requirements, (2) provide a more robust framework for addressing revenue issues, (3) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets, (4) provide more useful information to users of financial statements through improved disclosure requirements, and (5) simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer. Insurance contracts are specifically excluded from the guidance, but this could impact the Company's non-insurance revenues. In August 2015, the FASB issued ASU 2015-14 which defers the effective date of ASU 2014-09 for nonpublic entities to fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company is evaluating the effects of this new guidance and has not yet determined the impact on the financial statements.

Consolidation

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810) – Amendments to the Consolidation Analysis* which provides targeted improvements to consolidation guidance with respect to limited partnerships and other similarly structured entities. The new guidance addresses instances where a reporting entity consolidates another entity when the reporting entity is simply acting on the behalf of others, among other related issues. While the guidance is targeted, the application is relevant for all companies that are required to assess whether or not to consolidate certain entities. For nonpublic entities, the pronouncement is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company is currently assessing the impact the implementation of this guidance will have on its consolidated financial statements.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 3 – NEW ACCOUNTING PRONOUNCEMENTS (continued)

Not Yet Adopted (continued)

Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. This update aims to reduce the complexity in the presentation of debt issuance costs, as compared to debt discount and premium. Debt issuance costs should now be deducted from the carrying amount of the debt liability, consistent with the treatment of debt discounts. They should no longer be recognized as a deferred charge. For nonpublic entities, the pronouncement is effective for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption is permitted. The new guidance should be applied on a retrospective basis, and treated as a change in an accounting principle.

Investments

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)*. The guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the practical expedient of net asset value per share. It also changes the requirement for disclosure of all investments eligible to be measured using the practical expedient, and now requires disclosure only for those investments which have been so measured. For nonpublic entities, the pronouncement is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early application is permitted. The guidance should be applied retrospectively. The Company anticipates updating its fair value disclosures to adjust for any mutual funds currently included in the fair value hierarchies.

Short-Duration Contract Disclosures

In May 2015, the FASB issued ASU 2015-09, *Financial Services – insurance (Topic 944): Disclosures about Short-Duration Contracts* to increase transparency of estimates made in measuring the liability for unpaid claims and claim adjustment expenses. The guidance requires a variety of new disclosures. For nonpublic entities, the pronouncement is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. Early application is permitted. The amendments should be applied retrospectively by providing comparative disclosures for each period presented.

NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES

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

FASB ASC 820, *Fair Value Measurement* (“ASC 820”) requires consideration of three broad valuation techniques: (i) the market approach, (ii) the income approach, and (iii) the cost approach. Entities are required to determine the most appropriate valuation technique to use, given what is being measured and the availability of sufficient inputs. The guidance prioritizes the inputs to fair valuation techniques and allows for the use of unobservable inputs to the extent that observable inputs are not available.

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

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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

- **Level 1** - Unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities utilizing Level 1 inputs include equity securities listed in active markets, U.S. Treasury securities, and certain short term investments including money markets. 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, mortgage-backed securities (“MBSs”) and asset-backed securities (“ABSs”), corporate debt, private placement investments, preferred stocks, and derivatives, including options and interest rate swaps, and short term investments. Generally, the Company 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 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. If inputs to pricing models that were previously unobservable become observable, then an asset or liability can be transferred from Level 3 to Level 2.

Determination of fair values

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

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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

Valuation Techniques

Available-for-sale debt securities and short term investments - The fair value of AFS securities and short term investments in an active and orderly market (e.g. not distressed or forced liquidation) is determined by management after considering one of four primary sources of information: unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date, third-party pricing services, independent broker quotations, or pricing matrices. Security pricing is applied using a “waterfall” approach whereby publicly available prices are first sought from third-party pricing services; the remaining unpriced securities are submitted to independent brokers for prices; or lastly, securities are priced using an internal pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, and/or cash flows, and prepayments speeds. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third-party pricing services will normally derive the security prices from recent reported trades for identical or similar securities, making adjustments through the reporting date based upon available market observable information as outlined above. If there are no recent reported trades, the third-party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and are then discounted at a market rate. 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. Money markets included in short term investments are classified into Level 1 of the fair value hierarchy. Most prices provided by a third-party pricing service are classified into Level 2 because the inputs used in pricing the securities are market observable. Due to a general lack of transparency in the process that brokers use to develop prices, valuations that are based on brokers’ prices are classified as Level 3. Some valuations may be classified as Level 2 if the price can be corroborated.

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

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

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
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NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Valuation Techniques (continued)

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

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

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

AFS equity securities - The fair value of equity securities is based on unadjusted quoted market prices from a third party pricing service as well as primary and secondary broker quotes. These securities are generally categorized 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.

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

Other invested assets - Investments in limited partnerships are included in other invested assets. Limited partnerships do not have a readily determinable fair value, and as such, the Company values them at its pro-rata share of the limited partnership’s NAV, or its equivalent. Since these valuations have significant unobservable inputs, they are generally categorized as Level 3 in the fair value hierarchy. Also included in other invested assets are U.S. Treasuries which are categorized as Level 1.

Policyholder account liabilities - This represents the fair value of the embedded derivatives contained in equity-indexed annuity and life contracts are included in policyholder account liabilities. These derivatives are measured based on actuarial and capital market assumptions related to projected cash flows over the expected lives of the contracts.

Option pricing models are used to estimate fair value, taking into account assumptions for future equity indexed 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 the significant unobservable inputs used to value these financial instruments, they are included in Level 3.

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Notes to Consolidated Financial Statements
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NOTE 4 – FAIR VALUE MEASUREMENTS OF ASSETS AND LIABILITIES (continued)

Presented below is the fair value of all assets and liabilities subject to fair value determination as of December 31, 2015 (in thousands):

| | Level 1 | Level 2 | Level 3 | Not Presented at Fair Value | Total |
|---|----------------------|---------------------|------------|-----------------------------|---------------|
| AFS debt and equity securities: | | | | | |
| U.S. government obligations | 247,812 | \$ - | \$ - | \$ - | \$ 247,812 |
| Government agencies, authorities and subdivisions | - | 687,927 | - | - | 687,927 |
| Corporates | - | 10,031,195 | - | - | 10,031,195 |
| Private placements | - | 1,750,263 | - | - | 1,750,263 |
| Mortgage-backed securities | - | 4,394,502 | - | - | 4,394,502 |
| Total AFS debt securities | 247,812 | 16,863,887 | - | - | 17,111,699 |
| Preferred stock | - | 19,906 | - | - | 19,906 |
| Common stock | 41,005 | - | 5 | - | 41,010 |
| Total AFS equity securities | 41,005 | 19,906 | 5 | - | 60,916 |
| Total AFS debt and equity securities | 288,817 | 16,883,793 | 5 | - | 17,172,615 |
| Trading equity securities | 14,505 | - | - | - | 14,505 |
| Derivatives | 3,727 | 296,214 | - | - | 299,941 |
| Other invested assets | 82,676 | - | 273,983 | 274,780 | 631,439 |
| Short term investments | 244,043 | - | - | - | 244,043 |
| Separate account assets | 672,816 ¹ | 29,733 ¹ | 12,072 | - | 714,621 |
| Total assets subject to fair value disclosure | \$ 1,306,584 | \$ 17,209,740 | \$ 286,060 | \$ 274,780 | \$ 19,077,164 |

| | Level 1 | Level 2 | Level 3 | Not Presented at Fair Value | Total |
|--|---------|------------|---------------------------|-----------------------------|--------------|
| Policyholder account liabilities | \$ - | \$ - | \$ 1,760,404 ² | \$ - | \$ 1,760,404 |
| Derivatives | - | 139,507 | - | - | 139,507 |
| Total liabilities subject to fair value disclosure | \$ - | \$ 139,507 | \$ 1,760,404 | \$ - | \$ 1,899,911 |

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 mutual funds, common stocks, and bonds.

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, 2015 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.

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Notes to Consolidated Financial Statements
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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, 2015 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 | \$ - | \$ - | | \$ - | \$ - | | \$ - | \$ - | \$ - | \$ - | \$ - |
| Common stock | 5 | - | - | - | - | - | - | - | - | 5 | - |
| Total AFS debt and equity securities | 5 | - | - | - | - | - | - | - | - | 5 | - |
| Other invested assets | 245,043 | (1,725) | (8,927) | 148,639 | - | (109,047) | - | - | - | 273,983 | - |
| Separate account assets | 10,909 | - | (271) | 1,521 | - | (87) | - | - | - | 12,072 | - |
| Total invested assets | \$ 255,957 | \$ (1,725) | \$ (9,198) | \$ 150,160 | \$ - | \$ (109,134) | \$ - | \$ - | \$ - | \$ 286,060 | \$ - |
| Liabilities | | | | | | | | | | | |
| Policyholder account liabilities | \$ 1,815,568 | \$ (74,387) | \$ - | \$ - | \$ - | \$ - | \$ 19,223 | \$ - | \$ - | 1,760,404 | - |
| Total liabilities | \$ 1,815,568 | \$ (74,387) | \$ - | \$ - | \$ - | \$ - | \$ 19,223 | \$ - | \$ - | \$ 1,760,404 | \$ - |

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 2015, there were no significant transfers between levels.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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

Presented below is the fair value of all assets and liabilities subject to fair value determination as of December 31, 2014 (in thousands):

| Assets | Level 1 | Level 2 | Level 3 | Not Presented at Fair Value | Total |
|--|----------------------|---------------------|---------------------------|--------------------------------|---------------|
| AFS debt and equity securities: | | | | | |
| U.S. government obligations | \$ 232,765 | \$ - | \$ - | \$ - | \$ 232,765 |
| Government agencies, authorities and subdivisions | - | 84,662 | - | - | 84,662 |
| Corporates | - | 9,855,998 | - | - | 9,855,998 |
| Private placements | - | 1,772,427 | - | - | 1,772,427 |
| Mortgage-backed securities | - | 4,933,929 | - | - | 4,933,929 |
| Total AFS debt securities | 232,765 | 16,647,016 | - | - | 16,879,781 |
| Preferred stock | - | 6,767 | - | - | 6,767 |
| Common stock | 19,166 | - | 5 | - | 19,171 |
| Total AFS equity securities | 19,166 | 6,767 | 5 | - | 25,938 |
| Total AFS debt and equity securities | 251,931 | 16,653,783 | 5 | - | 16,905,719 |
| Trading equity securities | 14,890 | - | - | - | 14,890 |
| Derivatives | 516 | 676,653 | - | - | 677,169 |
| Other invested assets | 69,831 | - | 245,043 | 196,750 | 511,624 |
| Short term investments | 234,270 | 36,050 | - | - | 270,320 |
| Separate account assets | 734,757 ¹ | 26,003 ¹ | 10,909 | - | 771,669 |
| Total assets subject to fair value disclosure | \$ 1,306,195 | \$ 17,392,489 | \$ 255,957 | \$ 196,750 | \$ 19,151,391 |
| Liabilities | | | | | |
| | Level 1 | Level 2 | Level 3 | Not Presented at Fair Value | Total |
| Policyholder account liabilities | \$ - | \$ - | \$ 1,815,568 ² | \$ - | \$ 1,815,568 |
| Derivatives | - | 358,905 | - | - | 358,905 |
| Total liabilities subject to fair value disclosure | \$ - | \$ 358,905 | \$ 1,815,568 | \$ - | \$ 2,174,473 |

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 mutual funds, common stocks, and bonds.

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, 2014 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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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, 2014 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 | \$ 1,145 | \$ - | \$ (713) | \$ - | \$ - | \$ (432) | \$ - | \$ - | \$ - | \$ - | \$ - |
| Common stock | 5 | - | - | - | - | - | - | - | - | 5 | - |
| Total AFS debt and equity securities | 1,150 | - | (713) | - | - | (432) | - | - | - | 5 | - |
| Other invested assets | 193,287 | (5,332) | 3,574 | 88,358 | - | (62,275) | - | 27,431 | - | 245,043 | (5,332) |
| Separate account assets | 10,088 | - | 531 | 290 | - | - | - | - | - | 10,909 | - |
| Total invested assets | \$ 204,525 | \$ (5,332) | \$ 3,392 | \$ 88,648 | \$ - | \$ (62,707) | \$ - | \$ 27,431 | \$ - | \$ 255,957 | \$ (5,332) |
| Liabilities | | | | | | | | | | | |
| Policyholder account liabilities | \$ 1,673,028 | \$ 130,354 | \$ - | \$ - | \$ - | \$ - | \$ 12,186 | \$ - | \$ - | 1,815,568 | - |
| Total liabilities | \$ 1,673,028 | \$ 130,354 | \$ - | \$ - | \$ - | \$ - | \$ 12,186 | \$ - | \$ - | \$ 1,815,568 | \$ - |

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 2014, there were no significant transfers between fair value Levels 1 and 2. In 2014, certain partnerships were categorized into Level 3 of the fair value hierarchy and are reflected as transfers in.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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, 2015 and 2014 were as follows (in thousands):

| | 2015 | | 2014 | |
|--------------------------------|-----------------------|-------------------|-----------------------|-------------------|
| | <u>Carrying Value</u> | <u>Fair Value</u> | <u>Carrying Value</u> | <u>Fair Value</u> |
| Mortgage loans | 2,686,711 | 2,798,919 | 2,331,749 | 2,474,107 |
| Policy loans | 823,456 | 957,363 | 808,598 | 927,921 |
| Investment product liabilities | 12,268,024 | 11,249,685 | 11,772,836 | 12,166,237 |
| Debt | 457,743 | 601,560 | 467,381 | 620,550 |
| FHLB capital stock | 34,434 | 34,434 | 17,700 | 17,700 |

For short term investments, amortized cost 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 discounted cash flows derived from current interest rates adjusted for the Company's credit rating.

For FHLB capital stock, par value approximates fair value.

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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, 2015 and December 31, 2014 are as follows (in thousands):

| 2015 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|----------------|------------------------|-------------------------|---------------|
| AFS debt and equity securities: | | | | |
| U.S. government obligations | \$ 234,395 | \$ 13,478 | \$ 61 | \$ 247,812 |
| Government agencies, authorities and subdivisions | 676,653 | 15,772 | 4,498 | 687,927 |
| Corporate: | | | | |
| Communications | 844,968 | 48,903 | 12,583 | 881,288 |
| Consumer & retail | 2,643,296 | 101,896 | 33,108 | 2,712,084 |
| Financial institutions | 1,996,786 | 156,931 | 11,019 | 2,142,698 |
| Industrial and chemicals | 1,627,288 | 63,195 | 84,674 | 1,605,809 |
| REITS | 595,928 | 7,922 | 9,129 | 594,721 |
| Transportation | 240,380 | 17,268 | 2,481 | 255,167 |
| Utilities | 1,915,056 | 70,249 | 145,877 | 1,839,428 |
| Total corporate | 9,863,702 | 466,364 | 298,871 | 10,031,195 |
| Private placements | 1,725,580 | 58,787 | 34,104 | 1,750,263 |
| Mortgage-backed securities | 4,206,369 | 218,839 | 30,706 | 4,394,502 |
| Total AFS debt securities | \$ 16,706,699 | \$ 773,240 | \$ 368,240 | \$ 17,111,699 |
| Preferred stocks | 20,000 | - | 94 | 19,906 |
| Common stocks | 40,281 | 2,403 | 1,674 | 41,010 |
| Total AFS equity securities | \$ 60,281 | \$ 2,403 | \$ 1,768 | \$ 60,916 |
| Total AFS debt and equity securities | \$ 16,766,980 | \$ 775,643 | \$ 370,008 | \$ 17,172,615 |

| 2014 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|----------------|------------------------|-------------------------|---------------|
| AFS debt and equity securities: | | | | |
| U.S. government obligations | \$ 223,191 | \$ 22,693 | \$ 8 | \$ 245,876 |
| Government agencies, authorities and subdivisions | 61,315 | 10,236 | - | 71,551 |
| Corporate: | | | | |
| Communications | 816,456 | 84,583 | 1,693 | 899,346 |
| Consumer & retail | 2,247,662 | 169,870 | 4,284 | 2,413,248 |
| Financial institutions | 1,910,246 | 236,594 | 1,773 | 2,145,067 |
| Industrial and chemicals | 1,459,004 | 109,399 | 16,966 | 1,551,437 |
| REITS | 620,402 | 21,817 | 3,235 | 638,984 |
| Transportation | 214,849 | 26,973 | 258 | 241,564 |
| Utilities | 1,846,386 | 150,734 | 30,768 | 1,966,352 |
| Total corporate | 9,115,005 | 799,970 | 58,977 | 9,855,998 |
| Private placements | 1,687,316 | 93,873 | 8,762 | 1,772,427 |
| Mortgage-backed securities | 4,655,757 | 303,555 | 25,383 | 4,933,929 |
| Total AFS debt securities | \$ 15,742,584 | \$ 1,230,327 | \$ 93,130 | \$ 16,879,781 |
| Preferred stocks | 6,767 | - | - | 6,767 |
| Common stocks | 16,965 | 2,415 | 209 | 19,171 |
| Total AFS equity securities | \$ 23,732 | \$ 2,415 | \$ 209 | \$ 25,938 |
| Total AFS debt and equity securities | \$ 15,766,316 | \$ 1,232,742 | \$ 93,339 | \$ 16,905,719 |

NLV Financial Corporation and Subsidiaries
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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):

| | 2015 | 2014 | 2013 |
|---|-------------------|-------------------|-------------------|
| Net unrealized (losses) gains on AFS securities | \$ (734,177) | \$ 284,961 | \$ (873,037) |
| Net unrealized gains on separate accounts | 30 | 513 | 1,277 |
| Net unrealized gains on other invested assets | (8,926) | 3,575 | 1,572 |
| Related deferred policy acquisition costs | 227,484 | (54,110) | 292,539 |
| Related loss reserve | 6,373 | (2,316) | 7,121 |
| Related reserves | 22,736 | (40,922) | - |
| Related deferred income taxes | 139,094 | (45,043) | 143,931 |
| Related policyholder dividend obligation | 89,339 | (63,296) | 159,776 |
| Increase in net unrealized (losses) gains | (258,047) | 83,362 | (266,821) |
| Balance, beginning of year | 383,296 | 299,934 | 566,755 |
| Balance, end of year | <u>\$ 125,249</u> | <u>\$ 383,296</u> | <u>\$ 299,934</u> |

| | 2015 | 2014 |
|---|-------------------|-------------------|
| Balance, end of year includes: | | |
| Net unrealized gains on available-for-sale securities | \$ 404,957 | \$ 1,139,134 |
| Net unrealized gains on separate accounts | 6,088 | 6,058 |
| Net unrealized gains on other invested assets | 16,276 | 25,202 |
| Related deferred policy acquisition costs | (92,620) | (320,104) |
| Related loss reserve | (10,797) | (17,170) |
| Related reserves | (18,186) | (40,922) |
| Related deferred income taxes | (67,442) | (206,536) |
| Related policyholder dividend obligation | (113,027) | (202,366) |
| Total | <u>\$ 125,249</u> | <u>\$ 383,296</u> |

Net other comprehensive income related to unrealized (losses) gains on available-for-sale securities for 2015, 2014, and 2013 of (\$258.0) million, \$83.4 million, and (\$267.3) million, respectively, is presented net of reclassifications to net income for net realized investment gains (losses) during the period of \$22.0 million, \$26.0 million, and \$19.0 million, and net of tax and deferred acquisition cost offsets of \$13.9 million, \$16.6 million, and \$12.3 million, respectively.

The amortized cost and fair values of debt securities by contractual maturity at December 31, 2015, 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 | |
|--------------------------------|--------------------------|----------------------|
| | Amortized cost | Fair Value |
| Due in one year or less | \$ 538,236 | \$ 548,202 |
| Due after one yr through 5 yrs | 2,981,366 | 3,136,927 |
| Due after 5 yrs through 10 yrs | 5,663,224 | 5,525,673 |
| Due after ten years | 3,340,956 | 3,529,754 |
| Mortgage-backed securities | 4,182,915 | 4,371,143 |
| Total | <u>\$ 16,706,697</u> | <u>\$ 17,111,699</u> |

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Notes to Consolidated Financial Statements
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NOTE 5 – INVESTMENTS (continued)

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, 2015, 2014, and 2013 were \$840.3 million, \$605.3 million, and \$270.2 million, respectively. Gross realized gains on sales of available-for-sale debt securities for the years ended December 31, 2015, 2014, and 2013 were \$36.4 million, \$24.5 million, and \$16.1 million, respectively. Gross realized losses on sales of available-for-sale debt securities for the years ended December 31, 2015, 2014, and 2013 were \$0.4 million, \$0.1 million, and \$2.3 million, respectively. Gross realized gains on available-for-sale equity securities for the years ended December 31, 2015, 2014, and 2013 were \$0.02 million, \$14.6 million, and \$4.8 million, respectively. Gross realized losses on available-for-sale equity securities for the years ended December 31, 2015, 2014, and 2013 were \$0.2 million, \$0.4 million, and \$0.1 million, respectively.

The Company recognized the following realized losses resulting from other-than-temporary declines in fair value for the years ended December 31, (in millions):

| | 2015 | | 2014 | | 2013 |
|--|----------------|----|-------------|----|-------------|
| Debt securities | \$ 33.9 | \$ | 3.8 | \$ | 9.7 |
| Common and preferred equity securities | - | | 2.2 | | 0.6 |
| Limited partnerships | 1.4 | | 5.2 | | 3.6 |
| Total | <u>\$ 35.3</u> | \$ | <u>11.2</u> | \$ | <u>13.9</u> |

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

Gross unrealized losses and investment fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2015 were as follows (in thousands):

| 2015 | Less than 12 months | | 12 months or more | | Total | |
|---|---------------------|-------------------|-------------------|-------------------|--------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Description of Securities | | | | | | |
| U.S. government obligations | \$ 19,390 | \$ 61 | \$ - | \$ - | \$ 19,390 | \$ 61 |
| Government agencies, authorities and subdivisions | 244,804 | 4,498 | - | - | 244,804 | 4,498 |
| Corporate: | | | | | | |
| Communications | 243,478 | 9,187 | 10,077 | 3,396 | 253,555 | 12,583 |
| Consumer & retail | 932,482 | 30,064 | 37,248 | 3,044 | 969,730 | 33,108 |
| Financial institutions | 463,534 | 8,380 | 7,972 | 2,639 | 471,506 | 11,019 |
| Industrial and chemicals | 722,011 | 44,804 | 71,423 | 39,870 | 793,434 | 84,674 |
| REITS | 321,022 | 6,889 | 30,644 | 2,240 | 351,666 | 9,129 |
| Transportation | 82,850 | 2,481 | - | - | 82,850 | 2,481 |
| Utilities | 709,493 | 88,024 | 175,076 | 57,853 | 884,569 | 145,877 |
| Total corporate | 3,474,870 | 189,829 | 332,440 | 109,042 | 3,807,310 | 298,871 |
| Private placements | 612,475 | 33,109 | 16,624 | 995 | 629,099 | 34,104 |
| Mortgage-backed securities | 710,199 | 12,355 | 256,433 | 18,351 | 966,632 | 30,706 |
| Subtotal debt securities | 5,061,738 | 239,852 | 605,497 | 128,388 | 5,667,235 | 368,240 |
| Preferred stock | 19,906 | 94 | - | - | 19,906 | 94 |
| Common stock | 27,945 | 1,239 | 5,835 | 435 | 33,780 | 1,674 |
| Total securities | <u>\$5,109,589</u> | <u>\$ 241,185</u> | <u>\$ 611,332</u> | <u>\$ 128,823</u> | <u>\$5,720,921</u> | <u>\$ 370,008</u> |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 5 – INVESTMENTS (continued)

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

Gross unrealized losses and investment fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2014 were as follows (in thousands):

| 2014 | Less than 12 months | | 12 months or more | | Total | |
|---|---------------------|-------------------|-------------------|-------------------|--------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Description of Securities | | | | | | |
| Government agencies, authorities and subdivisions | \$ 2,212 | \$ 5 | \$ 200 | \$ 3 | \$ 2,412 | \$ 8 |
| Corporate: | | | | | | |
| Communications | 49,960 | 1,001 | 20,287 | 692 | 70,247 | 1,693 |
| Consumer & retail | 149,899 | 1,729 | 128,744 | 2,555 | 278,643 | 4,284 |
| Financial institutions | 47,203 | 1,162 | 29,710 | 611 | 76,913 | 1,773 |
| Industrial and chemicals | 213,274 | 9,532 | 93,834 | 7,434 | 307,108 | 16,966 |
| REITS | 59,454 | 2,047 | 49,542 | 1,188 | 108,996 | 3,235 |
| Transportation | 2,374 | 25 | 10,898 | 233 | 13,272 | 258 |
| Utilities | 469,748 | 25,906 | 57,763 | 4,862 | 527,511 | 30,768 |
| Total corporate | 991,912 | 41,402 | 390,778 | 17,575 | 1,382,690 | 58,977 |
| Private placements | 202,883 | 6,117 | 69,353 | 2,645 | 272,236 | 8,762 |
| Mortgage-backed securities | 67,453 | 3,052 | 553,257 | 22,331 | 620,710 | 25,383 |
| Subtotal debt securities | 1,264,460 | 50,576 | 1,013,588 | 42,554 | 2,278,048 | 93,130 |
| Preferred stock | - | - | - | - | - | - |
| Common stock | 6,260 | 209 | - | - | 6,260 | 209 |
| Total securities | \$ 1,270,720 | \$ 50,785 | \$ 1,013,588 | \$ 42,554 | \$ 2,284,308 | \$ 93,339 |

In 2015, of the \$239.9 million total unrealized losses on debt securities in the less than 12 months category, \$189.8 million total unrealized losses are in the corporate bond portfolio. The unrealized losses are concentrated in the utilities, industrial and chemical, and consumer and retail sectors. In 2015, the Barclays US Corporate Investment Grade Index, an investment grade corporate bond index, widened by approximately 34 basis points from 131 basis points at year end 2014 to 165 basis points at year end 2015. Over the same time period, the Barclays US Corporate High Yield Index widened by approximately 177 basis points from 483 basis points at year end 2014 to a level of 660 basis points at year end 2015. The spread widening in both investment-grade and high-yield corporate bonds was concentrated in the energy and metals and mining sectors, as the Barclays US Corporate Investment Grade Energy Index widened by approximately 114 basis points from 196 basis points to 310 basis points and the Barclays US Corporate Investment Grade Metals and Mining Index widened by approximately 258 basis points from 222 basis points to 480 basis points. Commodities related sectors experienced weakening conditions during 2015 and the group continues to hold and monitor some individual credits that experienced adverse price action during this timeframe.

Of the \$128.4 million unrealized losses on debt securities in the 12 months or more category, \$109.0 million was in the corporate bond portfolio concentrated in the utilities and industrial and chemical categories. Based upon 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, 2015 are temporary.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 5 – INVESTMENTS (continued)

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

The debt securities in an unrealized loss position for 12 months or more are concentrated in the corporate bond commodities related sectors of energy and metals and mining, with approximately \$55 million and \$32 million, respectively. The majority of the unrealized loss position in these securities is attributable to credit spread increases primarily reflecting lower energy and metals prices during 2015. 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, 2015, 2014, and 2013 the equity securities held in the trading category recorded \$1.2 million, \$2.0 million, and \$1.3 million, respectively, of net investment income. The cost of trading securities held at December 31, 2015 and 2014 was \$15.6 million and \$14.7 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.

Mortgage Loans and Real Estate

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

| | <u>2015</u> | <u>2014</u> |
|--------------------------------------|---------------------------|--------------------|
| <u>Geographic Region</u> | | |
| New England | 4.7% | 5.1% |
| Middle Atlantic | 5.0 | 5.4 |
| East North Central | 15.7 | 17.4 |
| West North Central | 11.9 | 6.5 |
| South Atlantic | 24.0 | 22.3 |
| East South Central | 4.3 | 5.5 |
| West South Central | 10.1 | 13.1 |
| Mountain | 9.9 | 9.4 |
| Pacific | 14.4 | 15.3 |
| Total | <u>100.0%</u> | <u>100.0%</u> |
| <u>Property Type</u> | | |
| Apartment | 14.7% | 18.0% |
| Retail | 26.9 | 22.9 |
| Office Building | 33.4 | 37.5 |
| Industrial | 15.2 | 15.3 |
| Hotel/Motel | 0.2 | 0.2 |
| Other Commercial | 9.6 | 6.1 |
| Total | <u>100.0%</u> | <u>100.0%</u> |
| Mortgage loans | \$2,686,711 | \$2,331,749 |
| Real estate | 44,667 | 54,041 |
| Total mortgage loans and real estate | <u>\$2,731,378</u> | <u>\$2,385,790</u> |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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, 2015
(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% | 288.4 | \$ 188.3 | \$ 44.0 | \$ 11.2 | \$ 4.2 | \$ 536.1 |
| 50% - 60% | 372.2 | 296.1 | 32.5 | 23.8 | - | 724.6 |
| 60% - 70% | 104.8 | 547.7 | 167.8 | 43.7 | 8.6 | 872.6 |
| 70% - 80% | 22.0 | 232.8 | 73.2 | 58.4 | 7.6 | 394.0 |
| 80% - 90% | - | - | 52.2 | 21.1 | 3.8 | 77.1 |
| > 90% | - | 5.9 | 12.9 | 17.1 | 47.5 | 83.4 |
| Total | \$ 787.4 | \$ 1,270.8 | \$ 382.6 | \$ 175.3 | \$ 71.7 | \$ 2,687.8 |

Debt Service Coverage Ratios as of December 31, 2014
(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% | 160.0 | \$ 153.2 | \$ 33.7 | \$ 43.9 | \$ 5.9 | \$ 396.7 |
| 50% - 60% | 250.8 | 231.8 | 59.0 | 23.0 | 20.1 | 584.7 |
| 60% - 70% | 74.0 | 443.6 | 191.5 | 22.0 | 17.1 | 748.2 |
| 70% - 80% | 15.4 | 163.3 | 116.0 | 58.6 | 11.1 | 364.4 |
| 80% - 90% | 6.4 | 20.8 | 60.0 | 18.0 | 21.4 | 126.6 |
| > 90% | - | 28.0 | 25.5 | 10.3 | 48.8 | 112.6 |
| Total | \$ 506.6 | \$ 1,040.7 | \$ 485.7 | \$ 175.8 | \$ 124.4 | \$ 2,333.2 |

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

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

| | 2015 | 2014 |
|----------------------------------|---------------------|---------------------|
| Commercial loans | \$ 2,693,531 | \$ 2,337,961 |
| Related valuation allowances | (1,568) | (1,566) |
| Impaired loans | (5,687) | (4,797) |
| Market value adjustment on hedge | 435 | 151 |
| Total | \$ 2,686,711 | \$ 2,331,749 |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 5 – INVESTMENTS (continued)

Mortgage Loans and Real Estate (continued)

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

| | 2015 | 2014 | 2013 |
|----------------------------|-------------|-------------|-------------|
| Impaired loans: | | | |
| Average total investment | \$ 20,876 | \$ 20,180 | \$ 19,044 |
| Interest income recognized | 1,132 | 966 | 1,078 |
| Interest received | 699 | 743 | 1,220 |
| Unpaid principal balance | 24,159 | 17,593 | 22,768 |

The Company reviews loans where there are indicators of potential impairments based on certain criteria, including macro-economic factors and loan specific indicators, and establishes a valuation allowance where applicable. As of December 31, 2015 and 2014, respectively the loan valuation allowance was \$1.6 million and \$1.6 million, with the change in valuation allowance recorded in net realized investment gains (losses).

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

| | 2015 | 2014 | 2013 |
|--|-------------|-------------|-------------|
| Changes to previously established valuation allowances | \$ 2 | \$ (938) | \$ (12,052) |
| Balance, beginning of year | 1,566 | 2,504 | 14,556 |
| Balance, end of year | \$ 1,568 | \$ 1,566 | \$ 2,504 |

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

At December 31, 2015, no loans were modified during the period in a troubled debt restructuring. At December 31, 2014, the Company had two mortgage loans which were modified during the period in a troubled debt restructuring. After restructuring, these loans had a subsequent payment default. Payment default is determined in the same manner as delinquency status – when interest and principal payments are 90 days past due.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 5 – INVESTMENTS (continued)

Net Investment Income

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

| | 2015 | 2014 | 2013 |
|---|------------|--------------|--------------|
| Debt securities interest | \$ 821,146 | \$ 805,164 | \$ 766,757 |
| Equity securities dividends | 2,936 | 4,432 | 5,329 |
| Mortgage loan interest | 135,120 | 125,904 | 130,576 |
| Policy loan interest | 41,175 | 40,886 | 40,010 |
| Real estate income | 9,254 | 8,525 | 6,750 |
| Derivative income | (86,402) | 199,074 | 334,341 |
| Partnership distributions | 27,131 | 24,594 | 22,556 |
| Other investment income | 273 | 740 | 47 |
| Gross investment income | 950,633 | 1,209,319 | 1,306,366 |
| Less: investment expenses | (25,425) | (23,219) | (20,960) |
| Less: valuation allowance on mortgage loans | - | - | 12,052 |
| Net investment income | \$ 925,208 | \$ 1,186,100 | \$ 1,297,458 |

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

| | 2015 | 2014 | 2013 |
|------------------------|------------|-----------|------------|
| Debt securities | \$ 1,664 | \$ 25,878 | \$ 5,248 |
| Equity securities | (180) | 12,046 | 5,109 |
| Mortgage loans | (2,802) | (1,481) | (5,598) |
| Partnerships | (1,725) | (5,332) | (3,595) |
| Other invested assets | (156) | (1,452) | (1,478) |
| Real estate | 26 | 1,170 | (4,429) |
| Property and equipment | - | (6,144) | - |
| Debt retirement | (5,409) | - | - |
| Total | \$ (8,582) | \$ 24,685 | \$ (4,743) |

Derivatives

The Company purchases OTC options and exchange-traded futures on the S&P 500, Russell 2000, and MSCI Emerging Markets 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 Sheets and are carried at fair value. Call options written are included in the derivatives liability and carried at fair value.

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 \$149.0 million as of December 31, 2015. The Company utilizes a scale based on credit rating of the counterparty to determine the appropriate amount of counterparty risk. As of December 31, 2015, there was no derivative counterparty exposure that exceeded \$20.5 million, net of collateral.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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, Russell 2000, or MSCI Emerging Markets 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, Russell 2000, or MSCI Emerging Markets indexes. The Company incorporates 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 \$1,760.4 million and \$1,815.6 million at December 31, 2015 and 2014 respectively.

The Company credits interest on policyholder account liabilities based on S&P 500, Russell 2000, and MSCI Emerging Markets 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, Russell 2000, and MSCI Emerging Markets 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 derivatives purchased are based on the same indexes that the crediting rates are based upon, they substantially offset the market risk associated with the crediting rate in the policy year being hedged. Since these movements are so closely correlated, there has not been any significant hedging ineffectiveness in the years ended December 31, 2015 and 2014.

The Company enters into interest rate swaps to reduce market risks from changes in interest rates. These swaps are used to hedge changes in fair value. The Company designates interest rate swaps as fair value hedges when they have met the requirements to be deemed fair value hedges. The interest rate swaps are used to convert fixed rate assets to floating rate. The Company recognizes gains and losses on the swaps along with the related hedged items within net investment income on the Consolidated Statements of Comprehensive Income. Ineffectiveness recognized through net investment income in the years ended December 31, 2015 and 2014 was a \$1.7 million loss and a \$0.2 million loss respectively.

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

| | 2015 | | 2014 | | Primary Underlying Risk Exposure |
|-----------------------|--------------|----------------------|--------------|------------|----------------------------------|
| | Notional | Fair Value | Notional | Fair Value | |
| Options purchased | \$ 7,879,380 | \$ 296,534 | \$ 7,642,970 | \$ 675,055 | Equity market |
| Options written | (7,170,320) | (139,507) | (6,882,470) | (358,905) | Equity market |
| Swaptions purchased | 500,000 | 1,161 | 500,000 | 1,601 | Interest rates |
| Interest rate swaps | 582,925 | (1,481) ¹ | 34,100 | (558) | Interest rates |
| Futures purchased | 103,055 | 3,727 | 18,098 | 516 | Equity market |
| Credit default swaps | - | - | - | - | Credit |
| Net fair market value | | \$ 160,434 | | \$ 317,709 | |

1. Interest rates swaps are reflected net of cash margin collateral of \$ 1.5 million and \$0.55 million in 2015 and 2014 respectively in the Consolidated Balance Sheets.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

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 7.0% 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 \$4.2 million, \$4.2 million, and \$4.5 million for 2015, 2014, and 2013, 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.

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

| | 2015 | 2014 | 2013 |
|--------------------------------------|-------------------|--------------------|--------------------|
| Insurance premiums: | | | |
| Direct | \$ 284,452 | \$ 291,018 | \$ 317,441 |
| Reinsurance assumed | 1,047 | 906 | 1,052 |
| Reinsurance ceded | (57,952) | (60,295) | (61,926) |
| Total insurance premiums | <u>\$ 227,547</u> | <u>\$ 231,629</u> | <u>\$ 256,567</u> |
| Increase in policy liabilities: | | | |
| Direct | \$ (38,970) | \$ (94,923) | \$ (45,627) |
| Reinsurance assumed | | - | (54) |
| Reinsurance ceded | 37,250 | 43,929 | 33,847 |
| Total increase in policy liabilities | <u>\$ (1,720)</u> | <u>\$ (50,994)</u> | <u>\$ (11,834)</u> |
| Policy benefits: | | | |
| Direct | \$ 519,441 | \$ 577,930 | \$ 532,348 |
| Reinsurance assumed | | 351 | 133 |
| Reinsurance ceded | (78,545) | (65,610) | (74,672) |
| Total policy benefits | <u>\$ 440,896</u> | <u>\$ 512,671</u> | <u>\$ 457,809</u> |
| Policyholders’ dividends: | | | |
| Direct | \$ 64,751 | \$ 83,921 | \$ 79,967 |
| Reinsurance ceded | (462) | (508) | (543) |
| Total policyholders’ dividends | <u>\$ 64,289</u> | <u>\$ 83,413</u> | <u>\$ 79,424</u> |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 6 – REINSURANCE (continued)

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, 2015 and 2014 was with Swiss Re for \$147.1 million and \$146.5 million, respectively. Total life insurance in force as of December 31, 2015 and 2014 was approximately \$93.8 billion and \$83.2 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) | 2015 | 2014 | 2013 |
|---|---------------------|-------------|-------------|
| Balance, beginning of year | \$ 951,160 | \$ 927,742 | \$ 546,864 |
| Acquisition costs deferred during the year | 318,636 | 313,010 | 259,080 |
| Amortization during the year | (202,049) | (235,482) | (170,741) |
| Adjustment through other comprehensive income during the year | 227,484 | (54,110) | 292,539 |
| Balance, end of year | \$ 1,295,231 | \$ 951,160 | \$ 927,742 |

The Company holds present value of future profits of insurance acquired ("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 \$3.5 million, \$3.9 million, and \$4.4 million for the years ended December 31, 2015, 2014, and 2013, respectively.

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

| Projected | |
|------------------|---------------------|
| Year | Amortization |
| 2016 | 3,100 |
| 2017 | 2,800 |
| 2018 | 2,600 |
| 2019 | 1,200 |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 8 – FEDERAL INCOME TAXES

The Company files income tax returns in the U.S. federal and certain state jurisdictions. The Company is no longer subject to U.S. federal, state, and local income tax examinations by tax authorities for years prior to 2010. During 2014, the IRS started its examination of the Company's 2010, 2011, 2012, and 2013 consolidated federal income tax returns.

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):

| | 2015 | | 2014 | | 2013 (as adjusted) | |
|--|-----------|--------|-----------|-------|-----------------------|-------|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| Current | \$ 12,281 | | \$ 19,809 | | \$ 21,010 | |
| Deferred | 29,663 | | 42,057 | | 35,770 | |
| Total income tax expense | \$ 41,944 | | \$ 61,866 | | \$ 56,780 | |
| Expected income taxes | \$ 52,937 | 35.0% | \$ 72,164 | 35.0% | \$ 65,675 | 35.0% |
| Dividends received deduction | (2,156) | (1.4) | (2,478) | (1.2) | (1,840) | (1.0) |
| Affordable housing tax credit | (20,602) | (13.6) | (16,435) | (8.0) | (15,232) | (8.1) |
| Corporate owned life insurance | (3,503) | (2.3) | (3,250) | (1.6) | (3,230) | (1.7) |
| Other, net | 3,901 | 2.5 | 2,652 | 1.3 | (176) | (0.1) |
| Total without amortization | \$ 30,577 | | \$ 52,653 | | \$ 45,197 | |
| Effective rate without amortization | | 20.2% | | 25.5% | | 24.1% |
| Affordable housing tax credit amortization | 11,367 | 7.5 | 9,213 | 4.5 | 11,583 | 4.0 |
| Total income tax expense | \$ 41,944 | | \$ 61,866 | | \$ 56,780 | |
| Effective federal income tax rate | | 27.7% | | 30.0% | | 28.1% |

As discussed in Note 2, Summary of Significant Accounting Policies, in 2014 the Company adopted ASU 2014-01: Accounting for Investments in Qualified Affordable Housing Projects. The prior years were restated to present the amortization of affordable housing tax credit investments in the current income tax expense line.

The Company paid \$0.0 million, \$10.0 million, and \$10.0 million in federal income taxes during 2015, 2014, and 2013, respectively.

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

| | 2015 | 2014 |
|---|----------|----------|
| Balance, beginning of year | \$ 7,325 | \$ 8,491 |
| Additions/(reductions) based on tax positions related to current year | - | (1,166) |
| Additions/(reductions) based on tax positions related to prior years | (1,165) | - |
| Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations | - | - |
| Settlements | - | - |
| Balance, end of year | \$ 6,160 | \$ 7,325 |

Total unrecognized tax benefits were \$7.2 million at December 31, 2015, including \$1.0 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, 2015, 2014, and 2013, the Company has recognized approximately \$0.2 million in expense, \$0.3 million in expense, and \$0.1 million in expense, respectively, related to interest and penalties. The Company had approximately \$1.0 million and \$0.8 million accrued for interest and penalties at December 31, 2015 and 2014, respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 8 – FEDERAL INCOME TAXES (continued)

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

| | 2015 | 2014 |
|--|--------------|--------------|
| Deferred income tax assets: | | |
| Policy liabilities | \$ 308,374 | \$ 363,631 |
| Pension and other employee benefits | 78,014 | 90,659 |
| Loss carryforwards | 5,929 | 1,487 |
| Tax credits | 21,776 | - |
| Other | 1,874 | 2,851 |
| Total deferred income tax assets | 415,967 | 458,628 |
| Deferred income tax liabilities: | | |
| Deferred policy acquisition costs | 350,642 | 238,762 |
| Debt/Equity Securities | 33,882 | 36,741 |
| Other invested assets | 419 | 3,989 |
| Net UCL AFS Debt/Equity Securities | 145,911 | 398,791 |
| PV Future Profits | 3,413 | 4,633 |
| Property and Equipment | 32,241 | 27,634 |
| Total deferred income tax liabilities | 566,508 | 710,550 |
| Total net deferred income tax assets (liabilities) | \$ (150,541) | \$ (251,922) |

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, 2015 or 2014.

At December 31, 2015, the Company has federal operating loss carryforwards related to the non-life insurance companies of \$15.8 million which expire in 2031 and 2034.

NOTE 9 – BENEFIT PLANS

The Company sponsors a qualified defined benefit pension plan covering substantially all employees. The plan is non-contributory, with benefits for National Life employees hired prior to July 1, 2001, based on an employee's retirement age, years of service, and compensation near retirement. Benefits for National Life employees hired after June 30, 2001, and other Company employees, are based on the amount credited to the employee's account each year, which is a factor of the employee's age, service, and compensation, increased at a specified rate of interest. The Company also sponsors a frozen non-contributory qualified defined benefit plan that provided benefits to employees in the Career channel general agencies. The plan was amended effective January 1, 2004 to freeze plan benefits. No new participants were admitted to the plan after December 31, 2003, and there were no increases in benefits after December 31, 2003 for existing participants. These pension plans are separately funded. Plan assets are primarily mutual funds and bonds held in a Company separate account and funds invested in a group variable annuity contract held in the general account of National Life. None of the securities held in the Company's separate account were issued by the Company, but some investments are advised by an affiliate.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

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

The Company sponsors defined benefit postretirement plans that provide medical benefits to employees, agency staff and agents. Medical coverage is contributory; with retiree contributions adjusted annually, and contain cost sharing features such as deductibles and copayments. The postemployment plans are not separately funded, and the Company, therefore, pays for plan benefits from operating cash flows. The costs of providing these benefits are recognized as they are earned by employees.

The Company also sponsors various defined contribution and deferred compensation plans.

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

| | Pension Benefits | | | Other Benefits | | |
|--|------------------|--------------|--------------|----------------|-------------|-------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Change in benefit obligation: | | | | | | |
| Benefit obligation, beginning of year | \$ 457,918 | \$ 349,373 | \$ 374,259 | \$ 32,086 | \$ 26,457 | \$ 29,935 |
| Service cost for benefits earned during the period | 9,541 | 7,104 | 7,013 | 335 | 266 | 382 |
| Interest cost on benefit obligation | 17,008 | 16,210 | 13,783 | 1,196 | 1,220 | 1,091 |
| Plan participants' contributions | - | - | - | 1,067 | 1,231 | 976 |
| Actuarial (gains)/ losses | (27,336) | 105,524 | (24,945) | (7,689) | 6,201 | (3,484) |
| Benefits paid | (22,162) | (20,293) | (20,737) | (3,128) | (3,289) | (2,443) |
| Benefit obligation, end of year | 434,969 | 457,918 | 349,373 | 23,867 | 32,086 | 26,457 |
| Change in plan assets: | | | | | | |
| Plan assets, beginning of year | 266,332 | 243,897 | 208,014 | - | - | - |
| Actual income on plan assets | (5,824) | 9,073 | 32,431 | - | - | - |
| Employer contributions | 24,129 | 33,655 | 24,189 | 2,061 | 2,058 | 2,443 |
| Plan participants' contributions | - | - | - | 1,067 | 1,231 | 976 |
| Benefits paid | (22,162) | (20,293) | (20,737) | (3,128) | (3,289) | (3,419) |
| Plan assets, end of year | 262,475 | 266,332 | 243,897 | - | - | - |
| Funded Status | \$ (172,494) | \$ (191,586) | \$ (105,476) | \$ (23,867) | \$ (32,086) | \$ (26,457) |

| | Pension Benefits | | | Other Benefits | | |
|--|------------------|--------------|--------------|----------------|-------------|-------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Amounts recognized in the Consolidated Balance Sheets: | | | | | | |
| Pension and other post-retirement benefit obligations liability | \$ 17,198 | \$ 19,493 | \$ 41,605 | \$ 28,271 | \$ 30,337 | \$ 33,528 |
| Accumulated other comprehensive income | 155,296 | 172,093 | 63,871 | (4,404) | 1,749 | (7,071) |
| Net amount recognized | \$ 172,494 | \$ 191,586 | \$ 105,476 | \$ 23,867 | \$ 32,086 | \$ 26,457 |
| Pension and other post-retirement benefit obligations liability | \$ (172,494) | \$ (191,586) | \$ (105,476) | \$ (23,867) | \$ (32,086) | \$ (26,457) |
| Amounts recognized in accumulated other comprehensive income consists of: | | | | | | |
| Net actuarial loss | \$ 155,296 | \$ 172,093 | \$ 63,871 | \$ (374) | \$ 8,793 | \$ 2,987 |
| Net prior service costs (benefits) | - | - | - | (4,030) | (7,044) | (10,058) |
| | \$ 155,296 | \$ 172,093 | \$ 63,871 | \$ (4,404) | \$ 1,749 | \$ (7,071) |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

The total accumulated benefit obligation (“ABO”), the accumulated benefit obligation and fair value of plan assets for the Company’s pension plans with accumulated benefit obligations in excess of plan assets, and the projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets as of the measurement date was as follows (in thousands):

| | 2015 | 2014 | 2013 |
|--|------------|------------|------------|
| Total Accumulated Benefit Obligation | \$ 406,842 | \$ 419,910 | \$ 335,384 |
| Plans with ABO in excess of plan assets: | | | |
| ABO | 406,842 | 419,910 | 335,384 |
| Fair value of plan assets (1) | 262,489 | 266,369 | 244,395 |
| Plans with PBO in excess of plan assets: | | | |
| PBO | 434,969 | 457,918 | 349,373 |
| Fair value of plan assets (1) | 262,489 | 266,369 | 244,395 |

(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 | | |
|---|------------------|-----------|-----------|----------------|------------|----------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Service cost for benefits earned during the period | \$ 9,541 | \$ 7,104 | \$ 7,013 | \$ 335 | \$ 266 | \$ 382 |
| Interest cost on benefit obligation | 17,008 | 16,210 | 13,783 | 1,196 | 1,220 | 1,091 |
| Expected (income) on plan assets | (19,151) | (17,060) | (14,566) | - | - | - |
| Net amortization of actuarial losses (gains) | 14,315 | 5,289 | 11,175 | 1,478 | 396 | 1,121 |
| Amortization of prior service costs (benefits) and plan amendments | - | - | (38) | (3,014) | (3,014) | (3,014) |
| Net periodic benefit cost (included in operating expenses) | \$ 21,713 | \$ 11,543 | \$ 17,367 | \$ (5) | \$ (1,132) | \$ (420) |

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

| | Pension Benefits | | | Other Benefits | | |
|---|------------------|--------------|-----------|----------------|------------|----------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Net gain (loss) | \$ 2,482 | \$ (113,511) | \$ 42,746 | \$ 7,690 | \$ (6,202) | \$ 1,278 |
| Prior service (cost) benefit | - | - | - | - | - | - |
| Amortization of (gain) loss | 14,315 | 5,289 | 11,175 | 1,477 | 396 | 1,121 |
| Amortization of prior service cost (benefits) | - | - | (38) | (3,014) | (3,014) | (3,014) |
| Total recognized in other comprehensive income | \$ 16,797 | \$ (108,222) | \$ 53,883 | \$ 6,153 | \$ (8,820) | \$ (615) |

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 \$13.6 million and \$3.0 million, respectively.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

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

| | Pension Benefits | | | Other Benefits | | |
|--|--------------------|-------------|-------------|----------------|-------|-------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Discount rate | 4.20% | 3.85% | 4.80% | 4.20% | 3.85% | 4.80% |
| 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 | | |
|--|--------------------|-------------|-------------|----------------|-------|-------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Discount rate | 3.85% | 4.80% | 3.80% | 3.85% | 4.80% | 3.80% |
| Rate of increase in future compensation levels | 3.0% - 5.0% | 3.0% - 5.0% | 3.0% - 5.0% | | | |
| Expected long term return on plan assets | 7.00% | 7.00% | 7.00% | | | |

Included in the pension and other post-retirement benefit obligations liability as reported on the Consolidated Balance Sheets are deferred compensation and employee disability liabilities of \$29.3 million and \$29.0 million as of December 31, 2015 and 2014, 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, 2015:

| | |
|--|-------|
| Weighted average health care cost trend rate assumed for next year | 7.67% |
| Rate to which the cost trend rate is assumed to decline | 5% |
| Year that the rate reaches the ultimate trend rate | 2025 |

Increasing the assumed HCCTR by one percentage point in each year would increase the accumulated post-retirement benefit obligation (“APBO”) by about \$0.8 million and would increase service and interest costs by about \$0.1 million. Decreasing the assumed HCCTR by one percentage point in each year would reduce the APBO by about \$0.7 million and would reduce service and interest costs by about \$0.1 million.

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

In 2015, the Company changed the amortization period for one of its plans where all or almost all of the participants are inactive. For these plans, the change in amortization base was from average future service to average future life expectancy in accordance with *ASC 715 – Compensation – Retirement Plans*. The change in methodology resulted in a decrease of net periodic expense of \$1.6 million in 2015.

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, 2015 | December 31, 2014 |
|----------------------------------|-------------------|-------------------|
| Fixed income | 40% | 38% |
| Equities | 54% | 55% |
| Group annuity contract and other | 6% | 7% |
| Total | 100% | 100% |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

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% fixed income, 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.

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

| | | 2015 | 2014 |
|--------------------------------|--------------------------------------|-------------------|-------------------|
| Equities – unaffiliated | Equity Funds | \$ 140,329 | \$ 147,415 |
| | Total equities - unaffiliated | 140,329 | 147,415 |
| Fixed income | Aerospace/Defense | 933 | - |
| | Chemicals | 1,619 | 1,893 |
| | Retailers | 1,748 | 1,096 |
| | Energy | - | 1,010 |
| | Food and Beverage | 4,915 | 5,118 |
| | Health Care | 1,007 | 1,078 |
| | Insurance - Health | 973 | 1,053 |
| | Insurance - Property and Casualty | 3,001 | 3,240 |
| | Machine Construction | 1,926 | 2,087 |
| | Manufacturing | 1,989 | 2,133 |
| | Media | 1,899 | 2,085 |
| | Pharmaceuticals | 4,230 | 3,060 |
| | Technology | 2,075 | 1,119 |
| | Transportation | 2,189 | - |
| | Wirelines | 950 | 1,030 |
| | Bond Funds | 75,328 | 75,300 |
| | Total fixed income | 104,782 | 101,302 |
| Short term investments | Money Market Funds - Banking | - | 4,660 |
| | Total short term investments | - | 4,660 |
| Partnerships | | 12,072 | 10,909 |
| Cash | | 832 | 459 |
| Group annuity | | 4,196 | 1,373 |
| | Total Investments (1) (2) | \$ 262,211 | \$ 266,118 |

(1) Includes investments totaling \$62,365 in 2015 and \$63,404 in 2014 advised by the Company's subsidiary SAMI.

(2) The difference to total plan assets shown of \$262,475 for 2015 and \$266,332 for 2014 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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

The valuation techniques used for the plan assets are:

Common stock – Common stocks consist of mutual funds that are traded daily and have a net asset value. These securities are categorized as Level 1.

Corporates - Corporate bonds are valued using cash flow models based on appropriate observable inputs such as market quotes, yield curves, interest rates, and spreads. Corporate bonds are categorized as Level 2 in the fair value hierarchy. Level 1 consists of bond mutual funds that are traded daily and have a readily determinable net asset value.

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 net asset value, or its equivalent. Since these valuations have significant unobservable inputs, they are generally categorized as Level 3 in 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.

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

The valuation of plan assets as of December 31 is as follows (in thousands):

| 2015 Fair Value | | | | <u>Not Presented</u> | |
|--------------------------|-------------------|------------------|------------------|----------------------|-------------------|
| Assets | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>at Fair Value</u> | <u>Total</u> |
| Common Stock | 140,329 | - | - | - | 140,329 |
| Corporates | 75,328 | 29,732 | - | - | 105,060 |
| Partnerships | - | - | 12,072 | - | 12,072 |
| Cash | 832 | - | - | - | 832 |
| Short term investments | - | - | - | - | - |
| Group annuity | - | 4,196 | - | - | 4,196 |
| Total Assets | \$ 216,489 | \$ 33,928 | \$ 12,072 | \$ - | \$ 262,489 |
| Liabilities | | | | | |
| Total Liabilities | - | - | - | (14) | (14) |
| Total Plan Assets | \$ 216,489 | \$ 33,928 | \$ 12,072 | \$ (14) | \$ 262,475 |

| 2014 Fair Value | | | | <u>Not Presented</u> | |
|--------------------------|-------------------|------------------|------------------|----------------------|-------------------|
| Assets | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>at Fair Value</u> | <u>Total</u> |
| Common Stock | 147,415 | - | - | - | 147,415 |
| Corporates | 75,300 | 26,253 | - | - | 101,553 |
| Partnerships | - | - | 10,909 | - | 10,909 |
| Cash | 459 | - | - | - | 459 |
| Short term investments | 4,660 | - | - | - | 4,660 |
| Group annuity | - | 1,373 | - | - | 1,373 |
| Total Assets | \$ 227,834 | \$ 27,626 | \$ 10,909 | \$ - | \$ 266,369 |
| Liabilities | | | | | |
| Total Liabilities | - | - | - | (37) | (37) |
| Total Plan Assets | \$ 227,834 | \$ 27,626 | \$ 10,909 | \$ (37) | \$ 266,332 |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 9 – BENEFIT PLANS (continued)

The tables below summarize the reconciliation of the beginning and ending balances and related changes for the years ended December 31, 2015 and 2014 for Level 3 fair value measurements for which significant unobservable inputs were used in determining each instrument's fair value.

| 2015 Level 3 Assets | Beginning Balance | Net Investment Gain (Loss) | Purchases | Issuances | Sales | Settlements | Transfer In to Level 3 | Transfer Out of Level 3 | Ending Balance |
|-----------------------|-------------------|----------------------------|-----------|-----------|---------|-------------|------------------------|-------------------------|----------------|
| <i>(in thousands)</i> | | | | | | | | | |
| Limited Partnerships | \$ 10,909 | \$ (272) | \$ 1,522 | \$ - | \$ (87) | \$ - | \$ - | \$ - | \$ 12,072 |

| 2014 Level 3 Assets | Beginning Balance | Net Investment Gain (Loss) | Purchases | Issuances | Sales | Settlements | Transfer In to Level 3 | Transfer Out of Level 3 | Ending Balance |
|-----------------------|-------------------|----------------------------|-----------|-----------|-------|-------------|------------------------|-------------------------|----------------|
| <i>(in thousands)</i> | | | | | | | | | |
| Limited Partnerships | \$ 10,088 | \$ 531 | \$ 290 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 10,909 |

Projected benefit payments for defined benefit obligations, and for projected Medicare Part D reimbursements for each of the five years following December 31, 2015, 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 |
|-----------|------------------------------------|----------------------------------|--|
| 2016 | \$19,669 | \$1,725 | \$41 |
| 2017 | 26,117 | 1,749 | 39 |
| 2018 | 23,182 | 1,759 | 40 |
| 2019 | 25,446 | 1,751 | 38 |
| 2020 | 25,052 | 1,769 | 36 |
| 2021-2025 | 129,093 | 8,905 | 166 |

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 2016 into its separately funded defined benefit pension plans is anticipated to be up to \$15.0 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.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
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NOTE 9 – BENEFIT PLANS (continued)

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, 2015. In 2015 and 2014, there were no impairments or other reductions recorded.

| | December 31, 2015 | | |
|------------------------------|------------------------------|------------------------------------|---------------------------|
| | <i>(Amounts in millions)</i> | | |
| | Gross | Accumulated Impairments | Carrying Value |
| Goodwill | \$ 7.7 | \$ (0.4) | \$ 7.3 |
| Intangibles - Non-amortizing | 47.2 | (1.5) | 45.7 |
| Total | <u>\$ 54.9</u> | <u>\$ (1.9)</u> | <u>\$ 53.0</u> |

NOTE 11 – DEBT

Debt consists of the following (in thousands):

| | 2015 | 2014 |
|---|--------------------------|-------------------|
| 7.5% Senior Notes: \$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. | <u>\$ 199,399</u> | \$ 199,367 |
| 6.5% Senior Notes: Original issue of \$75 million, maturing March 2035, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of NLVF and its subsidiaries. In 2009, the Company's subsidiary, National Life repurchased \$7.0 million of the senior note. Interest paid to the subsidiary is eliminated in consolidation. | 68,014 | 68,014 |
| 10.5% Surplus Notes: Original issue of \$200 million, maturing September 15, 2039, interest payable semiannually on March 15 and September 15. The notes are unsecured and subordinated to any existing or future indebtedness of National Life. | 190,330 | 200,000 |
| Total debt | <u>\$ 457,743</u> | <u>\$ 467,381</u> |

Interest paid on the 7.5% senior notes was \$15.0 million in 2015, 2014, and 2013. Interest paid on the 6.5% senior notes was \$4.4 million in 2015, 2014 and 2013. Interest paid on the 10.5% surplus note was \$21.0 million in 2015, 2014 and 2013.

In May 2014, NLVF repaid the outstanding note payable of \$20.6 million plus accrued interest of \$0.2 million. The \$20.6 million note payable was created via a Trust Preferred Pool of mandatorily redeemable trust preferred stock ("TPS") which held similar preferred stock from a number of other insurance companies. Upon repayment, the company that was created as part of this transaction, the NL Group Statutory Trust, was dissolved. Interest paid on the \$20.6 million note payable was \$0.3 million in 2014, and \$0.9 million in 2013.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 11 – DEBT (continued)

Throughout 2015, National Life repurchased \$9.7 million of the outstanding 10.5% surplus notes. A loss of \$5.4 million was recorded on the repurchase and is included in net realized investment gains (losses).

National Life has a secured asset-based borrowing capacity of \$1.7 billion with FHLB Boston. LSW has a secured asset-based borrowing capacity of \$4.0 billion with FHLB Dallas. National Life has an outstanding advance with FHLB Boston of \$79.2 million, and LSW has an outstanding advance with FHLB Dallas of \$581.6 million. These advances are considered operating leverage and are included in policyholder account liabilities. For additional information on FHLB 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 subclass 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. A jury trial on the fraudulent concealment claims was held in April 2014 and resulted in a defense verdict. No liability was found and no damages awarded. In an Order dated April 14, 2015, U.S. District Court Judge James V. Selna found in favor of LSW as to all remaining claims. On May 29, 2015, plaintiffs filed a notice of appeal from the final judgment with the United States Court of Appeals for the Ninth Circuit. Plaintiffs filed their appellate brief in December 2015. LSW will timely file its reply brief. It is anticipated that the matter will be set for oral argument in late 2016.

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2015

NOTE 12 – COMMITMENTS AND CONTINGENCIES (continued)

The Company currently leases rights to the use of certain data processing hardware from Dell Systems Corporation (formerly known as Perot Systems Corporation), Plano, Texas. This agreement was extended through January 31, 2025. The following is a schedule of future minimum lease payments as of December 31, 2015 (in thousands).

| Year | <u>Contract Obligation</u> |
|------------------------|----------------------------|
| 2016 | 6,000 |
| 2017 | 6,000 |
| 2018 | 6,000 |
| 2019 | 6,000 |
| 2020 | 6,000 |
| Total minimum payments | <u>\$ 30,000</u> |

The Company also has a services contract with Dell. In total, the Company paid \$15.0 million, \$12.9 million, and \$13.1 million for the years ended December 31, 2015, 2014, and 2013, respectively under the Dell contracts.

The Company has a multi-year contract for information systems application and infrastructure services from NTT Data, Boston, Massachusetts. The contract expires January 1, 2020. Expense paid under the contract with NTT was \$25.0 million, \$32.5 million, and \$23.5 million for the years ended December 31, 2015, 2014, and 2013, respectively. The expense paid includes a base amount and variable expenses related to project work performed during the year.

The Company has a multi-year contract with I-Pipeline which expires December 31, 2017. The contract provides new business support through electronic application. The Company paid \$2.3 million, \$2.3 million, and \$0.9 million for the years ended December 31, 2015, 2014, and 2013, respectively.

The Company signed a multi-year contract with Cognizant which expires December 31, 2017. The contract provides application support, web development and QA services. The Company paid \$10.2 million, \$8.1 million, and \$6.7 million for the years ended December 31, 2015, 2014, and 2013, respectively.

The Company's subsidiary, LSW, is a party to an amended lease agreement with Gaedeke Holdings IX, LLC for its LSW office facilities in Addison, Texas. The expiration date of this agreement is January 31, 2027. Rental expense incurred under this agreement was \$1.3 million and \$0.9 million in 2015 and 2014, respectively.

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

| Year | <u>Contract Obligation</u> |
|------------------------|----------------------------|
| 2016 | 1,434 |
| 2017 | 1,558 |
| 2018 | 1,578 |
| 2019 | 1,730 |
| 2020 | 1,808 |
| Thereafter | 10,678 |
| Total minimum payments | <u>\$ 18,786</u> |

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NOTE 12 – COMMITMENTS AND CONTINGENCIES (continued)

Unfunded Commitments – The Company had unfunded mortgage loan and partnership commitments of \$61.7 million and \$253.7 million respectively, at December 31, 2015. 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 2015 and 2014, the Company recorded a policyholder dividend obligation of \$11.3 million and \$13.8 million respectively. Similarly, unrealized gains on Closed Block investments may increase the policyholder dividend obligation liability. Unrealized gains in the Closed Block generated a policyholder dividend obligation through accumulated other comprehensive income of \$113.0 million, \$202.4 million, and \$139.1 million at December 31, 2015, 2014 and 2013, 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, 2015 and 2014 was \$124.3 million and \$216.2 million, respectively.

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NOTE 13 – NATIONAL LIFE CLOSED BLOCK (continued)

Summarized financial information for the Closed Block effects included in the consolidated financial statements as of December 31, 2015 and 2014, and for the three years ended December 31, 2015, 2014 and 2013 is as follows (in thousands):

| | <u>2015</u> | <u>2014</u> |
|---|---------------------|---------------------|
| Liabilities: | | |
| Policy liabilities and accruals | \$ 3,387,243 | \$ 3,553,967 |
| Other liabilities | 177 | - |
| Total liabilities | <u>\$ 3,387,420</u> | <u>\$ 3,553,967</u> |
| Assets: | | |
| Cash | \$ 7,826 | \$ 330 |
| Short term investments | 15,000 | - |
| Available-for-sale debt and equity securities | 2,443,863 | 2,626,323 |
| Mortgage loans | 205,530 | 190,296 |
| Policy loans | 403,474 | 424,447 |
| Accrued investment income | 33,821 | 35,270 |
| Premiums and fees receivable | 6,774 | 6,917 |
| Other assets | 52,093 | 42,125 |
| Total assets | <u>\$ 3,168,381</u> | <u>\$ 3,325,708</u> |
| Excess of reported liabilities over assets | \$ 219,039 | \$ 228,259 |
| Closed Block accumulated other comprehensive loss | - | - |
| Unrealized loss and liabilities | <u>\$ 219,039</u> | <u>\$ 228,259</u> |

NLV Financial Corporation and Subsidiaries
Notes to Consolidated Financial Statements
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NOTE 13 – NATIONAL LIFE CLOSED BLOCK (continued)

| | <u>2015</u> | <u>2014</u> | <u>2013</u> |
|---|-------------------|-------------------|-------------------|
| Revenues: | | | |
| Insurance premiums and other income | \$ 116,480 | \$ 125,453 | \$ 146,121 |
| Net investment income | 147,947 | 153,618 | 169,674 |
| Net realized investment gain (loss) | 93 | 22,086 | (500) |
| | <u> </u> | <u> </u> | <u> </u> |
| Total revenues | <u>\$ 264,520</u> | <u>\$ 301,157</u> | <u>\$ 315,295</u> |
| Benefits and Expenses: | | | |
| Decrease in policy liabilities | (60,593) | (102,746) | (69,023) |
| Policy benefits | 243,208 | 295,728 | 280,967 |
| Policyholders' dividends and dividend obligations | 53,619 | 72,535 | 70,126 |
| Interest credited to policyholder account liabilities | 7,659 | 8,006 | 8,505 |
| Operating expenses | 5,264 | 5,696 | 6,059 |
| Commission expenses | 1,177 | 1,286 | 1,399 |
| | <u> </u> | <u> </u> | <u> </u> |
| Total benefits and expenses | <u>\$ 250,334</u> | <u>\$ 280,505</u> | <u>\$ 298,033</u> |
| Pre-tax results of operations | 14,186 | 20,652 | 17,262 |
| Income taxes | 4,966 | 7,236 | 6,110 |
| | <u> </u> | <u> </u> | <u> </u> |
| Closed Block results of operations | \$ 9,220 | \$ 13,416 | \$ 11,152 |
| Other comprehensive income: | | | |
| Unrealized loss | - | - | - |
| Total Closed Block comprehensive income | <u>\$ 9,220</u> | <u>\$ 13,416</u> | <u>\$ 11,152</u> |
| | | | |
| Excess of reported Closed Block liabilities over Closed Block assets: | | | |
| Beginning of year | 228,259 | 241,675 | 252,827 |
| Closed Block comprehensive income | 9,220 | 13,416 | 11,152 |
| End of year | <u>\$ 219,039</u> | <u>\$ 228,259</u> | <u>\$ 241,675</u> |

Amortized cost of bonds held by the Closed Block at December 31, 2015 and 2014 were \$2,302.6 million and \$2,395.6 million, respectively.

Participating insurance in force within the Closed Block at December 31, 2015 and 2014 was \$6.6 billion and \$7.0 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.

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NOTE 14 – STATUTORY INFORMATION AND RESTRICTIONS

The Company's insurance operations, domiciled in the states of Vermont for National Life and Catamount Reinsurance Company 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. National Life and LSW do not have any permitted practices. Catamount has permitted practices approved by the State of Vermont.

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.

Catamount Reinsurance Company commenced business on August 5, 2015 as a special purpose financial captive life insurance company domiciled and licensed in the state of Vermont. Catamount entered into a coinsurance with funds withheld agreement with National Life to reinsure the majority of in force Closed Block policies. All outstanding shares of the Company's common stock are directly owned by National Life. All outstanding shares of National Life are currently held by its parent, NLVF. Catamount Reinsurance Company's use of permitted practices has no impact on National Life's surplus.

In 2015, LSW did not pay any dividends to National Life. In 2014 and 2013, LSW paid an ordinary dividend to National Life of \$30 million and \$25 million, respectively. In 2015 and 2014, National Life did not pay any dividend to NLVF. In 2013, National Life paid an ordinary dividend to NLVF of \$25 million. For U.S. GAAP, 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.

In 2015, there was a capital contribution of \$18 million from NLVF to National Life. There was a subsequent capital contribution of \$18 million from National Life to LSW.

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 \$1,770.0 million (unaudited) and \$1,541.2 million at December 31, 2015 and 2014, respectively. Statutory net income was \$12.0 million (unaudited), \$19.1 million, and \$88.5 million in 2015, 2014, and 2013, respectively.

Pursuant to certain statutory requirements, as of December 31, 2015, 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.

NLV Financial Corporation and Subsidiaries
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NOTE 15 – PARTICIPATING LIFE INSURANCE

Participating life insurance in force was 27.5% and 31.2% of the face value of total insurance in force at December 31, 2015 and 2014, respectively. The premiums on participating life insurance policies were 16.1%, 18.2%, and 23.1% of total individual life insurance premiums in 2015, 2014, and 2013, respectively.