

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Financial Statements and Schedules

December 31, 2019, 2018 and 2017

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 500
191 West Nationwide Blvd.
Columbus, OH 43215-2568

Independent Auditors' Report

The Board of Directors
Ohio National Mutual Holdings, Inc.:

We have audited the accompanying consolidated financial statements of Ohio National Mutual Holdings, Inc. and its subsidiaries (collectively, the Company), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2019, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 the auditors' 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, the auditor considers internal control relevant to the entity'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 entity'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 the Company as of December 31, 2019 and 2018, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2019, in accordance with U.S. generally accepted accounting principles.



Other Matter

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in Schedules 1 and 2 is presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Columbus, Ohio
March 26, 2020

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2019 and 2018

(Dollars in thousands)

Assets	2019	2018
Investments:		
Securities available-for-sale, at fair value:		
Fixed maturity securities	\$ 9,745,959	11,606,009
Fixed maturity securities on loan	238,652	303,757
Trading securities, at fair value:		
Fixed maturity securities	160	850
Equity securities, at fair value	40,468	68,361
Equity securities on loan, at fair value	—	274
Mortgage loans on real estate, net	1,446,093	1,335,742
Real estate, net	52,270	48,904
Policy loans	875,097	766,701
Other long-term investments	272,204	264,261
Short-term investments securities lending collateral	246,578	313,492
Short-term investments	213,529	170,146
Total investments	13,131,010	14,878,497
Cash and cash equivalents	288,218	247,261
Accrued investment income	77,849	100,630
Deferred policy acquisition costs	1,679,421	1,966,022
Reinsurance recoverable	3,946,180	2,111,698
Reinsurance deposit asset	905,770	—
Operating lease right-of-use assets	8,115	—
Other assets	386,324	358,770
Federal and foreign income tax recoverable	17,811	26,600
Assets held in separate accounts	19,926,103	19,489,189
Total assets	\$ 40,366,801	39,178,667
Liabilities and Equity		
Future policy benefits and claims	\$ 15,724,764	15,140,939
Policyholders' dividend accumulations	32,964	34,266
Other policyholder funds	170,779	164,147
Short-term borrowings	1,675	91,586
Long-term debt obligations (net of unamortized discount and debt issuance costs of \$6,623 in 2019 and \$6,996 in 2018)	953,878	853,504
Deferred federal and foreign income taxes	139,253	106,315
Operating lease liabilities	8,107	—
Other liabilities	543,617	519,942
Payables for securities lending collateral	246,578	313,492
Liabilities related to separate accounts	19,926,103	19,489,189
Total liabilities	37,747,718	36,713,380
Equity:		
Accumulated other comprehensive income	234,922	13,523
Retained earnings	2,384,161	2,451,764
Total equity	2,619,083	2,465,287
Total liabilities and equity	\$ 40,366,801	39,178,667

See accompanying notes to consolidated financial statements.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 2019, 2018 and 2017

(Dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Revenues:			
Traditional life insurance premiums	\$ 862,166	847,496	772,534
Annuity premiums and charges	445,085	571,784	523,958
Universal life policy charges	147,999	146,529	153,689
Group life and health insurance premiums	113,099	100,632	89,399
Accident and health insurance premiums	25,238	21,284	17,994
Investment management fees	45,181	51,452	30,438
Change in value of trading securities	—	—	2,449
Change in value of trading fixed maturity securities	(4)	(45)	—
Change in value of equity securities	4,819	(7,208)	—
Net investment income	524,794	553,278	506,944
Net realized gains (losses):			
Investment gains (losses):			
Total other-than-temporary impairment losses on securities	2,426	2,312	(4,778)
Portion of impairment losses recognized in other comprehensive income (loss)	(7,386)	(4,539)	(11,349)
Net other-than-temporary impairment losses on securities recognized in earnings	(4,960)	(2,227)	(16,127)
Realized gains, excluding other-than-temporary impairment losses on securities	215,334	5,293	12,924
Total investment gains (losses)	210,374	3,066	(3,203)
Derivative instruments	(154,443)	(6,000)	(291,294)
Loss on debt retirement	(10,263)	—	—
Other income	126,424	106,448	104,053
	<u>2,340,469</u>	<u>2,388,716</u>	<u>1,906,961</u>
Benefits and expenses:			
Benefits and claims	1,578,810	1,491,281	1,332,550
Provision for policyholders' dividends on participating policies	114,298	108,640	97,540
Amortization of deferred policy acquisition costs	265,038	154,419	114,128
Commissions, net	175,902	235,802	216,711
Other operating costs and expenses	307,959	331,953	324,925
	<u>2,442,007</u>	<u>2,322,095</u>	<u>2,085,854</u>
(Loss) income before income taxes	<u>(101,538)</u>	<u>66,621</u>	<u>(178,893)</u>
Income taxes:			
Current expense (benefit)	895	(972)	(15,119)
Deferred benefit	(34,830)	(5,056)	(189,720)
	<u>(33,935)</u>	<u>(6,028)</u>	<u>(204,839)</u>
Net (loss) income	\$ <u>(67,603)</u>	<u>72,649</u>	<u>25,946</u>

See accompanying notes to consolidated financial statements.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss)

Years ended December 31, 2019, 2018 and 2017

(Dollars in thousands)

	<u>Before tax</u>	<u>Tax (expense) benefit</u>	<u>After tax</u>
2019			
Net loss	\$		(67,603)
Other comprehensive income, net of taxes:			
Foreign currency translation adjustment	(10,027)	—	(10,027)
Unrecognized net periodic benefit cost	(1,202)	225	(977)
Unrealized gains (losses) on derivative instruments	299	(63)	236
Net unrealized gains (losses) on securities available-for-sale arising during the period:			
Securities available-for-sale	649,764	(138,885)	510,879
Deferred acquisition costs	(114,252)	23,993	(90,259)
Future policy benefits and claims	(61,427)	14,497	(46,930)
Other policyholder funds	25,670	(5,391)	20,279
Less:			
Net gains on securities available-for-sale realized during the period	207,982	(43,682)	164,300
Amortization of pension and other post-retirement benefits	(3,162)	664	(2,498)
Total other comprehensive income	<u>284,005</u>	<u>(62,606)</u>	<u>221,399</u>
Total comprehensive income			\$ <u><u>153,796</u></u>
2018			
Net income	\$		72,649
Other comprehensive loss, net of taxes:			
Foreign currency translation adjustment	(17,497)	—	(17,497)
Unrecognized net periodic benefit cost	9,402	(1,975)	7,427
Net unrealized gains (losses) on securities available-for-sale arising during the period:			
Securities available-for-sale	(285,061)	60,025	(225,036)
Deferred acquisition costs	81,269	(17,067)	64,202
Future policy benefits and claims	38,534	(9,645)	28,889
Other policyholder funds	(17,990)	3,778	(14,212)
Less:			
Net gains on securities available-for-sale realized during the period	15,464	(3,290)	12,174
Amortization of pension and other post-retirement benefits	(4,059)	852	(3,207)
Total other comprehensive loss	<u>(202,748)</u>	<u>37,554</u>	<u>(165,194)</u>
Total comprehensive loss			\$ <u><u>(92,545)</u></u>
2017			
Net income	\$		25,946
Other comprehensive income, net of taxes:			
Foreign currency translation adjustment	11,459	—	11,459
Unrecognized net periodic benefit cost	(437)	(6,946)	(7,383)
Net unrealized gains (losses) on securities available-for-sale arising during the period:			
Securities available-for-sale	86,818	19,191	106,009
Deferred acquisition costs	(26,819)	(3,331)	(30,150)
Future policy benefits and claims	(13,508)	2,542	(10,966)
Other policyholder funds	8,863	(617)	8,246
Less:			
Net gains on securities available-for-sale realized during the period	21,420	(4,733)	16,687
Amortization of pension and other post-retirement benefits	(4,009)	842	(3,167)
Total other comprehensive income including tax reform adjustment	<u>48,965</u>	<u>14,730</u>	<u>63,695</u>
Stranded tax effects of the tax reform rate change, net ¹	<u>—</u>	<u>(33,329)</u>	<u>(33,329)</u>
Total other comprehensive income	<u>48,965</u>	<u>(18,599)</u>	<u>30,366</u>
Total comprehensive income			\$ <u><u>56,312</u></u>

1. As a result of the Tax Cuts and Jobs Act (tax reform) and in conjunction with the adoption of Accounting Standards Update (ASU) 2018-02, Income Statement – Reporting Comprehensive Income, Reclassifications of Certain Tax Effects from Accumulated Other Comprehensive Income, the Company applied new tax rates to the components of Other Comprehensive Income driven by the change in Accumulated Other Comprehensive Income and identified the stranded tax effects of the tax reform rate change in a single line in this table. See Note 4.

See accompanying notes to consolidated financial statements.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Equity
Years ended December 31, 2019, 2018 and 2017

(Dollars in thousands)

	<u>Accumulated other comprehensive income</u>	<u>Retained earnings</u>	<u>Total equity</u>
Balance, December 31, 2016	\$ 120,381	2,381,139	2,501,520
Tax reform adjustment	33,329	(33,329)	—
Comprehensive income:			
Net income	—	25,946	25,946
Other comprehensive income	30,366	—	30,366
Total comprehensive income	<u> </u>	<u> </u>	<u>56,312</u>
Balance, December 31, 2017	184,076	2,373,756	2,557,832
Impact of adoption of ASU 2016-01*	(5,359)	5,359	—
Comprehensive loss:			
Net income	—	72,649	72,649
Other comprehensive loss	(165,194)	—	(165,194)
Total comprehensive loss	<u> </u>	<u> </u>	<u>(92,545)</u>
Balance, December 31, 2018	13,523	2,451,764	2,465,287
Comprehensive income:			
Net loss	—	(67,603)	(67,603)
Other comprehensive income	221,399	—	221,399
Total comprehensive income	<u> </u>	<u> </u>	<u>153,796</u>
Balance, December 31, 2019	\$ <u>234,922</u>	<u>2,384,161</u>	<u>2,619,083</u>

*See Note 3 for further detail.

See accompanying notes to consolidated financial statements.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2019, 2018 and 2017

(Dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:			
Net (loss) income	\$ (67,603)	72,649	25,946
Adjustments to reconcile net loss to net cash provided by operating activities:			
Interest credited to policyholder account values	249,426	236,964	226,986
Universal life and investment-type product policy fees	(406,228)	(415,644)	(404,182)
Capitalization of deferred policy acquisition costs	(156,827)	(231,828)	(235,076)
Amortization of deferred policy acquisition costs	265,038	154,419	114,128
Amortization and depreciation	24,996	26,463	11,377
Net realized (gains) losses on investments and derivative instruments	(45,668)	2,934	294,497
Change in value of trading securities	—	—	(2,449)
Change in value of trading fixed maturity securities	4	45	—
Change in value of equity securities	(4,819)	7,208	—
Deferred income tax benefit	(34,830)	(5,056)	(189,720)
(Decrease) increase in accrued investment income	22,781	(6,300)	(3,408)
Increase in operating lease right-of-use assets	(8,115)	—	—
(Increase) decrease in other assets and reinsurance recoverable	(106,501)	(67,377)	44,235
Increase in policyholder liabilities	602,004	787,915	524,368
Increase in policyholders' dividend accumulations and other funds	11,258	25,613	13,836
Decrease (increase) in federal and foreign income tax recoverable	8,789	1,367	(6,727)
Increase in operating lease liabilities	8,107	—	—
Increase in other liabilities	1,677	7,719	90,817
Other, net	418	(3,264)	(4,703)
Net cash provided by operating activities	<u>363,907</u>	<u>593,827</u>	<u>499,925</u>
Cash flows from investing activities:			
Proceeds from maturity of fixed maturity available-for-sale securities	212,081	368,308	249,676
Proceeds from sales, calls, redemptions, prepayments, and paydowns of fixed maturity available-for-sale securities	1,235,043	1,082,932	920,959
Proceeds from sale of equity securities	62,603	40,578	37,516
Proceeds from maturity of fixed maturity held-to-maturity securities	—	—	52,445
Proceeds from sales, calls, redemptions, prepayments, and paydowns of fixed maturity held-to-maturity securities	—	—	73,862
Proceeds from repayment of mortgage loans on real estate	166,304	203,250	218,756
Proceeds from sale of real estate	5,706	4,141	7,639
Cost of fixed maturity available-for-sale securities acquired	(1,720,935)	(2,770,215)	(1,685,123)
Cost of equity securities acquired	(31,207)	(33,377)	(26,556)
Cost of fixed maturity held-to-maturity securities acquired	—	—	(172,597)
Cost of mortgage loans on real estate acquired	(281,005)	(271,261)	(267,233)
Cost of real estate acquired	(7,247)	(3,116)	(2,201)
Cost of property, plant and equipment acquired	(13,674)	(11,896)	—
Derivative (payments) receipts, net	(64,807)	(60,355)	(239,061)
Change in payables for securities lending collateral, net	(66,914)	303,811	(264,799)
Net increase in short-term investments	(45,600)	(60,723)	(18,014)
Change in policy loans, net	(108,800)	(102,873)	(84,593)
Change in payable for securities and mortgage loans on real estate	2,668	(17,842)	—
Company owned life insurance settlement proceeds	—	98	—
Change in other invested assets, net	73,313	(27,350)	(68,226)
Net cash used in investing activities	<u>(582,471)</u>	<u>(1,355,890)</u>	<u>(1,267,550)</u>

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

Years ended December 31, 2019, 2018 and 2017

(Dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash flows from financing activities:			
Universal life and investment product account deposits	\$ 606,197	1,826,006	1,870,514
Universal life and investment product account withdrawals	(440,231)	(953,230)	(1,370,612)
Change in reinsurance deposit asset	32,483	—	—
Change in short-term borrowings	(89,958)	147	76,439
Other financing activities	(3,836)	10,687	15,856
Issuance of notes payable	399,248	—	—
Repayment of notes payable	(310,263)	—	—
Net cash provided by financing activities	<u>193,640</u>	<u>883,610</u>	<u>592,197</u>
Foreign currency translation adjustment	<u>(1,033)</u>	<u>(1,554)</u>	<u>617</u>
Net (decrease) increase in cash and cash equivalents	<u>(25,957)</u>	<u>119,993</u>	<u>(174,811)</u>
Cash and cash equivalents, beginning of period	<u>560,753</u>	<u>440,760</u>	<u>615,571</u>
Cash and cash equivalents, end of period	<u>\$ 534,796</u>	<u>560,753</u>	<u>440,760</u>
Supplemental disclosures:			
Federal income tax (received) paid	\$ (10,000)	2,239	9,863
Interest paid	69,761	62,318	58,423
Reinsurance funds withheld embedded derivative liability change	191	20	—
Non-cash consideration for reinsurance recoverable	1,858,332	—	—
Non-cash consideration for available-for-sale bonds transferred for reinsurance	(2,796,585)	—	—
Non-cash consideration for reinsurance deposit asset	938,253	—	—

See accompanying notes to consolidated financial statements.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2019, 2018 and 2017

(Dollars in thousands)

(1) Organization and Business Description

Organization

Ohio National Mutual Holdings, Inc. is a mutual holding company organized under Ohio insurance laws and owns 100% of Ohio National Financial Services, Inc. (“ONFS”), a stock holding company. ONFS owns 100% of The Ohio National Life Insurance Company (“ONLIC”), a life insurance subsidiary and Sycamore Re, Ltd. (“SYRE”), a special purpose financial captive life insurance company.

In 1998, ONLIC became a stock company under provisions of Sections 3913.25 to 3913.38 of the Ohio Revised Code relating to mutual holding companies. ONLIC owns 100% of Ohio National Life Assurance Corporation (“ONLAC”), a stock life insurance subsidiary, National Security Life and Annuity Company (“NSLAC”), a stock life insurance subsidiary, Montgomery Re, Inc. (“MONT”), a special purpose financial captive life insurance company, Kenwood Re, Inc. (“KENW”), a special purpose financial captive life insurance company, Camargo Re Captive, Inc. (“CMGO”), a special purpose financial captive life insurance company, Sunrise Captive Re, LLC (“SUNR”), an Ohio authorized reinsurer, Ohio National Equities, Inc. (“ONEQ”), a broker dealer registered under the Securities and Exchange Commission Act of 1934, and The O.N. Equity Sales Company (“ONESCO”), a broker dealer registered under the Securities and Exchange Commission Act of 1934.

SYRE owns 100% of a Delaware holding company, ON Foreign Holdings, LLC (“ONFH”), which owns 100% of Ohio National International Holdings Cooperatief U.A. (“ONIH”), a Dutch holding company. ONIH owns 100% of ON Netherlands Holdings B.V. (“ONNH”), a Dutch holding company. Effective December 27, 2019, ONIH was merged into ONNH, with ONNH being the surviving entity. As the transaction was between entities under common control, the operations of ONIH were transferred to ONNH at carrying value and, as such, there was no financial statement impact as a result of this transaction. ONNH owns Ohio National Seguros de Vida S.A. (“ONSP”), a Peruvian insurance company and ON Global Holdings, SMLLC (“ONGH”), a Delaware holding company. ONNH owns 100% of O.N. International do Brasil Participacoes, Ltda. (“OHIO”), which was formed to hold the equity method investment made when the Company entered into a 50% joint venture agreement with a Brazilian insurance company. Effective September 30, 2019, ONSA issued additional common equity shares to ONNH in exchange for a capital contribution of \$5,283. ONGH now owns 92% of ONSA and ONNH owns 8%. Prior to this transaction, ONGH owned 100% of Ohio National Sudamerica S.A. (“ONSA”), a Chilean holding company. ONSA owns 100% of Ohio National Seguros de Vida S.A. (“ONSV”), a Chilean insurance company.

Ohio National Mutual Holdings, Inc. and its subsidiaries are collectively referred to as “ONMH” or the “Company”.

Business

ONLIC and ONLAC are life and health (disability) insurers licensed in 49 states, the District of Columbia and Puerto Rico. ONLIC and ONLAC offered a full range of life, disability, and annuity products through independent agents and other distribution channels and are subject to competition from other insurers throughout the United States. The Company announced on September 6, 2018 that it will exclusively focus on growing its life insurance and disability insurance product lines going forward. The decision follows a comprehensive strategic review of the Company’s businesses, taking into account the continuously changing regulatory landscape, the sustained low interest rate environment, and the increasing cost of doing business, as well as growth opportunities and the Company’s competitive strengths. Effective September 15, 2018,

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2019, 2018 and 2017

(Dollars in thousands)

the Company is no longer accepting applications for annuities or new retirement plans, while continuing to service and support existing clients in both product lines.

In 2018, ONLIC offered certain variable annuity policyholders with the guaranteed minimum income benefit (“GMIB”) rider the opportunity to exchange that policy and associated rider for a fixed indexed annuity policy with an enhanced guaranteed lifetime withdrawal benefit (“GLWB”) rider. More than \$500,000 in account value was exchanged under this program.

Additionally, in late 2018 and into 2019, ONLIC offered to buy-back certain variable annuity policies from policyholders with the GMIB rider. The Company paid more than \$115,000 and \$58,000 related to the buy-back, during 2019 and 2018, respectively, which is included in benefits and claims on the corresponding statements of operations.

NSLAC is licensed in 17 states and the District of Columbia and services an existing portfolio of variable annuity products. Effective March 16, 2018, NSLAC no longer actively markets or issues new individual variable annuity business, which currently represents the majority of NSLAC’s inforce contracts and policies.

ONLIC, ONLAC and NSLAC are subject to regulation by the insurance departments of states in which they are licensed and undergo periodic examinations by those departments.

SYRE reinsured certain fixed indexed annuity and variable annuity-related risks for ONLIC. The variable annuity reinsurance agreement covered living benefits and death benefits sold only with or as a part of such living benefit riders. During 2019, ONLIC recaptured the majority of variable annuity-related risks, and reinsured them with SUNR. SUNR retrocedes the risks related to GMIB variable annuity contracts to SYRE. The effects of these transactions have no impact on the Company’s financial statements, as they eliminate in consolidation.

SUNR was capitalized in 2018 and was approved on January 9, 2019 by the Ohio Department of Insurance to begin assuming contracts written by ONLIC, effective April 1, 2019.

MONT engages in the business of reinsuring term life insurance and certain death benefit guarantee universal life policies with affiliated companies. KENW and CMGO engage in the business of reinsuring term life insurance with affiliated companies.

ONEQ earns revenue by retaining a sales load from the sale of variable life insurance contracts on behalf of ONLAC and variable annuity contracts, fixed annuity contracts and fixed indexed annuity contracts on behalf of ONLIC, to unrelated third party broker dealers under distribution agreements with ONLAC and ONLIC. ONESCO earns commissions and fees from sales of variable life contracts under a distribution agreement with ONLAC and annuity contracts under a distribution agreement with ONLIC as well as commissions and fees related to sales of unaffiliated products.

ONSV provides insurance and other retirement products to the Chilean market. ONSP provides death, survival and disability insurance in the Peruvian Social Security System. The Brazilian joint venture provides insurance and other retirement products to the Brazilian market.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2019, 2018 and 2017

(Dollars in thousands)

(2) Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). All intercompany transactions and balances have been eliminated in consolidation.

(3) Summary of Significant Accounting Policies

The significant accounting policies followed by the Company that materially affect financial reporting are summarized below.

(a) *Change in Accounting Principle*

The Company has in previous years accounted for direct financing leases under the legacy lease accounting guidance within ASC 840. Upon adoption of ASC 842 in 2019, buyer-lessors are required to evaluate direct financing leases for whether the underlying asset has been purchased based on the transfer of control. The Company’s direct financing leases do not qualify as a sale of the underlying asset; as such, the Company will account for them as receivables under Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 310 effective January 1, 2019.

(b) *Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to adopt accounting policies and make estimates and assumptions that affect amounts reported in the consolidated financial statements. In applying these policies and estimates, management makes subjective and complex judgments that frequently require assumptions about matters that are inherently uncertain. Actual results could differ from estimates.

The most significant estimates and assumptions include those used in determining the balance, amortization and recoverability of deferred policy acquisition costs, the liability for future policy benefits and claims, contingencies, provision for income taxes, deferred taxes, uncertain income tax positions and contingencies, allowance for loan losses for mortgage loans on real estate, valuation of and impairment losses on investments and valuation of embedded derivatives. Although some variability is inherent in these estimates, the recorded amounts reflect management’s best estimates based on facts and circumstances as of the consolidated balance sheet date. Management believes the amounts provided are appropriate.

(c) *Fair Value*

Certain assets and liabilities are measured at estimated fair value in the Company’s consolidated balance sheets. The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. Note 6 to the consolidated financial statements includes further disclosures of estimated fair values.

(d) *Investments*

Net Investment Income and Net Realized Gains (Losses)

Income on investments is reported within net investment income. Gains and losses on sales of investments, impairment losses and changes in the allowance for loan losses on mortgage loans are reported within net realized gains (losses).

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2019, 2018 and 2017

(Dollars in thousands)

Fixed Maturity and Equity Securities

Fixed maturity and equity securities classified as available-for-sale are reported at their estimated fair value. Unrealized gains and losses, net of adjustments to deferred policy acquisition costs, future policy benefits and claims, other policyholder funds and deferred federal income tax, are recorded as a separate component of accumulated other comprehensive income in equity. Effective January 1, 2018, the Company reclassified all equity securities available-for-sale to equity securities, at fair value as a result of the adoption of Accounting Standards Update (“ASU”) 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-01”). See Note 7 for further information.

Fixed maturity securities related to the Company’s funds withheld reinsurance arrangements are classified as trading and are stated at estimated fair value. Changes in estimated fair value of these securities are included in change in value of trading securities in the consolidated statements of operations.

Fixed maturity and equity securities classified as trading are reported at their estimated fair value. Changes in estimated fair value of these securities are included in change in value of trading securities in the consolidated statements of operations. Effective January 1, 2018, the Company reclassified all equity securities classified as trading to equity securities, at fair value as a result of the adoption of ASU 2016-01. See Note 7 for further information.

Realized gains (losses) on the sale of investments are determined on the basis of specific security identification on the trade date. Any capital gains occurring in the Closed Block portfolio are offset by increases in the deferred policyholder obligation for that group of policies. See Note 16 for further information on the Closed Block.

For mortgage-backed securities, the Company recognizes income using a constant effective yield method based on prepayment assumptions and the estimated economic life of the securities. When estimated prepayments differ significantly from actual prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. Any resulting adjustment is included in net investment income. All other investment income is recorded using the interest method without anticipating the impact of prepayments.

Dividends are recorded on the ex-dividend date and interest is accrued as earned using an effective yield method giving effect to amortization of premiums and accretion of discounts.

Management regularly reviews its fixed maturity and equity securities portfolios in order to evaluate the necessity to record impairment losses for other-than-temporary declines in estimated fair value of investments. See Note 7 for management’s description and analysis of the portfolio.

Mortgage Loans on Real Estate

Mortgage loans on real estate are carried at the unpaid principal balance less an allowance for loan losses. The allowance is comprised of a specific and general component. The specific component relates to loans that have been identified as impaired and is generally measured as the difference between the impaired principal balance less the fair value of the collateral, if collateral dependent, less cost to sell. The Company provides allowances for impairments of these mortgage loans based on a review by portfolio managers. For the general component, management’s periodic evaluation of the adequacy of the allowance is based on past

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loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors.

Commercial mortgages can be restructured in a troubled debt restructuring ("TDR"). The Company assesses loan modifications on a case by case basis to evaluate whether a TDR has occurred and will then establish a specific valuation allowance for the excess carrying value of the loan over the estimated fair value of the collateral.

Changes in the allowance are recorded in net realized gains (losses). Loans in foreclosure and loans considered to be impaired as of the consolidated balance sheet date are placed on nonaccrual status. Interest received on nonaccrual status mortgage loans is included in net investment income in the period received.

Real Estate

Real estate, net, which is comprised of buildings and improvements held for company investment and other real estate owned, is carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful life of the assets. The estimated useful life for company occupied real estate is 30 to 39 years and the estimated useful life for building improvements is 5 to 20 years. The estimated useful life for real estate held for investment is 17 to 39 years and the estimated useful life for building improvements is 5 to 16 years. Real estate, net also includes land which is carried at cost.

The Company occupies less than 50% of buildings held for company investment.

The cost basis of the real estate and building improvements was \$58,645 and \$54,513 at December 31, 2019 and 2018, respectively. Accumulated depreciation was \$12,062 and \$11,296 at December 31, 2019 and 2018, respectively. Related depreciation expense was \$1,907, \$1,922 and \$1,713 for the years ended December 31, 2019, 2018 and 2017, respectively, and is included in net investment income in the consolidated statements of operations. The cost basis of land was \$5,687 and \$5,390 at December 31, 2019 and 2018, respectively.

The Company reviews the estimated useful lives of these long lived assets and assesses for impairment when certain events or changes in operations occur.

Policy Loans

Policy loans are stated at unpaid principal balances. Interest income on such loans is recorded as earned using the contractually agreed upon interest rate and is included in net investment income on the consolidated statements of operations. Generally, accrued interest is capitalized on the policy's anniversary date.

Other Long Term Investments

The direct financing leases entered in to prior to the adoption of ASC 842, which consist principally of building and land purchase and leasing arrangements, will continue to be accounted for as capital leases under ASC 840. Direct financing leases are carried at minimum lease payments to be received less unearned income. Building leases generally have a 75% - 80% loan-to-value ("LTV") at inception and a 9 to 21 year repayment schedule. Land leases generally have a 60% - 70% LTV at inception, a five year repayment schedule and have several principal and interest cash flow structures.

Venture capital partnerships are carried on the equity method basis.

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Securities Lending Program

The Company participates in an indemnified securities lending program administered by an unaffiliated agent in which certain portfolio holdings are loaned to third parties. The borrower must deliver to the Company's agent collateral having a market value equal to at least 102% and 105%, respectively, of the market value of the domestic and foreign securities loaned. The collateral received by the Company's agent from the borrower to secure loans on behalf of the Company must be in the form of cash, securities issued or guaranteed by the U.S. government or its agencies, or a bank letter of credit or equivalent obligation as may be pre-approved by the Company. The Company monitors the estimated fair value of the loaned securities on a daily basis and additional collateral is obtained as necessary. The asset, short-term investments securities lending collateral, and corresponding liability, payables for securities lending collateral, are recorded on the consolidated balance sheets. Income and expenses associated with securities lending transactions are reported within net investment income.

Short-term Investments

Short-term investments include securities and other investments with remaining maturities of one year or less, but greater than three months, at the time of purchase and are stated at estimated fair value.

(e) Derivatives

The Company enters into derivative transactions that do not meet the criteria for hedge accounting or have not been designated in hedging relationships by the Company pursuant to FASB ASC Topic 815, *Derivatives and Hedging*. The Company purchases equity index put options, equity futures, currency futures, equity swaps and interest rate swaptions as hedges for certain riders that were sold with variable annuity products. The Company similarly purchases equity index call options as hedges for the fixed indexed annuity and indexed universal life products. These transactions provide the Company with an economic hedge, which is used as part of its overall risk management strategies. The futures derivative instruments are carried at estimated fair value in other long-term investments or other liabilities, and the remaining derivative instruments are carried at estimated fair value in other long-term investments, with changes in estimated fair value recorded in net realized gains (losses) derivative instruments in the consolidated statements of operations.

The Company enters into derivative transactions that meet the criteria for hedge accounting pursuant to FASB ASC Topic 815, *Derivatives and Hedging* ("ASC 815"). The Company purchased a foreign currency swap that meets the criteria for hedge accounting as a cash flow hedge. The swap instrument is carried at estimated fair value in other long-term investments or other liabilities. Changes in the estimated fair value of the swap are recorded in other comprehensive income in the consolidated balance sheets.

The Company sold variable annuities and fixed indexed annuities, issues certain insurance products and investment contracts, and is a party to certain reinsurance agreements that have embedded derivatives. The Company assesses each identified embedded derivative to determine whether it is required to be bifurcated. The embedded derivative is bifurcated from the host contract and accounted for as a freestanding derivative if:

- the combined instrument is not accounted for in its entirety at fair value with changes in fair value recorded in earnings;

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- the terms of the embedded derivative are not clearly and closely related to the economic characteristics of the host contract; and
- a separate instrument with the same terms as the embedded derivative would qualify as a derivative instrument.

Such embedded derivatives are carried at estimated fair value with the reinsurance embedded derivatives reported in reinsurance recoverables in the consolidated balance sheets. The change in the estimated fair value is reported in benefits and claims in the consolidated statements of operations.

(f) Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all short-term and highly liquid investments with original maturities of three months or less (including securities lending collateral, commercial paper and reverse repurchase agreements) to be cash equivalents.

(g) Segregated Special Surplus Fund

ONLIC has established a segregated special surplus fund for the benefit of SUNR, a consolidated subsidiary, in accordance with a reinsurance agreement undertaken during the year. The assets are to be used to provide the protection to maintain SUNR's statutory total adjusted capital at a level of at least 200% of its authorized control level risk based capital. The segregated special surplus fund is held in a custodial account. At December 31, 2019, the required amount to be segregated was \$35,826 and the value of the custodial account was \$36,437, which was invested in the following assets at December 31, 2019:

	<u>2019</u>
Cash and cash equivalents	\$ 3,090
Securities available-for-sale, at fair value:	
Fixed maturity securities	25,579
Mortgage loans on real estate, net	<u>7,768</u>
Total custodial account value	<u>\$ 36,437</u>

(h) Deferred Policy Acquisition Costs and Capitalized Sales Inducements

The Company incurs costs in connection with acquiring new and renewal insurance business. Costs that are related directly to the successful acquisition or renewal of insurance contracts are capitalized as deferred acquisition costs ("DAC"). Such costs generally include:

- incremental direct costs of contract acquisitions;
- the portion of the employee's total compensation, excluding any compensation that is deferred as part of contract acquisitions, and payroll related fringe benefits for certain costs related directly to time spent performing underwriting, policy issuance, medical/inspection, and sales force contract selling acquisition activities of a successful contract;
- other costs related directly to the insurer's acquisition activities noted above that would not have been incurred had the issuance of the contract not occurred; and

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- certain advertising costs that meet the deferral criteria.

All other acquisition costs such as general advertising, market research, training, administration and unsuccessful acquisition efforts are expensed as incurred.

DAC is subject to recoverability testing in the year of policy issuance and loss recognition testing at the end of each reporting period. For traditional nonparticipating life insurance products, DAC is amortized with interest over the premium paying period of the related policies in proportion to premium revenue. Such anticipated premium revenue is estimated using the same assumptions as were used for computing liabilities for future policy benefits.

For traditional participating life insurance products, DAC is amortized in proportion to gross margins of the related policies. Gross margins are determined for each issue year and are equal to premiums plus investment income less death claims, surrender benefits, administrative costs, expected policyholder dividends, and the increase in reserve for future policy benefits.

For investment and universal life products, DAC is amortized with interest over the lives of the policies in relation to the present value of the estimated future gross revenues (projected investment income, asset fees, cost of insurance charges, policy administration fees, surrender charges, and net realized gains and losses) or estimated future gross profits (gross revenues less interest credits, policy benefits and policy maintenance expenses).

DAC for participating life products, investment products and universal life business is adjusted to reflect the impact of unrealized gains and losses on the related fixed maturity securities available-for-sale.

The most significant assumptions that are involved in the estimation of future gross profits include future gross separate account performance, surrender/lapse rates, withdrawal/partial withdrawal, interest margins and mortality. The Company's long-term assumption for gross separate account performance, net of investment fees, is 7.3%, a blend of expected returns from stock, money market and bond funds representative of the in-force block of contracts before a deduction for policy charges. The Company assumes that the level of separate account assets resulting from market performance will revert, over a three year period, to the level expected if the long-term assumed trend rate had applied. This assumption is commonly referred to as a reversion to the mean. The Company's policy regarding the reversion to the mean process does not permit projected returns to be below 0.0% or in excess of 15.0% during the three-year reversion period.

Changes in assumptions can have a significant impact on the amount of DAC reported for investment products and universal life insurance products and their related amortization patterns. In the event actual experience differs from assumptions or assumptions are revised, the Company is required to record an increase or decrease in DAC amortization expense ("DAC unlocking"), which could be significant. In general, increases in the estimated general and net separate account returns result in increased expected future profitability and may lower the rate of DAC amortization, while increases in lapse/surrender and mortality assumptions reduce the expected future profitability of the underlying business and may increase the rate of DAC amortization. Any resulting DAC unlocking adjustments are reflected currently in the amortization of DAC in the consolidated statements of operations.

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The Company's policy for internal replacements that result in a replacement contract that is substantially changed from the replaced contract the replaced contract shall be accounted for as extinguished and unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement assets from the replaced contract shall not be deferred in connection with the replacement contract.

The Company offers certain sales inducements to contract holders. Sales inducements are product features that enhance the investment yield on a contract. The Company utilizes the following sales inducements:

- day-one bonuses which increase the account value at inception; and
- enhanced yield options which credit interest for a specified period in excess of rates currently being offered for other similar contracts.

Sales inducements are deferred and amortized using the same methodology and assumptions used to amortize DAC.

(i) Reinsurance

Reinsurance is an agreement by which a reporting entity transfers all or part of its risk under a contract to another reporting entity. For each of its reinsurance agreements, the Company determines whether the agreement provides indemnification against loss or liability relating to insurance risk in accordance with applicable accounting standards. The Company reviews all contractual features, including those that may limit the amount of insurance risk to which the reinsurer is subject or features that delay the timely reimbursement of claims. To the extent there are loss limiting features that preclude the reinsurer from assuming the risk of significant loss, the Company accounts for such agreements using deposit accounting.

Accounting for reinsurance requires the use of significant management estimates and assumptions, particularly related to the future performance of the underlying business and the potential impact of counterparty credit risk. The Company periodically reviews actual and anticipated experience compared to the assumptions used to establish assets and liabilities relating to ceded and assumed reinsurance and evaluates the strength of counterparties to its reinsurance agreements. Reinsurance does not discharge the Company from its primary liability to policyholders and to the extent that a reinsurer should be unable to meet its obligations, the Company would be liable to policyholders.

Amounts recoverable under reinsurance agreements, which totaled \$3,946,180 and \$2,111,698 as of December 31, 2019 and 2018, respectively, include ceded reserves, paid and unpaid claims, and certain other amounts.

Effective July 1, 2019, the Company entered into a reinsurance agreement to coinsure 100% of its retained inforce bank owned life insurance ("BOLI") and single premium deferred annuity ("SPDA") blocks of business with a third party reinsurer licensed as an authorized reinsurer in the State of Ohio.

Reinsurance premiums ceded and reinsurance recoveries on benefits and claims incurred are deducted from the respective income and expense accounts on the consolidated statements of operations. Assets and liabilities related to reinsurance ceded are reported on a gross basis.

The Company enters into reinsurance agreements with various insurance subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

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See Note 11 for additional reinsurance disclosures and information.

(j) Equipment, Computer Software and Hardware and Properties Occupied by the Company

Equipment, which is included in other assets, is stated at cost, less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful lives of the assets. The estimated life is generally 2 to 15 years for equipment. The cost basis of the equipment was \$68,123 and \$61,613 at December 31, 2019 and 2018, respectively. Accumulated depreciation of equipment was \$49,244 and \$44,701 at December 31, 2019 and 2018, respectively. Related depreciation expense was \$5,871, \$5,742 and \$6,167 for the years ended December 31, 2019, 2018 and 2017, respectively.

Computer software and hardware, which is included in other assets, is stated at cost, less accumulated amortization. Purchased software costs, as well as certain internal and external costs incurred to develop internal-use computer software during the application development stage, are capitalized. Such costs are amortized generally over a 2 to 10 year period using the straight-line method based upon the estimated useful life of the assets. The cost basis of computer software was \$117,386 and \$107,718 at December 31, 2019 and 2018, respectively. Accumulated amortization of computer software and hardware was \$64,972 and \$59,589 at December 31, 2019 and 2018, respectively. Related amortization expense was \$9,380, \$9,908 and \$7,463 for the years ended December 31, 2019, 2018 and 2017, respectively.

Properties occupied by the Company, which are included in other assets, are carried at cost less accumulated depreciation. Depreciation is determined using the straight-line method over the estimated useful life of the assets. The estimated useful life for company occupied real estate is 30 to 32 years and the estimated useful life for building improvements is 9 to 30 years. The cost basis of the buildings, improvements and land was \$45,779 and \$45,637 at December 31, 2019 and 2018, respectively. Accumulated depreciation of buildings and improvements was \$20,133 and \$18,437 at December 31, 2019 and 2018, respectively. Related depreciation expense was \$1,647, \$1,623 and \$1,562 for the years ended December 31, 2019, 2018, and 2017, respectively. Properties occupied by the Company also include related land which is carried at cost.

The Company reviews the estimated useful lives of these long lived assets and assesses for impairment when certain events or changes in operations occur.

The Company has \$4,611 and \$12,712 of capital projects in process recorded in other assets at December 31, 2019 and 2018, respectively.

(k) Goodwill and Intangible Assets

Goodwill and intangible assets are included in other assets. In a business combination, goodwill is the result of the excess of cost over the estimated fair value of the net assets acquired. Intangible assets are non-financial assets that lack physical substance resulting from a business combination.

Goodwill and intangible assets are assets acquired by the Company as a result of acquisitions in prior years of the NSLAC and ONSV entities. The Company has \$1,314 of goodwill recorded in other assets at December 31, 2019 and 2018.

Goodwill is not amortized, but is evaluated for impairment annually or more frequently if events or circumstances, such as adverse changes in the business climate, require an interim evaluation. The

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evaluation includes the use of management assumptions which may be inherently uncertain. During the 2019 annual impairment tests, the Company concluded that the estimated fair value of the goodwill was in excess of its carrying value and, therefore, not impaired.

The Company has \$179 and \$191 of intangible assets recorded in other assets on the balance sheets at December 31, 2019 and 2018, respectively, related to insurance licenses acquired with the purchase of NSLAC by ONLIC in 2002. The value of the intangible is primarily dependent upon the maintenance of the New York license. License fees are paid annually in order to maintain the license in good standing. Each license remains intact and in good standing as there have been no events that would impact NSLAC's ability to do business in the New York or New Jersey markets. In 2018, the Company evaluated and concluded that its intangible assets had a useful life that was determinable and began amortizing the assets over that life. The Company amortized \$12 and \$4, respectively, for the years ended December 31, 2019 and 2018.

(l) Separate Accounts

Separate account assets and liabilities represent contract holders' funds, which have been segregated into accounts with specific investment objectives. Separate account assets are recorded at estimated fair value based primarily on market quotations of the underlying securities. The investment income and gains or losses of these accounts accrue directly to the contract holders. The activity of the separate accounts is not reflected in the consolidated statements of operations and cash flows except for the fees the Company receives for administrative services and risks assumed and the activity related to guaranteed contracts, which are riders to existing variable annuity contracts. These are recorded in either annuity premiums and charges or benefits and claims in the consolidated statements of operations. Separate account seed money is recorded as a trading security.

(m) Revenues and Benefits

Traditional Life Insurance Products

Traditional life insurance products include those products with fixed and guaranteed premiums and benefits and consist primarily of whole life, limited-payment life, term life, and certain annuities with life contingencies.

Premiums for traditional life insurance products are recognized as revenue when due. Benefits and expenses are associated with earned premiums; therefore, profits are recognized over the life of the contract. This association is accomplished through the provision for future policy benefits and the deferral and amortization of policy acquisition costs.

Investment Products and Universal Life Insurance Products

Investment products consist primarily of individual and group variable and fixed deferred annuities, annuities without life contingencies, guaranteed investment contracts and fixed indexed annuities. Universal life insurance products include universal life, variable universal life, indexed universal life and other interest-sensitive life insurance policies.

Revenues for investment products and universal life insurance products consist of net investment income, cost of insurance charges, asset fees, policy administration fees, and surrender charges that have been earned and assessed against policy account balances during the period. The timing of revenue recognition as it relates to fees assessed on investment contracts and universal life contracts is determined based upon the

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nature of such fees. Cost of insurance charges and policy administrative fees are assessed on a daily, monthly or annual basis, and recognized as revenue when assessed and earned. Certain amounts assessed that represent compensation for services to be provided in future periods such as unearned front end loads are reported as unearned revenue and recognized in income over the periods benefited. Surrender charges are recognized upon surrender of a contract in accordance with contractual terms. Policy benefits and claims that are charged to expense include benefits and claims incurred in the period in excess of related policy account balances, maintenance costs, and interest credited to policy account balances.

Accident and Health Insurance Products

Accident and health insurance premiums including group life (burial and survivorship) and health (disability) are recognized as revenue in accordance with the terms of the policies. Policy claims are charged to expense in the period that the claims are incurred.

(n) Investment Management Fees

Investment management fees are earned by various subsidiaries in conjunction with money management activities. The fees are based on a percentage of assets at the end of each quarter and are recognized in income as earned.

Revenue earned by the broker dealer operations, which is based on agreed upon commission rates, is recognized when the respective broker dealer entity's performance obligation is satisfied. For fees paid up front, the performance obligation is the sale of the contract and as such, is fulfilled on the trade date. Certain variable commission revenue is considered constrained, as it is dependent on the account value at future points in time as well as the length of time and whether the policy remains in force, all of which are highly susceptible to factors outside the Company's influence. The constraint is overcome when the account value and investor activities are known, usually monthly, at which point the revenue is recognized. The broker dealer operations had no remaining performance obligations to satisfy related to revenue from contracts with customers as of December 31, 2019.

The following table illustrates the revenue recognized from contracts with customers reported in investment management fees, net investment income and other income on the consolidated statements of operations, and the timing of revenue recognition, for the year ending December 31, 2019 and 2018:

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	Registered investment and variable contracts	General securities	Fee based and other	Total
December 31, 2019				
Revenues from contracts with customers				
Other income	\$ 51,713	1,729	15,018	68,460
Net investment income	—	—	28	28
Investment management fees	—	—	45,181	45,181
Total revenue from contracts with customers	<u>\$ 51,713</u>	<u>1,729</u>	<u>60,227</u>	<u>113,669</u>
Timing of revenue recognition				
Satisfaction of performance obligation:				
Transferred at a point in time	\$ 51,713	1,729	60,227	113,669
Total revenue from contracts with customers	<u>\$ 51,713</u>	<u>1,729</u>	<u>60,227</u>	<u>113,669</u>
December 31, 2018				
Revenues from contracts with customers				
Other income	\$ 61,298	2,334	13,503	77,135
Net investment income	—	—	29	29
Investment management fees	—	—	51,450	51,450
Total revenue from contracts with customers	<u>\$ 61,298</u>	<u>2,334</u>	<u>64,982</u>	<u>128,614</u>
Timing of revenue recognition				
Satisfaction of performance obligation:				
Transferred at a point in time	\$ 61,298	2,334	64,982	128,614
Total revenue from contracts with customers	<u>\$ 61,298</u>	<u>2,334</u>	<u>64,982</u>	<u>128,614</u>

(o) Other Income

The Company earns sales load fees on the sale of ONLAC variable universal life contracts by unrelated third party brokers through various subsidiaries. The Company also earned sales load fees on ONLIC variable, fixed and fixed indexed annuity contracts. Sales load fees are recognized as revenue when earned. Additionally, the various subsidiaries of the Company sold registered investment products and variable contracts sponsored by unaffiliated parties.

(p) Future Policy Benefits and Claims

The Company establishes liabilities for amounts payable under insurance policies. Generally, amounts are payable over an extended period of time and related liabilities are calculated as the present value of future expected benefits to be paid reduced by the present value of future expected premiums. Such liabilities are established based on methods and underlying assumptions in accordance with GAAP and applicable actuarial standards. The process of calculating reserve amounts for a life insurance organization involves the use of a number of assumptions, including those related to persistency (how long a contract stays with a company), mortality (the relative incidence of death in a given time), morbidity (the relative incidence of disability resulting from disease or physical ailment) and interest rates (the rates expected to be paid or received on financial instruments, including insurance or investment contracts). The methods used in

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determining the liability for unpaid losses and future policy benefits are standard actuarial methods recognized by the American Academy of Actuaries.

Liabilities for traditional life insurance policies are calculated using a net level premium method based on estimates of mortality, morbidity, investment yields, and withdrawals which were used or which were being experienced at the time the policies were issued.

Liabilities for investment products in the accumulation phase, fixed deferred annuities, fixed indexed annuities, group annuities, universal life insurance products and variable universal life insurance products are calculated based on participants' contributions plus interest credited less applicable contract charges.

Liabilities for payout annuities are calculated using the present value of future benefits discounted using varying interest rates. Liabilities for variable payout annuities also include maintenance costs in the present value calculation.

Liabilities for disability income policies are calculated using a net level premium method based on estimates of mortality, morbidity, investment yields, and withdrawals which were used or which were being experienced at the time the policies were issued. Liabilities for disability income policies on claims are calculated using the present value of future benefits and maintenance costs discounted using varying interest rates, depending on the year the claim was incurred.

The Company regularly reviews its estimates of future policy benefits and claims liabilities and compares them with its actual experience. Differences result in changes to the liability balances with related charges or credits to benefit expenses in the period in which the change occurs.

The Company issued traditional variable annuity contracts through its separate accounts, for which investment income and gains and losses on investments accrue directly to, and investment risk is borne by, the contract holder.

The Company also issued nontraditional variable annuity contracts through its separate accounts in which the Company provides various forms of guarantees/riders to benefit the related contract holders. These guarantees are accounted for as insurance liabilities or as embedded derivatives depending on how and when the benefit is paid. Specifically, a guarantee is accounted for as an embedded derivative if a guarantee is paid out without requiring the occurrence of a specific insurable event or the policyholder to annuitize. Alternatively, a guarantee is accounted for as an insurance liability if the guarantee is paid only upon either the occurrence of a specific insurable event, or annuitization. In certain cases, a guarantee may have elements of both an insurance liability and an embedded derivative and in such cases the guarantee is split and accounted for under both models.

The Company has five main types of rider benefits offered with individual variable annuity contracts:

- guaranteed minimum death benefit ("GMDB");
- guaranteed minimum income benefit ("GMIB");
- guaranteed minimum accumulation benefit ("GMAB");
- guaranteed minimum withdrawal benefit ("GMWB"); and
- guaranteed lifetime withdrawal benefit ("GLWB").

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The Company also issued fixed indexed annuity contracts with an enhanced GLWB rider.

The Company refers to the total of the five types issued with variable annuity contracts and fixed indexed annuity contracts, collectively, as the “G reserves.”

Guarantees accounted for as insurance liabilities in future policy benefits and claims include GMDBs, GMIBs and certain GLWBs that require annuitization.

Guarantees accounted for as embedded derivatives include GMWBs, GMABs and certain GLWBs that do not require annuitization, as well as the index crediting feature within the fixed indexed annuity contracts. At inception, the Company attributes to the embedded derivative a portion of the projected future guarantee fees to be collected from the policyholder equal to the present value of projected future guaranteed benefits. The embedded derivatives are carried at estimated fair value and reported in future policy benefits and claims.

(q) Participating Business/Policyholder Dividends

Participating business, which refers to policies that participate in profits through policyholder dividends, represents 14.0%, 13.1% and 12.3% of the Company’s ordinary life insurance in force as of December 31, 2019, 2018 and 2017, respectively. The liability for policyholder dividends includes the estimated amount of annual dividends earned by policyholders and is recorded in other policyholder funds in the accompanying consolidated balance sheets. Policyholder dividends incurred are recorded in the provision for policyholders’ dividends on participating policies in the accompanying consolidated statements of operations.

Policyholder dividends are approved annually by ONLIC’s board of directors based upon the amount of distributable statutory surplus. The aggregate amount of policyholder dividends is related to actual interest, mortality, morbidity, and expense experience for the year, as well as management’s judgment as to the appropriate level of statutory surplus to be retained by ONLIC.

(r) Income Taxes

The Company files a life/non-life consolidated federal income tax return which includes its U.S. domestic subsidiaries. United States Department of the Treasury (“Treasury”) regulations generally require a five year waiting period as to when a life insurance company can be included in the consolidated federal income tax return. A subsidiary life insurance company may obtain approval sooner, if the provisions of the Treasury regulations are met. SUNR met the Treasury regulations and received approval to join the consolidated return in 2019.

SYRE was formed in Bermuda in 2008 as a life insurance company and elected to be treated as a U.S. taxpayer. In 2013, SYRE was redomesticated to the United States. In 2015, SYRE was re-domiciled from the U.S. to the Cayman Islands and elected to be a U.S. taxpayer. SYRE joined the consolidated return on January 1, 2014.

The method of allocation between the companies is subject to written agreement, approved by the Board of Directors. Allocations are based upon separate return calculations with current credit for net losses. Intercompany tax balances are settled quarterly.

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The Company's policy for recording interest and penalties associated with audits, claims and adjustments is to record such amounts as a component of current income tax (benefit) expense.

The foreign life insurance subsidiaries owned by the Company file tax returns in accordance with applicable foreign laws in their respective countries of domestication. U.S. taxation of foreign affiliates may differ in timing and amount from taxation under foreign laws. The impact of the returns filed subject to foreign tax law has been reflected in the provision for income tax expense and related liabilities.

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. Valuation allowances are established when it is determined that it is more likely than not that the deferred tax asset will not be fully realized. Current income taxes are charged to operations based upon amounts estimated to be payable as a result of taxable operations for the current year.

In determining the need for a valuation allowance, the Company considers the carryback capacity to absorb capital losses, reversal of existing temporary differences, estimated future taxable income and prudent and feasible tax planning strategies. The determination of the valuation allowance for the Company's deferred tax assets requires management to make certain judgments and assumptions regarding future operations that are based on historical experience and expectations of future performance. Management's judgments are subject to change given the inherent uncertainty in predicting future performance, which is impacted by such factors as policyholder behavior, competitive pricing, and specific industry and market conditions.

Related to Global intangible low-taxed income ("GILTI") tax rules, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the 'period cost method') or (2) factoring such amounts into a company's measurement of its deferred taxes (the 'deferred method'). The Company has elected the period cost method, which will be determined annually if the Company's GILTI inclusion arises to a material amount from a U.S. tax compliance perspective.

On December 22, 2017, President Donald Trump signed into law the tax legislation commonly known as the Tax Cuts and Jobs Act. See Note 4 for a description of the new tax law.

(s) *Litigation Contingencies*

The Company is a party in various legal actions arising in the normal course of business. Given the inherent unpredictability of these matters, it is difficult to estimate the impact on the Company's financial position. Liabilities are established when it is probable that a loss has been incurred and the amount of loss can be reasonably estimated. Legal costs are recognized as incurred and for the estimated amount to be incurred.

On a quarterly and annual basis, the Company reviews relevant information with respect to liabilities for litigation, regulatory investigations and litigation-related contingencies to be reflected in the Company's consolidated financial statements. See Note 20 for further information.

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(t) Foreign Currency

Assets, liabilities and operations of foreign subsidiaries are recorded based on the functional currency of each entity. The determination of the functional currency is made based on the appropriate economic and management indicators. The local currencies of foreign operations are the functional currencies. Assets and liabilities of foreign subsidiaries are translated from the functional currency to U.S. dollars at the exchange rates in effect at each year end and income and expense accounts are translated at the average exchange rates during the year. The resulting translation adjustments are charged or credited directly to other comprehensive income, net of applicable taxes.

(u) Employee Benefit Plans

The Company sponsors and/or administers various plans that provide defined benefit pension and other postretirement benefits covering eligible employees and sales representatives. Measurement dates used for all of the defined benefit pension and other postretirement benefit plans correspond with the year end of the Company. The Company recognizes the funded status of the projected benefit obligation (“PBO”) less plan assets for pension benefits and the accumulated benefit obligation (“ABO”) for other postretirement benefits for each of its plans. The Company recognizes an expense for differences between actual experience and estimates over the average future service period of participants. The actuarial gains (losses) and prior service costs (credit) not yet included in net periodic benefit costs are charged to accumulated other comprehensive income (“AOCI”), net of income tax.

The obligations and expenses associated with these plans require the use of assumptions such as discount rate, expected long-term return on plan assets, rate of compensation increases, healthcare cost trend rates, as well as participant demographics such as rate and age of retirements, withdrawal rates and mortality. Management determines these assumptions based upon a variety of factors such as historical performance of the plan and its assets, currently available market and industry data and mortality tables, and expected benefit payout streams. The assumptions used may differ materially from actual results due to, among other factors, changing market and economic conditions and changes in participant demographics. These differences may have an effect on the Company’s consolidated financial statements.

The Company sponsors a defined contribution plan for substantially all employees. The Company also sponsors a qualified contributory defined contribution profit-sharing plan for substantially all employees. Discretionary Company contributions are based on the net earnings of the Company. Accordingly, the Company recognizes compensation cost for current contributions.

(v) Adoption and Future Adoption of New Accounting Pronouncements

The Company generally applies the “other public entity” requirements when adopting new accounting standards. Where the standard adoption timeframes differentiate between U.S. Securities and Exchange Commission (“SEC”) filers and other public business entities (“PBE”), the Company follows the adoption timelines for other public business entities as the Company does not meet the requirements of an SEC filer.

Adoption of New Accounting Pronouncements

Effective January 1, 2019, the Company adopted ASU 2019-10, Financial Instruments – *Derivatives and Hedging (Topic 815): Effective Dates*, ASU 2019-04, *Codification Improvements to Topic 815, Derivatives and Hedging*, ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The guidance refines, expands and simplifies hedge accounting for financial and

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nonfinancial risk. The adoption of this guidance did not significantly impact the Company's consolidated financial statements or financial statement disclosures.

Effective January 1, 2019, the Company adopted ASU 2019-10, *Leases (Topic 842): Effective Dates*, ASU 2019-01, *Leases (Topic 842): Codification Improvements* (March 2019), ASU 2018-20, *Leases (Topic 842): Narrow Scope Improvements for Lessors* (December 2018), ASU 2018-11, *Leases (Topic 842): Targeted Improvements* (July 2018), and ASU 2016-02, *Leases (Topic 842)* using the prospective application of the guidance and prior periods continue to be presented in accordance with Topic 840. This new guidance requires lessees to recognize a lease liability measured on a discounted basis and a right-of-use asset for the lease term for those leases classified as operating leases under previous guidance. Under this guidance, lessor accounting is largely unchanged except to align lessor accounting with the lease accounting model and ASC Topic 606, *Revenue from Contracts with Customers*, and thus the accounting for sale and leaseback transactions has been simplified. Additionally, the Company elected the package of practical expedients and recognized on the Consolidated Statement of Financial Position \$9,189 of operating lease liabilities and \$9,151 of operating lease right-of-use assets at adoption. The adoption of this guidance did not have a material impact on the Statement of Income, Stockholders' Equity, and Statement of Cash Flows. See Note 19 for additional disclosures.

Effective January 1, 2019, the Company adopted ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities*. This guidance requires premium on callable debt securities to be amortized to the earliest call date. The adoption of this guidance did not significantly impact the Company's consolidated financial statements or financial statement disclosures.

In February 2018, the Company early adopted ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This guidance gives financial statement preparers an option to reclassify stranded tax effects within AOCI to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The guidance also requires disclosure of (1) a description of the accounting policy for releasing income tax effects from AOCI, (2) whether the Company elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act, and (3) information about the other income tax effects that are reclassified. The Company chose to early adopt this standard effective for the year ended December 31, 2017. As a result of adoption, (\$33,329) was reclassified from AOCI to retained earnings.

In January 2018, the Company adopted ASU 2017-05, *Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*. This guidance defines in substance nonfinancial assets, and clarifies that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The adoption of this guidance did not impact the Company's consolidated financial statements.

In January 2018, the Company adopted ASU 2016-18, *Statement of Cash Flows, (Topic 230): Restricted Cash*. This guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts

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shown on the statement of cash flows. The adoption of this guidance did not impact the Company's consolidated financial statements, except for expanded disclosures.

In January 2018, the Company adopted ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*. This guidance requires entities to immediately recognize the income tax consequences of intercompany asset transfers. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In January 2018, the Company adopted guidance on cash flow statement presentation, ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. The guidance addresses how certain specific cash receipts and cash payments are presented and classified in the statement of cash flows. The adoption of this guidance did not impact the Company's consolidated financial statements.

In January 2018, the Company adopted ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This guidance requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. This guidance requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). This guidance eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The Company adopted the standard using a modified retrospective approach. The adoption of the standard resulted in a reclassification of approximately \$6,783, pre-tax, \$5,359, net of tax as of December 31, 2018, from accumulated other comprehensive income to retained earnings.

Effective January 1, 2018, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance outlines a single, comprehensive model for accounting for revenue from contracts with customers and applies primarily to commissions, advisory fees and sales loads earned by the Company's broker dealer operations, as Topic 606 specifically excludes insurance contracts from its scope. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements. In adopting the standard, the Company recognized approximately \$17,000 in sub-advisory fees as a portion of other operating costs and expenses for the year ended December 31, 2018 (gross basis), where in previous years they were reported as part of investment management fees (net basis).

Future Adoption of New Accounting Pronouncements

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, effective for fiscal years beginning after December 15, 2020 for public business entities. This ASU removes specific exceptions to the general principles in Topic 740 in GAAP. Management has not yet assessed the impact that this guidance may have on the consolidated financial statements.

In October 2018, the FASB issued ASU 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance of Variable Interest Entities*, effective for fiscal years beginning after December 15, 2019 for public business entities. The guidance amends previous issued guidance for determining whether an indirect interest held through a related party is a VIE. It is anticipated this guidance will result in more

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decision makers not consolidating VIEs. Early adoption is permitted. Management does not expect that this guidance will have a material impact on the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*, effective for fiscal years ending after December 15, 2019 for public business entities. This guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). This guidance requires a customer in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The guidance also requires the customer to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. Early adoption is permitted. Management has not yet assessed the impact that this guidance may have on the consolidated financial statements.

In August 2018, the FASB issued ASU 2018-14, *Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans*, effective for fiscal years ending after December 15, 2020 for public business entities. This guidance removes disclosures that are no longer considered cost beneficial, clarifies the specific requirements of disclosures, and adds disclosure requirements identified as relevant. Early adoption is permitted. Management does not expect that this guidance will have a material impact on the consolidated financial statements except for changes to disclosures.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, effective for fiscal years beginning after December 15, 2019 for public business entities. This guidance modifies the disclosure requirements on fair value measurements in Topic 820, *Fair Value Measurement*, by removing, modifying and adding certain disclosures associated with fair value measurements. Early adoption is permitted. Management does not expect this guidance will have a material impact on the consolidated financial statements except for changes to disclosures.

In August 2018, the FASB issued ASU 2018-12, *Financial Services – Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*, and in November 2019, the FASB issued ASU 2019-09, *Financial Services – Insurance (Topic 944): Effective Date*. The new guidance is effective for fiscal years beginning after December 15, 2023 for PBE non-SEC filers. Early adoption is permitted. This new guidance impacts existing recognition, measurement, presentation, and disclosure requirements for long-duration insurance contracts issued by an insurance entity. Management has not yet assessed the impact that this guidance may have on the consolidated financial statements, but expects it to be material.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* effective for annual periods beginning after January 1, 2020 which eliminates some portions of the goodwill impairment test to simplify the test. The guidance also eliminates the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. Management does not expect that this guidance will have a material impact on the consolidated financial statements.

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The FASB has issued guidance on measurement of credit losses on financial instruments: ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*, ASU 2019-10, *Financial Instruments – Credit Losses (Topic 326): Effective Dates*, ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*, ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses*, ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses* (November 2018) and ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (June 2016). The new guidance is effective for fiscal years beginning after December 15, 2022 for PBE non-SEC filers. Early adoption is permitted. ASU 2016-13 replaces the incurred loss impairment methodology with one that reflects expected credit losses. The measurement of expected credit losses will be based on historical loss information, current conditions, and reasonable and supportable forecasts after implementation of this guidance. The guidance also requires enhanced disclosures. Management has not yet assessed the impact that this guidance may have on the consolidated financial statements.

(w) Subsequent Events

The Company has evaluated subsequent events through March 26, 2020, the date that the consolidated financial statements were available to be issued.

In January 2020, the Company issued a \$425,000, 5.550% fixed rate senior note due January 24, 2030. The proceeds of this note were used to retire the term loan issued during 2019. See Note 12 – Long Term Debt Obligations for additional details.

During the first quarter of 2020, ONSV sold all of its Level 3 securities. At the time of sale, the securities had a book value of \$31,244 and a market value of \$43,687, which resulted in a realized gain of \$12,443.

(4) Risks

The Company participates in an industry where there are risk factors that could have material adverse effects on the business and operating results. The following is a description of the various risk factors:

Legal/Regulatory Risk is the risk that changes in the legal or regulatory environment in which the Company operates could result in increased competition, reduced demand for the Company's products, or additional unanticipated expenses in the pricing of its products.

On December 22, 2017, President Donald Trump signed into law the tax legislation commonly known as the Tax Cuts and Jobs Act (the "Act"). Under FASB ASC Topic 740, *Income Taxes*, the effects of new legislation are recognized upon enactment, which, for federal legislation, is the date the President signs a bill into law.

The Act reduces the corporate income tax rate to 21 percent (previously 35 percent), effective January 1, 2018, for all corporations. The effects of the new legislation were recognized by adjusting the Company's deferred tax assets ("DTAs") and/or deferred tax liabilities ("DTLs") as of December 31, 2017. The effects of changes in tax laws or rates on DTAs or DTLs are allocated to continuing operations and are reflected in the tax rate reconciliation in Note 14.

The Company made an election to reclassify the income tax effects of the Act from AOCI to retained earnings in its 2017 consolidated financial statements. The reclassification only includes impacts of the tax

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rate change from 35% to 21%. The Company's policy was to reclassify the full impact in the first year. There was no valuation allowance associated with these AOCI balances.

See Note 14 for disclosures relating to taxes in the consolidated financial statements.

State insurance regulators and the NAIC regularly re-examine existing laws and regulations applicable to insurance companies, their products, and how those products may be sold. Changes in these laws and regulations may affect the Company's operating results.

Changes in the tax treatment for corporate owned life insurance ("COLI") and BOLI could impact the Company's ability to sell those products in the future or existing policies may be surrendered or allowed to lapse.

Increased assessments from guaranty associations may occur if there is an increase of impaired, insolvent or failed insurers in the jurisdictions in which the Company operates.

Changes in the regulatory environment and changes in laws in the countries of our international insurance operations could have a material adverse effect on our results of operations. Our international insurance operations are principally regulated by insurance regulatory authorities in the jurisdictions in which they are located or operate.

Concentration Risk is the risk that arises from the Company's reliance upon certain key business relationships. Based on policyholder account balances, the Company's largest distributor of individual (fixed and variable) annuity products accounted for approximately 13% of total individual annuity reserves as of December 31, 2019 and 2018. It is possible that a change in the Company's relationship with this distributor could result in the loss of existing business and a large outflow of the Company's general account assets along with the subsequent loss of the investment spread earned on those assets.

Mortality Risk is the risk that overall life expectancy assumptions used by the Company in the pricing of its life insurance and annuity products prove to be too aggressive. This situation may occur, for example, as a result of pandemics, terrorism, natural disasters, or acts of war. The Company attempts to reduce this risk through geographical diversification and the purchase of reinsurance.

Reinsurance Risk is the risk that the reinsurance companies, where the Company has ceded a portion of its underwriting risk, may default on their obligation. The Company has entered into reinsurance contracts to cede a portion of its general account life, annuity and health business. The Company attempts to mitigate this risk by monitoring the ratings of reinsurance companies it chooses to cede risk to, requiring collateral to support ceded reserves and / or following up on any outstanding balances with reinsurance companies.

Ratings Risk is the risk that rating agencies change their outlook or rating of the Company or a subsidiary of the Company. If such ratings were lowered significantly relative to our competitors, our ability to market products to new customers could be harmed as well as the potential loss of existing customers. The Company monitors its Risk-Based Capital ("RBC") and other ratios for adequacy and maintains regular communications with the rating agencies in its effort to minimize the adverse impact of this risk.

Cyber Risk is the potential for information and systems to be vulnerable to adverse events, such as breaches, thefts, compromised integrity, damage, fraud, or business disruption, caused by internal, external or third parties. The loss of confidentiality, integrity or availability for information and systems could disrupt

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operations, result in the loss of business, materially affect profitability and negatively impact the Company's reputation. The Company utilizes a defense in depth approach to physically, administratively and technically mitigate cyber risk. Multiple layers of security controls provide redundancy in the event a security control fails or a vulnerability is exploited. Despite these efforts, there is still a risk a cyber incident could happen.

Credit Risk is the risk that issuers of investment securities, mortgagees on mortgage loans or other parties, including reinsurers and derivative counterparties, default on their contractual obligations or experience adverse changes that would affect the Company. The Company attempts to minimize the adverse impact of this risk by monitoring the portfolio diversification, the Company's exposure to impairment, collectability of the loans and the credit quality of reinsurers and derivative counterparties as well as, in many cases, requiring collateral, lines of credit or assets in trust to manage credit exposure.

Interest Rate Risk is the risk that interest rates will change and impact the valuation of the fixed maturity securities. A change in rates may cause certain interest-sensitive products to become uncompetitive or may cause disintermediation. To the extent that liabilities come due more quickly than assets mature, an insurer would have to borrow funds or sell assets prior to maturity and potentially recognize a gain or loss.

Equity Market Risk is the risk of loss due to declines in the equity markets in which the Company participates. A decline in the stock market will affect the value of equity securities and the contract value of the Company's individual variable annuity contracts which offer guaranteed benefit riders as well as fixed indexed annuity and indexed universal life contracts. Losses in the equity market could result in declines in separate account assets and assets under management thus affecting investment management fees revenue and may require the Company to accelerate the amortization of DAC.

The Company attempts to minimize the adverse impact of equity market risk by monitoring the diversification of the Company's investment portfolio and through reinsurance arrangements with third-parties. The Company uses equity index put options, equity index call options, equity swaps and interest rate swaptions to minimize exposure to the market risk associated with guarantees on certain underlying policyholder liabilities.

Liquidity Risk is the risk that the Company may not have the ability to sell certain investments to meet obligations of the Company.

If the tax treatment of existing BOLI policies is changed, there is the potential that a portion of the issued policies may be surrendered or allowed to lapse in a short period of time creating a liquidity strain. The Company has applied risk mitigation through diversifying BOLI sales to community banks and credit unions. Credit unions are tax exempt entities, thus eliminating the surrender risk due to any pending tax law changes. In addition, the Company manages the BOLI growth to not exceed a specified percentage of general account assets to minimize the risk of liquidity strain.

Foreign Currency Risk is the risk that the Company's consolidated financial statements could be adversely impacted by fluctuations in exchange rates as the Company's financial statements are presented in U.S. dollars and the financial statements of our subsidiaries outside of the U.S. are translated into U.S. dollars. Additionally, the Company could be impacted by significant changes in global economic conditions.

Investment Risk – see Note 7 for additional risks specific to the investment portfolio.

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Coronavirus (COVID-19)

The Company is exposed to potential risk associated with the recent outbreak of Coronavirus (“COVID-19”). As this is a currently fluid situation, the impact of a widespread COVID-19 outbreak is difficult to assess and predict, and the Company is closely monitoring the situation through the Hamilton County Public Health office, as well as the Centers for Disease Control (“CDC”). Risks related to the outbreak include disruptions to business operations resulting from quarantines of employees, policyholders, or our distribution in areas affected by the outbreak, disruptions to business operations resulting from travel restrictions, and uncertainty around the duration of the virus’ impact.

The Company has business continuity plans in place to attempt to mitigate the risk posed to business operations by disruptive incidents such as these.

Subsequent to December 31, 2019, equity and financial markets have experienced significant volatility and interest rates have continued to decline due to the COVID-19 pandemic. The Company is currently in the process of determining the impact of the pandemic to its operations and financial condition.

(5) Changes in Accumulated Other Comprehensive Income

The following table shows the changes in accumulated other comprehensive income, net of taxes, by component for the years ended December 31:

		Pensions and other post- retirement benefits	Foreign currency translation adjustment	Adjustment to:			Unrealized gains (losses) ¹	Total
				Future policy benefits and claims	Other policyholder funds	Deferred acquisition costs		
December 31, 2017	\$	(36,892)	(21,912)	(34,682)	14,021	(71,763)	335,304	184,076
Other comprehensive (loss) income before reclassifications		7,427	(17,497)	28,889	(14,212)	64,202	(230,395) ²	(161,586)
Amounts reclassified from accumulated other comprehensive income		3,207	—	—	—	—	(12,174)	(8,967)
Change		10,634	(17,497)	28,889	(14,212)	64,202	(242,569)	(170,553)
December 31, 2018	\$	(26,258)	(39,409)	(5,793)	(191)	(7,561)	92,735	13,523
Other comprehensive income (loss) before reclassifications		(977)	(10,027)	(46,930)	20,279	(90,259)	511,115	383,201
Amounts reclassified from accumulated other comprehensive income		2,498	—	—	—	—	(164,300)	(161,802)
Change		1,521	(10,027)	(46,930)	20,279	(90,259)	346,815	221,399
December 31, 2019	\$	(24,737)	(49,436)	(52,723)	20,088	(97,820)	439,550	234,922

1. Unrealized gains (losses) include unrealized impact of derivative instruments

2. The impact of adoption of ASU 2016-01 results in a difference of \$5,359, net of tax, between other comprehensive (loss) income before reclassifications in this table and the securities available-for-sale on the statement of consolidated statement of comprehensive income (loss).

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The following table shows the reclassifications out of accumulated other comprehensive (loss) income, net of taxes, for the years ended December 31:

Details about accumulated other comprehensive income (loss) components	2019	2018	Consolidated statements of income location
Amortization of pensions and other post-retirement benefits:			
Prior service costs	\$ 127	128	Other operating costs and expenses
Actuarial losses	(3,289)	(4,187)	Other operating costs and expenses
	(3,162)	(4,059)	Loss before income taxes
	664	852	Income tax current benefit
	(2,498)	(3,207)	Net loss
Unrealized gains/(losses) on securities available-for-sale:			
	207,982	15,464	Realized gains, excluding other-than-temporary impairment losses on securities
	(43,682)	(3,290)	Income tax current expense
	164,300	12,174	Net gain
Total reclassification for the year	\$ 161,802	8,967	Total net gain

(6) Fair Value Measurements

Fair Value Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. The market approach utilizes prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses discounted cash flows to determine fair value. When applying either approach, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs reflect the assumptions market participants would use in valuing a financial instrument based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company's estimates about the assumptions market participants would use in valuing financial assets and financial liabilities based on the best information available in circumstances.

The Company is required to categorize its assets and liabilities that are carried at estimated fair value on the consolidated balance sheets into a three level hierarchy based on the priority of the inputs to the 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). If the inputs used to measure estimated fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement.

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The levels of the fair value hierarchy are as follows:

- **Level 1** – Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market at the measurement date. The types of assets and liabilities utilizing Level 1 valuations generally include U.S. government securities, actively traded equity securities, cash and cash equivalents, short-term investments, separate account assets, and exchange traded derivatives.
- **Level 2** – Fair value is based on significant inputs, other than quoted prices included in Level 1 that are observable in active markets or that are derived principally from or corroborated by observable market data through correlation or other means for identical or similar assets and liabilities. The types of assets and liabilities utilizing Level 2 valuations generally include U.S. government agency securities, municipal bonds, foreign government debt, certain corporate debt, asset-backed, mortgage-backed, private placement, equity securities, derivatives, securities lending collateral, cash equivalent securities, and short-term investments.
- **Level 3** – Fair value is based on unobservable inputs for the asset or liability for which there is little or no market activity at the measurement date. Unobservable inputs used in the valuation reflect management's best estimate about the assumptions market participants would use to price the asset or liability. The types of assets and liabilities utilizing Level 3 valuations generally include certain U.S. treasury securities and other government obligations (including certain investments in debt instruments issued by the U.S. military which are supported by lease payments), corporate debt, asset-backed or mortgage-backed securities, embedded derivatives associated with fixed indexed annuity contracts, and reinsurance contracts and embedded derivatives associated with living benefit contracts.

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The following table presents the Company's hierarchy for its financial assets and liabilities measured at estimated fair value on a recurring basis at December 31, 2019:

Assets	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Securities available-for-sale:				
Fixed maturity securities:				
U.S. Treasury securities and obligations of U.S. government	\$ 26,801	60,222	4,403	91,426
Obligations of states and political subdivisions	—	960,817	—	960,817
Debt securities issued by foreign governments	—	5,373	—	5,373
Corporate	—	6,483,347	22,023	6,505,370
Asset-backed	—	1,287,120	75,839	1,362,959
Mortgage-backed	—	1,053,978	4,688	1,058,666
Trading securities:				
Fixed maturity securities:				
Corporate	—	154	—	154
Asset-backed	—	6	—	6
Equity securities	34,709	5,759	—	40,468
Other long-term investments:				
Derivative assets:				
Currency futures	98	—	—	98
Equity put options	—	9	—	9
Equity index call options	—	52,554	—	52,554
Swap	—	1,192	—	1,192
Swaptions	—	60,212	—	60,212
Short-term investments securities lending collateral	—	246,578	—	246,578
Short-term investments	121,787	91,742	—	213,529
Cash and cash equivalents	287,223	—	—	287,223
Reinsurance recoverable:				
GMIB reinsurance contracts	—	—	1,244,029	1,244,029
Other assets:				
GMAB/GMWB embedded derivatives ¹	—	—	22,151	22,151
Assets held in separate accounts	19,926,103	—	—	19,926,103
Total assets	\$ 20,396,721	10,309,063	1,373,133	32,078,917
Liabilities				
Future policy benefits and claims:				
GLWB embedded derivatives	\$ —	—	20,034	20,034
Fixed indexed annuity embedded derivatives ²	—	—	166,353	166,353
Derivative liabilities:				
Currency futures	2,143	—	—	2,143
Equity put options	—	56,756	—	56,756
Total liabilities	\$ 2,143	56,756	186,387	245,286

¹ All GMAB riders. The reserve balance for the GMAB riders was negative and thus reclassified as an asset.

² Represents embedded derivative portion of fixed indexed annuity base contracts only. There are no embedded derivatives in fixed indexed GLWB riders.

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The following table presents the Company's hierarchy for its financial assets and liabilities measured at estimated fair value on a recurring basis at December 31, 2018:

Assets	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Securities available-for-sale:				
Fixed maturity securities:				
U.S. Treasury securities and obligations of U.S. government	\$ 41,423	69,821	—	111,244
Obligations of states and political subdivisions	—	1,088,329	—	1,088,329
Debt securities issued by foreign governments	—	33,194	—	33,194
Corporate	—	7,755,210	16,295	7,771,505
Asset-backed	—	1,568,918	54,634	1,623,552
Mortgage-backed	—	1,268,879	13,063	1,281,942
Trading securities:				
Fixed maturity securities:				
Corporate	—	808	—	808
Asset-backed	—	42	—	42
Equity securities	45,314	23,321	—	68,635
Other long-term investments:				
Derivative assets:				
Equity futures	5,679	—	—	5,679
Currency futures	1,227	—	—	1,227
Equity put options	—	57,604	—	57,604
Equity index call options	—	9,221	—	9,221
Swap	—	736	—	736
Swaptions	—	32,437	—	32,437
Short-term investments securities				
lending collateral	—	313,492	—	313,492
Short-term investments	125,277	44,869	—	170,146
Cash and cash equivalents	226,525	19,990	—	246,515
Reinsurance recoverable:				
GMIB reinsurance contracts	—	—	1,280,905	1,280,905
Other assets:				
GMAB/GMWB embedded derivatives ¹	—	—	603	603
Assets held in separate accounts	19,489,189	—	—	19,489,189
Total assets	\$ 19,934,634	12,286,871	1,365,500	33,587,005
Liabilities				
Future policy benefits and claims:				
GMAB/GMWB embedded derivatives	—	—	2,566	2,566
GLWB embedded derivatives ²	\$ —	—	20,032	20,032
Fixed indexed annuity embedded derivatives ³	—	—	124,953	124,953
Derivative liabilities:				
Currency futures	2,866	—	—	2,866
Total liabilities	\$ 2,866	—	147,551	150,417

¹ All GMAB "W" riders. The reserve balance for these GMAB riders was negative and thus reclassified as an asset.

² Relates to variable annuity GLWB riders only.

³ Represents embedded derivative portion of fixed indexed annuity base contracts only.

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Determination of Fair Values

The valuation methodologies used to determine the estimated fair values of assets and liabilities under the exit price notion of FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, reflect market participant objectives and are based on the application of the fair value hierarchy that prioritizes observable market inputs over unobservable inputs. The Company determines the estimated fair values of certain financial assets and financial liabilities based on quoted market prices, where available. The Company also determines estimated fair value based on future cash flows discounted at the appropriate current market rate. Estimated fair values include adjustments for credit-related and liquidity issues of the underlying issuer of the investment.

The Company has policies and guidelines that establish valuation methodologies and consistent application of such methodologies. These policies and guidelines provide controls around the valuation process. These controls include appropriate review and analysis of investment prices against market activity or price variances, review of secondary pricing sources, review of price source changes, and review of methodology changes.

The following is a discussion of the methodologies used to determine estimated fair values for the financial instruments listed in the above tables:

Fixed maturity and equity securities – The estimated fair value of fixed maturity and equity securities is generally obtained from independent pricing services based on market quotations of reported trades for identical or similar securities.

When there are no recent reported trades, the Company uses third party pricing services that use matrix or model processes to develop a security price using future cash flow expectations and collateral performance discounted at an estimated market rate. For the pricing of asset-backed and mortgage-backed securities, the models include estimates for future principal prepayments based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. Since these securities have been priced using market observable inputs that are obtained by the independent pricing services, the Company has classified these fixed maturity securities as Level 2 assets.

Fixed maturity securities not priced by independent services are generally priced using an internal pricing matrix. The internal pricing matrix is developed by obtaining spreads for corporate securities with varying weighted average lives and bond ratings. The weighted average life and bond rating of a particular fixed maturity security to be priced using the internal matrix are important inputs into the model and are used to determine a corresponding spread that is added to the appropriate U.S. Treasury yield to create an estimated market yield for that bond. The estimated market yield is then used to estimate the fair value of the particular fixed maturity security. Since the inputs used for the internal pricing matrix are based on observable market data, the Company has classified these fair values within Level 2.

In some instances the independent pricing service will price securities using independent broker quotations from market makers and other broker/dealers recognized to be market participants, which utilize inputs that may be difficult to corroborate with observable market data. These fixed maturity securities are classified as Level 3 assets.

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For certain asset-backed and mortgage-backed fixed maturity securities with complex cash flows that are not priced by independent pricing services, management determines the fair value using other modeling techniques, primarily commercial software applications utilized for valuing securitized investments with variable cash flows. These fixed maturity securities are classified as Level 3 assets.

At December 31, 2019, 83.0% of the estimated fair values of fixed maturity securities were obtained from independent pricing services, 15.7% from the Company's internal pricing matrices and 1.3% from other sources. At December 31, 2018, 84.1% of the estimated fair values of fixed maturity securities were obtained from independent pricing services, 15.3% from the Company's internal pricing matrices and 0.6% from other sources.

Derivative instruments - The Company enters into derivative transactions comprised of equity index put options, equity futures, currency futures, equity swaps and interest rate swaptions as hedges for certain riders that were sold with variable annuity products. The Company similarly purchases equity index call options as hedges for the fixed indexed annuity and indexed universal life products. The equity and currency futures are exchange traded derivatives and the estimated fair value is based on an active market quotation. The Company has classified the estimated fair values of the exchange traded derivatives as Level 1 assets and liabilities. The equity index put options, equity index call options, equity swaps and interest rate swaptions are valued using pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. These derivative assets are classified as Level 2 assets.

Short-term investments - Short-term investments include fixed maturity securities that mature in less than one year and are valued in the same manner as the fixed maturity securities. These fixed maturity securities are classified as Level 2 assets. A portion of short-term investments are bank deposits that are classified as Level 1 assets since these investments are very liquid and not subject to valuation fluctuations.

Cash and cash equivalents - Cash is considered a Level 1 asset as it is the functional currency in the U.S. and is the most liquid form of an asset and not subject to valuation fluctuations. Cash equivalents are comprised of publicly traded money market accounts, commercial paper and reverse repurchase agreements. The publicly traded money market accounts are considered to be Level 1 assets and commercial paper is considered to be a Level 2 asset.

Assets held in separate accounts - Separate account assets are recorded at estimated fair value based primarily on market quotations of the underlying securities and reported as a summarized total on the consolidated balance sheets. The underlying securities are mutual funds that are valued using the reported net asset value which is published daily. The Company has classified the estimated separate account assets as Level 1 assets.

GMIB reinsurance contracts and GMAB/GMWB/GLWB embedded derivatives - Certain of the Company's individual variable annuity contracts that include guaranteed benefit riders accounted for as embedded derivatives are measured at estimated fair value separately from the host variable annuity contract. These guarantees take the form of guaranteed withdrawal and income benefits on variable annuity products.

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The fair value of these assets and liabilities is estimated using the present value of future benefits minus the present value of future premiums over the expected lives of the contracts using various capital market and actuarial assumptions. The Company uses a risk neutral valuation methodology in which cash flows are projected under multiple capital market scenarios using observable risk free rates.

The valuation of the embedded derivatives also includes a credit adjustment using the Company's nonperformance risk to the present value of the future cash flows.

Other significant inputs to the valuation models for the derivatives associated with the guaranteed benefit riders include capital market assumptions, such as interest rate, equity indices, foreign currency rates, counterparty credit, and implied volatility assumptions, as well as various policyholder behavior assumptions that are actuarially determined, including lapse rates, benefit utilization rates, mortality rates, and withdrawal rates.

Since many of the assumptions utilized in the valuation of the reinsurance contracts and embedded derivatives are unobservable and are considered to be significant inputs to the valuations, these are classified as Level 3 assets and liabilities.

Fixed indexed annuity embedded derivatives - The Company's fixed indexed annuity contracts include embedded derivatives which are measured at estimated fair value separate from the host fixed indexed annuity contract. These embedded derivatives are estimated using the option budget method. The option budget rate is used as the best estimate of the future values of the index credits. The embedded derivative incorporates the excess cash flows, or those cash flows that represent the value of the indexes in excess of guarantee values. These cash flows are then discounted using the risk free rates plus a nonperformance risk spread, adjusted for margins.

Nonperformance risk is based on the counterparty's debt and cash flows obtained from publicly available information. Risk margins capture the non-capital market risk of the instrument which represents the additional risks assumed due to the uncertainties of the actuarial assumptions.

Other significant inputs to the valuation model for these derivatives include capital market assumptions, such as interest rate, equity indices, and volatility surface values, as well as various policyholder behavior assumptions that are actuarially determined, including lapse rates, benefit utilization rates, mortality rates, and withdrawal rates.

Since many of the assumptions utilized in the valuation of these reserves are unobservable and are considered to be significant inputs to the valuations, these are classified as Level 3 liabilities.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The following tables summarize the reconciliation of the beginning and ending balances and related changes in fair value measurements for which significant unobservable inputs were used in determining the estimated fair value for the years ended December 31:

Assets	Investments				Reinsurance Recoverable	Other Assets	Total assets
	U.S. treasury securities and obligations of U.S. government	Corporate	Asset - backed	Mortgage - backed	GMB reinsurance	GMAB/GMWB embedded derivatives	
December 31, 2017	\$ —	4,962	14,924	7,532	1,187,888	31,727	1,247,033
Net investment gains/(losses):							
In earnings (realized and unrealized) ¹	—	(1,721)	(255)	(23)	93,017	(31,124)	59,894
Unrealized in OCI ²	—	(731)	(279)	(100)	—	—	(1,110)
Purchases	—	4,264	11,000	7,406	—	—	22,670
Settlements	—	(524)	(2,673)	(1,752)	—	—	(4,949)
Transfers into Level 3	—	15,007	41,126	—	—	—	56,133
Transfers out of Level 3	—	(4,962)	(9,209)	—	—	—	(14,171)
December 31, 2018	—	16,295	54,634	13,063	1,280,905	603	1,365,500
Net investment gains/(losses):							
In earnings (realized and unrealized) ¹	—	897	8,203	(29)	(36,876)	21,548	(6,257)
Unrealized in OCI ²	137	227	(70)	308	—	—	602
Purchases	—	852	17,999	—	—	—	18,851
Settlements	(160)	(9,981)	(1,134)	(1,007)	—	—	(12,282)
Transfers into Level 3	4,426	13,733	8,288	5,416	—	—	31,863
Transfers out of Level 3	—	—	(12,081)	(13,063)	—	—	(25,144)
December 31, 2019	\$ 4,403	22,023	75,839	4,688	1,244,029	22,151	1,373,133
Change in unrealized gains/(losses):							
Still held at December 31:							
2018	\$ —	2	(247)	(23)	93,017	(31,124)	61,625
2019	\$ —	(4)	142	(28)	(36,876)	21,548	(15,218)

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Liabilities	Future policy benefits and claims			Total liabilities
	GMAB/ GMWB embedded derivatives³	GLWB embedded derivatives	Fixed indexed annuity embedded derivatives	
December 31, 2017	\$ —	(16,550)	—	(16,550)
Net investment gains/(losses):				
In earnings (realized and unrealized) ¹	<u>(2,566)</u>	<u>(3,482)</u>	<u>(124,953)</u>	<u>(131,001)</u>
December 31, 2018	(2,566)	(20,032)	(124,953)	(147,551)
Net investment gains/(losses):				
In earnings (realized and unrealized) ¹	<u>2,566</u>	<u>(2)</u>	<u>(41,400)</u>	<u>(38,836)</u>
December 31, 2019	\$ <u>—</u>	<u>(20,034)</u>	<u>(166,353)</u>	<u>(186,387)</u>
Change in unrealized gains/(losses):				
Still held at December 31:				
2018	\$ <u>(2,566)</u>	<u>(3,482)</u>	<u>(124,953)</u>	<u>(131,001)</u>
2019	\$ <u>2,566</u>	<u>(2)</u>	<u>(41,400)</u>	<u>(38,836)</u>

¹ Net realized investment gains and losses included in earnings reflect gains/(losses) on sales of financial instruments, changes in fair value of other assets and liabilities, other-than-temporary impairments, amortization and accretion of premiums or discounts and derivative settlements activity.

² Unrealized investment gains and losses recorded in other comprehensive (loss) income include changes in market value of certain instruments.

³ In 2018, the GMAB reserve balance was negative and reclassified as an asset.

In 2017, all GMAB riders due to reclass. These reserves remained positive and were classified as a liability.

The following tables present certain quantitative information about the significant unobservable inputs used in the fair value measurement for asset and liability classes measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31. Certain securities classified as Level 3 excluded from the table below are obtained from non-binding broker quotes where observable inputs are not reasonably obtainable by the Company.

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	Assets/ liabilities measured at fair value	Valuation techniques(s)	Unobservable input description ²	Input/range of inputs	Weighted average	Impact of increase in input on fair value
2019						
Assets						
Reinsurance recoverable:						
GMIB reinsurance contracts	1,244,029	Stochastic actuarial model	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.4% - 100%	* *	Decrease Decrease
			Base Lapse Rates duration 1-10 duration 11+	0.3% - 7.6% 3.6% - 6.6%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%Rollup) Sys with utilization IB Utilization	1.0% - 4.5% 95% - 100% 0% - 13% 0.3% - 60%	* * * *	Increase Increase Increase Increase
			Non-performance risk (Credit Spread) Equity market volatility	0.58% - 0.85% 15.4% - 20.7%	* *	Decrease Increase
GMAB/GMWB embedded derivatives ¹	22,151	Stochastic actuarial model	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.3% - 100%	* *	Decrease Decrease
			Base Lapse Rates dur 1-10 dur 11+	0.7% - 18.6% 6.2% - 11.0%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%Rollup) Sys with utilization Non-performance risk (Credit Spread) Equity market volatility	1.0% - 1.5% N/A 0% 2.68% - 3.32% 15.4% - 20.7%	* * * * *	Decrease N/A Decrease Decrease Increase

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	Assets/ liabilities measured at fair value	Valuation techniques(s)	Unobservable input description ²	Input/range of inputs	Weighted average	Impact of increase in input on fair value
2019						
Liabilities						
GLWB embedded derivatives	20,034	Stochastic actuarial model	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.3% - 100%	* *	Decrease Decrease
			Base Lapse Rates duration 1-10 duration 11+	0.2% - 16.8% 7.0% - 8.6%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%MAW) Sys with utilization	0% 95% - 100% 0% - 29%	* * *	Decrease Increase Increase
			Non-performance risk (Credit Spread) Equity market volatility	2.68% - 3.32% 15.4% - 20.7%	* *	Decrease Increase
Fixed indexed annuity embedded derivatives	166,353	Option budget method	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.3% - 100%	* *	Decrease Decrease
			Base Lapse Rates duration 1-10 duration 11+	0.5% - 25.0% 4.0% - 25.0%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%MAW) Sys with utilization	0% 90% 0% - 30%	* * *	Decrease N/A Decrease
			Non-performance risk (Credit Spread) Equity market volatility surface rates	2.37% - 2.95% 5.0% - 20.2%	* *	Decrease Increase

¹ All GMAB riders. The reserve balance for these GMAB riders was negative and thus reclassified as an asset.

² Sys = Systematic

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	Assets/ liabilities measured at fair value	Valuation technique(s)	Unobservable input description ²	Input/range of inputs	Weighted average	Impact of increase in input on fair value
2018						
Assets:						
Reinsurance recoverable:						
GMIB reinsurance contracts	1,280,905	Stochastic actuarial model	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.4% - 100%	* *	Decrease Decrease
			Base Lapse Rates duration 1-10 duration 11+	0.3% - 7.6% 3.6% - 6.6%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%Rollup) Sys with utilization IB utilization	1.0% - 4.5% 90% - 100% 0% - 16% 0.5% - 75%	* * * *	Increase Increase Increase Increase
			Non-performance risk (Credit Spread) Equity market volatility	0.67% - 1.09% 14.3% - 21.7%	* *	Decrease Increase
GMAB/GMWB embedded derivatives ¹	603	Stochastic actuarial model	Mortality rates ages 0-59 ages 60+	0 - 0.5% 0.3% - 100%	* *	Decrease Decrease
			Base Lapse Rates dur 1-10 dur 11+	0.7% - 18.6% 6.2% - 11.0%	* *	Decrease Decrease
			Non-Sys with rates (%AV) Sys with rates (%Rollup) Sys with utilization Non-performance risk (Credit Spread) Equity market volatility	1.0% - 4.5% N/A 0% 0.68% - 2.84% 14.3% - 21.7%	* * * * *	Decrease N/A Decrease Decrease Increase

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	Assets/ liabilities measured at fair value	Valuation techniques(s)	Unobservable input description ²	Input/range of inputs	Weighted average	Impact of increase in input on fair value
2018						
Liabilities						
GMAB/GMWB embedded derivatives	2,566	Stochastic actuarial model	Mortality rates			
			ages 0-59	0 - 0.5%	*	Decrease
			ages 60+	0.3% - 100%	*	Decrease
			Base Lapse Rates			
			duration 1-10	0.7% - 18.6%	*	Decrease
			duration 11+	6.2% - 11.0%	*	Decrease
			Non-Sys with rates (%AV)	1.0% - 4.5%	*	Decrease
			Sys with rates (%Rollup)	N/A	*	N/A
			Sys with utilization	0%	*	Decrease
			Non-performance risk (Credit Spread)	0.68% - 2.84%	*	Decrease
			Equity market volatility	14.3% - 21.7%	*	Increase
GLWB embedded derivatives	20,032	Stochastic actuarial model	Mortality rates			
			ages 0-59	0 - 0.5%	*	Decrease
			ages 60+	0.3% - 100%	*	Decrease
			Base Lapse Rates			
			duration 1-10	0.2% - 16.8%	*	Decrease
			duration 11+	7.0% - 8.6%	*	Decrease
			Non-Sys with rates (%AV)	0%	*	Decrease
			Sys with rates (%MAW)	90% - 100%	*	Increase
			Sys with utilization	0% - 30%	*	Increase
			Non-performance risk (Credit Spread)	0.68% - 2.84%	*	Decrease
			Equity market volatility	14.3% - 21.7%	*	Increase
Fixed indexed annuity embedded derivatives	124,953	Option budget method	Mortality rates			
			ages 0-59	0 - 0.5%	*	Decrease
			ages 60+	0.3% - 100%	*	Decrease
			Base Lapse Rates			
			duration 1-10	0.5% - 12.0%	*	Decrease
			duration 11+	4.0% - 12.0%	*	Decrease
			Non-Sys with rates (%AV)	0%	*	Decrease
			Sys with rates (%MAW)	90%	*	N/A
			Sys with utilization	0% - 30%	*	Decrease
			Non-performance risk (Credit Spread)	0.86% - 2.60%	*	Decrease
			Equity market volatility			
			surface rates	5.0% - 20.2%	*	Increase

¹ All GMAB "W" riders. The reserve balance for these GMAB riders was negative and thus reclassified as an asset.

² Sys = Systematic

* The stochastic actuarial models are generated using one thousand scenarios. Weighted average values are not meaningful for these valuations.

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Asset Transfers Between Levels

The Company reviews its fair value hierarchy classifications annually. Transfers into or out of Level 3 are primarily due to the availability of quoted market prices or changes in the Company's conclusion that pricing information received from a third party pricing service is not reflective of market activity.

	Transfers out of Level 2 into Level 3	Transfers out of Level 3 into Level 2
2019		
Assets		
Securities available-for-sale:		
Fixed maturity securities:		
US Treasury securities	\$ 4,426	—
Corporate	13,733	—
Asset-backed	8,288	12,081
Mortgage-backed	5,416	13,063
2018		
Assets		
Securities available-for-sale:		
Fixed maturity securities:		
Corporate	\$ 15,007	4,962
Asset-backed	41,126	9,209

During the years ended December 31, 2019 and 2018, the Company transferred investments totaling \$31,863 and \$56,133, respectively, into Level 3 from Level 2 as a result of lack of visibility to observe significant inputs to price. During the years ended December 31, 2019 and 2018, the Company transferred investments totaling \$25,144 and \$14,171, respectively, out of Level 3 into Level 2 as a result of the availability of observable pricing inputs for these securities. There were no transfers from Level 2 or Level 3 into Level 1 in 2019 or 2018.

Fair Value Measurement on a Nonrecurring Basis

For mortgage loans, the valuation techniques were primarily based on the estimated fair value of the underlying collateral. These values were determined using third-party appraisals.

There were no assets measured at fair value on a nonrecurring basis for the years ended December 31, 2019 and 2018.

Financial Instruments Not Carried at Fair Value

FASB ASC Topic 825, *Financial Instruments*, requires additional disclosure of the fair value information about existing on and off balance sheet financial instruments. ASC Topic 825 excludes certain assets and liabilities, including insurance contracts, other than policies such as annuities that are classified as investment contracts, from its disclosure requirements. The Company's assets and liabilities subject to ASC Topic 825

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disclosure that have not been presented at fair value in the ASC Topic 820 tables above are presented in the table below:

	Carrying value	Estimated fair value	Fair value hierarchy		
			Level 1	Level 2	Level 3
2019					
Assets:					
Mortgage loans on real estate	\$ 1,446,093	1,487,044	—	92,738	1,394,306
Policy loans	875,097	987,296	—	—	987,296
Liabilities:					
Investment contracts	3,572,309	3,362,956	—	3,362,956	—
Policyholders' dividend accumulations and other policyholder funds	203,743	203,743	203,743	—	—
Short-term debt	1,675	1,675	—	1,675	—
Long-term debt obligations	953,878	1,014,148	—	614,148	400,000
2018					
Assets:					
Mortgage loans on real estate	\$ 1,335,742	1,332,540	—	101,953	1,230,587
Policy loans	766,701	827,495	—	—	827,495
Liabilities:					
Investment contracts	4,138,046	4,415,553	—	4,415,553	—
Policyholders' dividend accumulations and other policyholder funds	198,413	198,413	198,413	—	—
Short-term debt	91,586	91,586	—	91,586	—
Long-term debt obligations	853,504	990,510	—	990,510	—

FASB ASC Topic 825, *Financial Instruments*, requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). The following table presents the Company's financial assets and liabilities contained in other assets, other invested assets, and other liabilities on the consolidated balance sheet:

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		Carrying amount		
Financial assets identified in other assets	2019	2018		
Accounts receivable due from external parties	\$ 8,358	8,882	Carrying value approximates fair value	
Other ⁽¹⁾	377,965	349,888		
Total other assets	\$ 386,323	358,770		
		Carrying amount		
Financial assets identified in other long-term investments	2019	2018		
Derivative instruments	\$ 114,065	106,904	Carrying value approximates fair value	
Receivable for securities	1,824	1,939	Carrying value approximates fair value	
Joint venture	22,239	22,103	Carrying value approximates fair value	
Other invested assets	1,570	1,570	Carrying value approximates fair value	
Other ⁽¹⁾	132,506	131,745		
Total other long-term investments	\$ 272,204	264,261		
		Carrying amount		
Financial liabilities identified in other liabilities	2019	2018		
Interest payable	\$ 7,724	7,305	Carrying value approximates fair value	
Derivative liabilities	58,899	2,866	Carrying value approximates fair value	
Collateral liabilities	78,280	106,880	Carrying value approximates fair value	
Investments in transit and payable for securities	7,648	4,982	Carrying value approximates fair value	
Other ⁽¹⁾	391,066	397,909		
Total other liabilities	\$ 543,617	519,942		

(1) Items included in "Other" are not in the scope of ASU 2016-01, but are presented for reconciliation purposes to agree to the balance sheet caption. Included in this category are goodwill and property and fixed assets, which are measured in accordance with the methodology described in Note 3, and FHLB common stock, which is carried at amortized cost. For all remaining items in this classification, carrying value approximates fair value.

In estimating the fair value of financial instruments, the Company used the following methods and assumptions:

Mortgage loans on real estate – The fair value of mortgage loans on real estate is estimated using discounted cash flow analyses, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. Loans with similar characteristics are aggregated for purposes of the calculations. The Company has mortgage loans that are valued based on market observable quotes and are classified as Level 2. The Company has mortgage loans that are valued using internally obtained credit ratings and are classified as Level 3.

Policy loans – The fair value of policy loans is estimated using discounted cash flow calculations. The expected life of the loan is based on internal assumptions; therefore, the Company classifies these as Level 3 assets.

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Investment contracts – The fair value of the Company’s liabilities under investment contracts is estimated using one of two methods. For investment contracts without defined maturities, fair value is the estimated amount payable on demand, net of certain surrender charges. For investment contracts with known or determined maturities, fair value is estimated using discounted cash flow analyses. Cash flows are discounted at a rate that reflects the nonperformance risk of the Company. The amounts shown in the above table are net of reinsurance. The inputs are market observable; therefore, the Company classifies these as Level 2 liabilities.

Policyholders’ dividend accumulations and other policyholder funds – The carrying amount reported in the consolidated balance sheets for these instruments approximates their estimated fair value. The amounts can be converted to cash by the policyholder; therefore, the Company classifies these amounts as Level 1.

Short-term borrowings – The carrying amount of short-term borrowings related to revolving credit facilities is a reasonable estimate of its fair value because the interest rates are variable based on current market rates.

Long-term debt obligations – The fair value of senior and surplus notes is estimated by discounting the scheduled cash flows of the notes using a market rate applicable to the yield, credit quality and maturity of similar debt instruments. The valuation inputs are based on market observable information; therefore, the Company classifies these as Level 2 liabilities. The fair value of the term loan is determined by the bank to be the carrying value of the loan as it is not traded on the open market. The Company classifies this as a Level 3 liability.

(7) Investments

Investment Risks and Uncertainties

Investments are exposed to various risks and uncertainties that affect the determination of estimated fair values, the ability to sell certain investments during strained market conditions, the recognition of impairments, and the recognition of income on certain investments. These risks and uncertainties include:

- the risk that the Company’s assessment of an issuer’s ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer;
- the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated;
- the risk that foreign currency exchange rates could negatively impact the valuation of certain investments that are not denominated in U.S. dollars;
- the risk that the Company obtains inaccurate information for the determination of the estimated fair value estimates and other than temporary impairments; and
- the risk that new information or changes in other facts and circumstances lead the Company to change its intent to hold the security to maturity or until it recovers in value.

Any of these situations are reasonably possible and could result in a charge to income in a future period.

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The determination of impairments is highly subjective and is based upon periodic evaluations and assessments of known and inherent risks associated with each asset class. Such evaluations and assessments are revised as conditions change and new information becomes available.

The recognition of income on certain investments, including asset-backed and mortgage-backed securities, is dependent upon certain factors such as prepayments and defaults, and changes in factors could result in changes in amounts to be earned.

Fixed Maturity and Equity Securities

Fixed Maturity and Equity Securities by Sector

The amortized cost and estimated fair value of available-for-sale and trading securities for fixed maturity securities by sector as of December 31 is as follows:

	2019				
	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Estimated fair value</u>	<u>Non- credit OTTI</u>
Securities available-for-sale:					
Fixed maturity securities:					
U.S. Treasury securities and obligations of U.S. government	\$ 85,161	6,265	—	91,426	—
Obligations of states and political subdivisions	921,056	42,634	(2,873)	960,817	—
Debt securities issued by foreign governments	4,971	402	—	5,373	—
Corporate	6,014,219	500,317	(9,166)	6,505,370	—
Asset-backed	1,329,751	35,545	(2,337)	1,362,959	(2,377)
Mortgage-backed	1,030,526	29,763	(1,623)	1,058,666	(14,408)
Total fixed maturity securities	<u>\$ 9,385,684</u>	<u>614,926</u>	<u>(15,999)</u>	<u>9,984,611</u>	<u>(16,785)</u>
Trading securities:					
Fixed maturity securities:					
Corporate	\$ 149	5	—	154	—
Asset-backed	6	—	—	6	—
Total fixed maturity securities	<u>\$ 155</u>	<u>5</u>	<u>—</u>	<u>160</u>	<u>—</u>

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	2018				
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value	Non- credit OTTI
Securities available-for-sale:					
Fixed maturity securities:					
U.S. Treasury securities and obligations of U.S. government	\$ 107,340	4,567	(663)	111,244	—
Obligations of states and political subdivisions	1,067,998	28,262	(7,931)	1,088,329	—
Debt securities issued by foreign governments	34,772	18	(1,596)	33,194	—
Corporate	7,671,938	267,650	(168,083)	7,771,505	—
Asset-backed	1,608,408	25,732	(10,588)	1,623,552	(2,828)
Mortgage-backed	1,287,060	16,381	(21,499)	1,281,942	(21,542)
Total fixed maturity securities	<u>\$ 11,777,516</u>	<u>342,610</u>	<u>(210,360)</u>	<u>11,909,766</u>	<u>(24,370)</u>
Trading securities:					
Fixed maturity securities:					
Corporate	\$ 798	10	—	808	—
Asset-backed	42	—	—	42	—
Total fixed maturity securities	<u>\$ 840</u>	<u>10</u>	<u>—</u>	<u>850</u>	<u>—</u>

Non-credit other than temporary impairment (“OTTI”) represents the amount of cumulative non-credit OTTI losses recognized in other comprehensive income on securities as of the date of OTTI that also had credit impairments.

The Company’s fixed maturities portfolio is comprised primarily of investment grade securities. Based upon designations by the NAIC, investment grade securities comprised 97.3% and 97.7% of the Company’s total available-for-sale and trading securities portfolio as of December 31, 2019 and 2018, respectively.

Investments with a fair value of \$14,427 and \$14,518 as of December 31, 2019 and 2018, respectively, were on deposit with various regulatory agencies as required by law and are included in securities available-for-sale.

Maturities of Fixed Maturity Securities

The amortized cost and estimated fair value of fixed maturity securities available-for-sale, and trading as of December 31, 2019, by contractual maturity, are shown below. 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. Mortgage-backed securities are classified based on the last payment date of the underlying mortgage loans with the longest contractual duration as of December 31, 2019.

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	Fixed maturity securities			
	Available-for-sale		Trading	
	Amortized cost	Estimated fair value	Amortized cost	Estimated fair value
Due in one year or less	\$ 278,545	282,201	24	24
Due after one year through five years	1,910,040	1,988,185	125	130
Due after five years through ten years	2,945,524	3,126,827	—	—
Due after ten years	4,251,574	4,587,398	6	6
Total	\$ 9,385,683	9,984,611	155	160

Continuous Gross Unrealized Losses for Fixed Maturity and Equity Securities

The following tables present the estimated fair value and gross unrealized losses of the Company's fixed maturity (aggregated by sector) and equity securities in an unrealized loss position, aggregated by length of time the securities have been in a continuous unrealized loss position at December 31:

	Less than 12 months		12 months or longer		Total	
	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses	Estimated fair value	Unrealized losses
2019						
Obligations of states and political subdivisions	\$ 156,152	(2,340)	5,747	(533)	161,899	(2,873)
Corporate	191,232	(1,896)	131,390	(7,270)	322,622	(9,166)
Asset-backed	232,682	(2,138)	21,388	(199)	254,070	(2,337)
Mortgage-backed	124,749	(872)	45,125	(751)	169,874	(1,623)
Total fixed maturity securities	\$ 704,815	(7,246)	203,650	(8,753)	908,465	(15,999)
2018						
U.S. Treasury securities and obligations of U.S. government	\$ 32,688	(335)	18,514	(328)	51,202	(663)
Obligations of states and political subdivisions	150,014	(2,436)	165,376	(5,495)	315,390	(7,931)
Debt securities issued by foreign governments	18,098	(812)	14,078	(784)	32,176	(1,596)
Corporate	2,766,901	(98,818)	982,708	(69,265)	3,749,609	(168,083)
Asset-backed	362,053	(2,978)	302,948	(7,610)	665,001	(10,588)
Mortgage-backed	273,491	(3,503)	459,336	(17,996)	732,827	(21,499)
Total fixed maturity securities	\$ 3,603,245	(108,882)	1,942,960	(101,478)	5,546,205	(210,360)

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Concentrations related to fixed maturity securities in an unrealized loss position are included in the tables below. The tables summarize the fixed maturity securities by sector in an unrealized loss position for less than and greater than twelve months as of December 31:

<u>Unrealized losses</u>	<u>Less than 12 months</u>	<u>12 months or longer</u>	<u>Total</u>	<u>Number of Securities</u>
2019				
99.9%-80%				
Obligations of states and political subdivisions	\$ (2,340)	(533)	(2,873)	50
Corporate	(1,833)	(5,620)	(7,453)	147
Asset-backed	(2,138)	(199)	(2,337)	131
Mortgage-backed	(872)	(751)	(1,623)	74
Below 80%				
Corporate	(63)	(1,650)	(1,713)	6
Total	<u>\$ (7,246)</u>	<u>(8,753)</u>	<u>(15,999)</u>	<u>408</u>
2018				
99.9%-80%				
U.S. Treasury securities and obligations of U.S. government	\$ (177)	(328)	(505)	17
Obligations of states and political subdivisions	(2,436)	(5,495)	(7,931)	140
Debt securities issued by foreign governments	(812)	(784)	(1,596)	7
Corporate	(95,971)	(63,877)	(159,848)	1,916
Asset-backed	(2,978)	(7,610)	(10,588)	296
Mortgage-backed	(3,503)	(17,996)	(21,499)	262
Below 80%				
U.S. Treasury securities and obligations of U.S. government	(158)	—	(158)	11
Corporate	(2,847)	(5,388)	(8,235)	79
Total	<u>\$ (108,882)</u>	<u>(101,478)</u>	<u>(210,360)</u>	<u>2,728</u>

Evaluation of Other Than Temporarily Impaired Investments

Management regularly reviews its fixed maturity and equity securities portfolios to evaluate the necessity of recording impairment losses for other than temporary declines in fair value of investments.

An analysis is prepared which focuses on the issuer's ability to service its debts and the extent and length of time the security has been valued below cost. This review process includes an assessment of the credit quality and an assessment of the present value of future cash flows of the identified investment in the securities portfolio and for equity securities, an assessment of near-term recovery and whether the security will recover its amortized cost basis in a reasonable period of time.

For corporate securities, the Company evaluates the present value of cash flows using the financial performance of the issuer based upon credit performance and investment ratings. Residential mortgage-backed securities and asset-backed securities are assessed for impairment using default estimates based on

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the underlying collateral performance including default rates, recovery rates and prepayment speeds. Cash flows generated by the collateral are then utilized, along with consideration for the issuer's position in the overall structure, to determine cash flows associated with the security.

For any securities identified in the review of the portfolio, the Company considers additional relevant facts and circumstances in evaluating whether the security is other than temporarily impaired. Relevant facts and circumstances that may be considered include:

- comparison of current estimated fair value of the security as compared to cost;
- length of time the estimated fair value has been below cost;
- financial position of the issuer, including the current and future impact of any specific events, including changes in management;
- analysis of issuer's key financial ratios based upon the issuer's financial statements;
- any items specifically pledged to support the credit along with any other security interests or collateral;
- the Company's intent to sell the security or if it is more likely than not that it will be required to sell the security before it can recover the amortized cost or, for equity securities, the forecasted recovery of estimated fair value in a reasonable period of time;
- overall business climate including litigation and government actions;
- rating agency downgrades;
- analysis of late payments, revenue forecasts and cash flow projections for use as indicators of credit issues; and
- other circumstances particular to an individual security.

For each security deemed by management that meets the criteria for additional analysis, the Company prepares an analysis of the present value of the expected cash flows, using the interest rate implicit in the investment at the date of acquisition. To the extent that the present value of cash flows generated by a debt security is less than the amortized cost, an OTTI is recognized in the consolidated statements of operations.

For those debt securities for which the Company has the intent to sell the security, or if it is more likely than not that it will be required to sell the security before recovery of the amortized cost, the entire unrealized loss (the amount that the amortized cost basis exceeds the estimated fair value) is recognized in the consolidated statements of operations. For those debt securities for which the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security, but the security has suffered a credit loss (the amortized cost basis exceeds the present value of the expected cash flows), the impairment charge (excess of amortized cost over estimated fair value) is bifurcated with the credit loss portion recorded in the consolidated statements of operations, and the remainder, or non-credit loss portion, is recorded in other comprehensive income (loss). The Company prospectively accretes the value of the investment through interest income to the extent the future cash flows of the security are expected to be in excess of the new cost basis.

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The Company discloses as part of the separate component of AOCI the non-credit portion of any OTTI. Subsequent changes in estimated fair value that are not considered OTTI are not included in the separate component of AOCI.

Current Year Evaluation

The Company has concluded securities in an unrealized loss position as of December 31, 2019 and 2018 reflect temporary fluctuations in economic factors that are not indicative of OTTI due to the Company's ability and intent to hold the fixed maturity security investments until recovery of estimated fair value or amortized cost and for equity securities, anticipate a forecasted recovery in a reasonable period of time.

Total unrealized losses decreased from December 31, 2018 to December 31, 2019 due to tighter credit spreads and decreases in interest rates. Accordingly no write-downs were deemed necessary for the securities reflected in the tables above.

Mortgage Loans

Mortgage Loans by Portfolio Segment

Mortgage loans consist of both commercial mortgage loans originated in the United States and Chile and residential mortgage loans originated in Chile. Mortgage loans are collateralized by the underlying properties. Collateral on mortgage loans must meet or exceed 125% of the loan at the time the loan is made. The carrying amounts of our mortgage loan portfolio as of December 31 were as follows:

	<u>2019</u>	<u>2018</u>
Mortgage loans		
Commercial mortgage loans	\$ 1,356,976	1,240,492
Residential mortgage loans	<u>93,353</u>	<u>99,255</u>
Total amortized cost	1,450,329	1,339,747
Valuation allowance	<u>4,236</u>	<u>4,005</u>
Net carrying value	<u>\$ 1,446,093</u>	<u>1,335,742</u>

Concentration of Credit Risk

The Company diversifies its mortgage loan portfolio by both geographic region and property type to reduce concentration risk. 93.6% of the Company's portfolio is collateralized by properties located in the United States, with the remaining 6.4% located in Chile. Total loans in any state did not exceed 13.1% as of December 31, 2019 and 2018.

As of December 31, 2019, loans in the states of Texas and Ohio exceeded 10.0% of the total loan portfolio and had carrying values of \$177,018 and \$147,536, respectively. As of December 31, 2018, loans in the states of Texas and Ohio exceeded 10.0% of the total loan portfolio and had carrying values of \$157,754 and \$152,103, respectively.

Furthermore, the Company manages risk by underwriting relatively nominal individual commercial loans. The average loan, at origination, was approximately \$2,638 and \$2,529 in 2019 and 2018, respectively.

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Commercial Mortgage Loans

The Company performs an annual performance review of the commercial mortgage loan portfolio and assigns a rating based on the property's loan to value ("LTV"), age, mortgage debt service coverage ("DSC") and occupancy. This analysis helps identify loans that may experience difficulty. If a loan is not paying in accordance with contractual terms, it is placed on a watch list and monitored through inspections and contact with the property's local representative. In addition, as part of portfolio monitoring, the Company physically inspected nearly 100% of the properties in the portfolio. The LTV and DSC ratios are applied consistently across the entire commercial mortgage loan portfolio.

The following table summarizes our commercial mortgage loan portfolio, net of allowance, LTV ratios and DSC ratios using available data as of December 31. The ratios are updated as information becomes available.

LTV	DSC						Total
	Greater than 2.0x	1.8x to 2.0x	1.5x to 1.8x	1.2x to 1.5x	1.0x to 1.2x	Less than 1.0x	
2019							
0% - 50%	\$ 284,557	73,016	144,925	138,914	55,935	7,892	705,239
50% - 60%	33,628	22,091	99,932	91,486	41,843	4,133	293,113
60% - 70%	—	7,395	35,513	125,792	21,459	6,470	196,629
70% - 80%	—	—	3,891	35,079	28,989	4,703	72,662
80% and greater	—	—	—	8,213	35,330	42,078	85,621
Total	\$ 318,185	102,502	284,261	399,484	183,556	65,276	1,353,264
2018							
0% - 50%	\$ 252,291	84,480	148,965	140,564	39,084	10,882	676,266
50% - 60%	11,851	27,190	71,427	91,783	51,540	6,463	260,254
60% - 70%	—	23,587	46,620	63,310	45,474	10,660	189,651
70% - 80%	—	—	978	33,244	24,159	19,241	77,622
80% and greater	—	—	2,043	7,801	11,714	11,661	33,219
Total	\$ 264,142	135,257	270,033	336,702	171,971	58,907	1,237,012

LTV and DSC ratios are measures frequently used in commercial real estate to determine the quality of a mortgage loan. The LTV ratio is a comparison between the current loan balance and the value assigned to the property and is expressed as a percentage. If the LTV is greater than 100%, this would indicate that the loan amount exceeds the value of the property. It is preferred that the LTV be less than 100%. Our corporate policy directs that our LTV on new mortgages not exceed 75% for standard mortgages.

The DSC ratio compares the property's net operating income to its mortgage debt service payments. If the debt service coverage ratio is less than 1.0x, this would indicate that the property is not generating enough income after expenses to cover the mortgage payment. Therefore, a higher debt service coverage ratio could indicate a better quality loan.

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Residential Mortgage Loans

The Company considers performing mortgages to be those loans that are either current on payments or delinquent by four payments or less. Upon missing the fifth payment, the Company considers these loans nonperforming. In accordance with the mortgage agreement, performing mortgages continue to record principal, interest and monetary correction. Monetary correction is defined as an economic adjustment to functional currency amounts arising from changes in inflation. The principal, interest and monetary correction values of those missed payments are 100% provisioned for. All loans classified as nonperforming are considered to be impaired.

Management continually monitors residential mortgages to determine their status. Residential mortgages that are nonperforming are required to have an appraisal every two years. Based on the appraised value, management determines if an adjustment to the carrying value is necessary. All loans classified as nonperforming have been placed on nonaccrual status.

The following table summarizes our residential mortgage loan portfolio, net of allowance, performing and nonperforming positions which was last updated as of December 31:

	<u>2019</u>	<u>2018</u>
Residential mortgage loans		
Performing	\$ 92,800	96,420
Nonperforming	29	2,310
Total	<u>\$ 92,829</u>	<u>98,730</u>

Allowance for Loan Losses

The allowance for loan losses is comprised of two components, specific and general, based on amounts collectively and individually evaluated for impairment. The Company's commercial mortgage loan portfolio has experienced minimal historical losses throughout the years, including the last three years. The residential mortgage loans are individually evaluated for impairment once a residential mortgage goes past due. The Company has not had any TDRs in 2019 or 2018.

The general component of the allowance for loan losses is maintained at a level believed adequate by management and reflects management's best estimate of probable credit losses, including losses incurred at the balance sheet date but not yet identified by specific loan.

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A rollforward of the allowance for loan losses is as follows:

	<u>Commercial</u>	<u>Residential</u>	<u>Total</u>
Balance, December 31, 2017	\$ 3,413	605	4,018
Provision	120	18	138
Charge-offs	—	(73)	(73)
Recoveries	(53)	(86)	(139)
Effect of exchange rates	—	61	61
Balance, December 31, 2018	<u>3,480</u>	<u>525</u>	<u>4,005</u>
Provision	288	65	353
Charge-offs	—	(13)	(13)
Recoveries	(56)	(62)	(118)
Effect of exchange rates	—	9	9
Balance, December 31, 2019	<u><u>\$ 3,712</u></u>	<u><u>524</u></u>	<u><u>4,236</u></u>

The Company has other financing receivables with contractual maturities of one year or less such as reinsurance recoverables and premiums receivables. The Company does not record an allowance for these items since the Company has not had any significant collection issues related to these types of receivables. The Company writes off the receivable if it is deemed to be uncollectible.

Mortgage Loan Aging

The table below depicts the loan portfolio exposure, net of allowance, of the remaining principal balances (which equal the Company's recorded investment), by type, as of December 31:

	<u>30-59 days past due</u>	<u>60-89 days past due</u>	<u>90 days or more past due</u>	<u>Total past due</u>	<u>Current</u>	<u>Total</u>	<u>Recorded investment > 90 days and accruing</u>
2019							
Commercial mortgage loans	\$ —	—	—	—	1,353,264	1,353,264	—
Residential mortgage loans	5,199	1,096	10,323	16,618	76,211	92,829	60
Total	<u>\$ 5,199</u>	<u>1,096</u>	<u>10,323</u>	<u>16,618</u>	<u>1,429,475</u>	<u>1,446,093</u>	<u>60</u>
2018							
Commercial mortgage loans	\$ 2,138	—	—	2,138	1,234,874	1,237,012	—
Residential mortgage loans	5,460	3,704	2,496	11,660	87,070	98,730	69
Total	<u>\$ 7,598</u>	<u>3,704</u>	<u>2,496</u>	<u>13,798</u>	<u>1,321,944</u>	<u>1,335,742</u>	<u>69</u>

Performance, Impairment and Foreclosures

At December 31, 2019 and 2018, the Company had no mortgage loans in the process of foreclosure. Mortgage loan write-downs were \$0 in 2019, 2018 and 2017. There were four and eight foreclosures of residential mortgage loans during 2019 and 2018, respectively.

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Commercial mortgage loans in foreclosure and mortgage loans considered to be impaired as of the balance sheet date are placed on a nonaccrual status if the payments are not current. Interest received on nonaccrual status mortgage loans is included in net investment income in the period received.

Residential mortgages are placed on nonaccrual status once management believes the collection of accrued interest is doubtful. Once residential mortgages are classified as nonaccrual loans, interest income is recognized under the cash basis.

The carrying value of mortgage loans on nonaccrual status as of December 31:

	2019	2018
Mortgage loans		
Residential mortgage loans	\$ 2,117	2,310
Total	\$ 2,117	2,310

The recorded investment in and unpaid principal balance of impaired loans along with the related specific allowance for loan losses, if any, and the average recorded investment and interest income recognized during the time the loans were impaired as of December 31 were as follows:

		Recorded investment	Unpaid principal balance	Related allowance	Average recorded investment	Interest income recognized
2019						
With an allowance recorded:						
Commercial mortgages	\$	1,589	1,926	(337)	1,628	125
Residential mortgages		2,281	2,805	(524)	1,169	—
Total	\$	3,870	4,731	(861)	2,797	125
2018						
With an allowance recorded:						
Commercial mortgages	\$	1,666	2,060	(394)	1,721	143
Residential mortgages		2,310	2,890	(580)	2,763	—
Total	\$	3,976	4,950	(974)	4,484	143

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Other Long Term Investments

The components of other long-term investments were as follows as of December 31:

	2019	2018
Direct financing leases	\$ 57,533	88,419
FHLB common stock	50,039	43,326
Derivative instruments	114,065	106,904
Receivable for securities	1,823	1,939
Joint venture	22,239	22,103
Chilean financing receivables	21,147	—
Other invested assets	5,358	1,570
Total	\$ 272,204	264,261

The Company is a member of the Federal Home Loan Bank (“FHLB”) of Cincinnati. Through its membership, and by purchasing FHLB stock, the Company can enter into deposit contracts.

Effective January 1, 2019, contracts that previously qualified for direct financing lease classification under FASB ASC Topic 840 no longer qualify for lease accounting under Topic 842 and will be accounted for as financing receivables under Topic 310.

The following table lists the components of the net investment in direct financing leases as of December 31:

	2019	2018
Total minimum lease payments to be received	\$ 84,182	132,990
Less unearned income	(26,649)	(44,571)
Net investment in direct financing leases	\$ 57,533	88,419

The minimum lease payments did not include executory costs, allowance for uncollectibles, or unguaranteed residual values of leased property for 2019 and 2018. Past favorable payment experience, a minimum required LTV ratio of 75% - 80% at lease inception as well as the Company’s right to repossess the property after two missed payments have resulted in not holding an allowance for uncollectibles by the Company and no leases are on nonaccrual status. Credit quality is monitored based on past payment history.

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The table below depicts the direct financing leasing exposure of remaining principal balances (which equal the Company's recorded investment) by type as of December 31:

	<u>30-59 days past due</u>	<u>60-89 days past due</u>	<u>90 days or more past due</u>	<u>Total past due</u>	<u>Current</u>	<u>Total</u>	<u>Recorded investment > 90 days and accruing</u>
2019	\$ 965	—	—	965	56,568	57,533	—
2018	\$ 1,845	—	—	1,845	86,574	88,419	—

Future undiscounted cash flows from direct financing leases as of December 31, 2019 are as follows:

2020	\$ 5,608
2021	6,168
2022	7,478
2023	10,877
2024	5,109
Thereafter	48,942
Total undiscounted lease payments	\$ 84,182
Less imputed interest	(26,649)
Lease receivable	57,533

Securities Lending

As of December 31, 2019 and 2018, the Company received \$246,578 and \$313,492, respectively, of cash collateral on securities lending. The cash collateral is invested in short-term investments, which are recorded in the consolidated balance sheets in short-term investments securities lending collateral with a corresponding liability recorded in payables for securities lending collateral to account for the Company's obligation to return the collateral. The Company had not received any non-cash collateral on securities lending as of December 31, 2019 and 2018. As of December 31, 2019 and 2018, the Company had loaned securities with a fair value of \$238,652 and \$304,031, respectively, which are recognized in the consolidated balance sheets in securities available-for-sale and equity securities.

Variable Interest Entities

In the normal course of business, the Company invests in fixed maturity securities structured through trusts, joint ventures, limited partnerships, or limited liability companies that could qualify as VIE. A VIE is a legal entity that lacks sufficient equity to finance their activities, or the equity investors of the entities as a group lack any of the characteristics of a controlling interest. The primary beneficiary of a VIE is generally the enterprise that has both the power to direct the activities most significant to the VIE, and is the enterprise that will absorb a majority of the fund's expected losses or receive a majority of the fund's expected residual returns. The Company evaluates its interest in certain fixed maturity securities, joint ventures, limited

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partnerships, and limited liability companies to determine if the entities meet the definition of a VIE and whether the Company is the primary beneficiary and should consolidate the entity based upon the variable interests it held both at inception and where there is a change in circumstances that requires a reconsideration.

The Company has determined that it is not the primary beneficiary of these investments as the Company does not have the power to direct the activities that most significantly impact the entities' performance. The Company's maximum exposure to loss is limited to the carrying values of these securities. There are no liquidity arrangements, guarantees or other commitments by third parties that affect the fair value of the Company's interest in these assets.

Net Investment Income

Analysis of investment income by investment type follows for the years ended December 31:

	Investment income		
	2019	2018	2017
Gross investment income:			
Securities available-for-sale:			
Fixed maturity securities	\$ 478,703	507,723	408,653
Equity securities	—	—	2,557
Fixed maturity trading securities	23	68	88
Fixed maturity held-to-maturity securities	—	3,080	60,581
Equity securities	923	4,173	—
Mortgage loans on real estate	71,298	67,643	67,682
Real estate	5,804	5,865	6,558
Policy loans	39,156	35,166	28,913
Short-term investments	12,931	11,304	6,663
Other long-term investments	7,145	7,941	7,506
Total gross investment income	615,983	642,963	589,201
Interest expense	(58,582)	(63,196)	(58,533)
Other investment expenses	(32,607)	(26,489)	(23,724)
Net investment income	\$ 524,794	553,278	506,944

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Net Realized Gains (Losses)

Analysis of net realized gains (losses) by investment type follows for the years ended December 31:

	Realized (losses) gains on investments		
	2019	2018	2017
Securities available-for-sale:			
Fixed maturity securities ¹	\$ 207,982	2,356	3,493
Equity securities	—	—	1,566
Trading securities:			
Fixed maturity securities	—	1	5
Equity securities	—	—	755
Fixed maturity held-to-maturity securities	—	—	(12,190)
Equity securities, at fair value	920	783	—
Mortgage loans on real estate**	(126)	(92)	(3,906)
Real estate	1,896	(72)	(493)
Other long-term investments	(66)	157	4,089
Total realized losses on investments	210,606	3,133	(6,681)
Change in allowances for mortgage loans on real estate*	(232)	(67)	3,478
Net realized gains (losses) on investments***	\$ 210,374	3,066	(3,203)

* Commercial mortgage loans

** Includes the changes in the allowance for residential mortgages

*** Includes realized losses on derivatives which are presented separately on the statements of income

¹ \$197,876 is attributable to the BOLI SPDA reinsurance treaty implemented in 2019. See Note 11 for further detail.

Realized gains (losses) on investments, as shown in the table above, include write-downs for OTTI of \$4,960, \$2,227 and \$16,127 for the years ended December 31, 2019, 2018 and 2017, respectively. As of December 31, 2019, fixed maturity securities with a carrying value of \$49,313, which had a cumulative write-down of \$16,336 due to OTTI, remained in the Company's investment portfolio.

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The following tables summarize total OTTI losses on securities by asset type for the years ended December 31:

	<u>Total OTTI</u>	<u>Recognized in OCI</u>	<u>Recognized in earnings</u>
2019			
Fixed maturity securities:			
Corporate	\$ 4,703	—	4,703
Asset-backed	(451)	(643)	192
Mortgage-backed	<u>(6,678)</u>	<u>(6,743)</u>	<u>65</u>
Total other-than-temporary impairment losses	<u>\$ (2,426)</u>	<u>(7,386)</u>	<u>4,960</u>
2018			
Fixed maturity securities:			
Obligation of states and political subdivisions	\$ 878	878	—
Corporate	1,722	—	1,722
Asset-backed	(1,703)	(1,835)	132
Mortgage-backed	<u>(3,209)</u>	<u>(3,582)</u>	<u>373</u>
Total other-than-temporary impairment losses	<u>\$ (2,312)</u>	<u>(4,539)</u>	<u>2,227</u>
2017			
Fixed maturity securities:			
Obligation of states and political subdivisions	\$ 1,272	443	829
Corporate	15,298	—	15,298
Asset-backed	(11,126)	(11,126)	—
Mortgage-backed	<u>(666)</u>	<u>(666)</u>	<u>—</u>
Total other-than-temporary impairment losses	<u>\$ 4,778</u>	<u>(11,349)</u>	<u>16,127</u>

Credit Loss Rollforward

The following table summarizes the cumulative amounts related to the Company's credit loss portion of the OTTI losses on fixed maturity securities held as of December 31, that the Company does not intend to sell and it is not more likely than not that the Company will be required to sell the security prior to recovery of the amortized cost basis and for which the non-credit portion of the loss is included in other comprehensive income:

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	2019	2018	2017
Cumulative credit loss, beginning of year	\$ 22,288	32,069	63,083
New credit losses	3,058	1,172	12,248
Change in credit losses on securities included in the beginning balance	1,902	1,055	3,879
Subtotal	27,248	34,296	79,210
Less:			
Losses related to securities included in the current year beginning balance sold or paid down during the period	10,912	12,008	47,141
Cumulative credit loss, end of year	\$ 16,336	22,288	32,069

Sales of Fixed Maturity Securities, Available-for-Sale

The following table summarizes fixed maturity securities available-for-sale activity:

	2019	2018	2017
Proceeds	\$ 1,146,781	1,013,556	804,473
Gross realized gains	226,532	7,657	13,420
Gross realized losses	\$ (7,223)	(4,640)	(10,247)

Prior to the reclassification of all fixed maturity held-to-maturity securities during 2018, the Company could sell securities classified as held-to-maturity if the Company became aware of evidence of significant deterioration in an issuer's creditworthiness and/or a significant increase in the risk weights of debt securities for regulatory RBC purposes. The Company sold zero, zero and one held-to-maturity securities in 2019, 2018 and 2017, respectively. Proceeds from the sale of those securities were \$0, \$0 and \$6,000 in 2019, 2018 and 2017, respectively. There were no net losses realized on the sale of those securities in 2019, 2018 and 2017, respectively.

Net Unrealized Gains (Losses) on Available-for-Sale Securities

An analysis by investment type of the change in unrealized gains (losses), before taxes, on securities available-for-sale is as follows for the years ended December 31:

	2019	2018	2017
Securities available-for-sale:			
Fixed maturity securities	\$ 466,678	(316,985)	71,448
Equity securities	—	—	400
Change in net unrealized gains	\$ 466,678	(316,985)	71,848

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The following table summarizes the unrealized gains and losses recognized during the year ended December 31, 2019 on equity securities still held at December 31, 2019:

	2019	2018
Net gains and losses recognized during the period on equity securities	\$ 4,353	(3,828)
Less: Net gains and losses recognized during the period on equity securities sold during the period	466	(3,380)
Unrealized gains and losses recognized during the reporting period on equity securities still held at the reporting date	\$ 4,819	(7,208)

The components of net unrealized gains (losses) on securities available-for-sale in AOCI arising during the period were as follows as of December 31:

	2019	2018	Change
Securities available-for-sale	\$ 598,928	132,250	466,678
Unrealized losses related to closed block	(33,020)	(8,124)	(24,896)
Future policy benefits and claims	(69,621)	(8,194)	(61,427)
Deferred policy acquisition costs	(123,824)	(9,572)	(114,252)
Other policyholder funds	25,428	(242)	25,670
Deferred federal income tax provision	(91,907)	(29,803)	(62,104)
Net unrealized gains	\$ 305,984	76,315	229,669
	2018	2017	Change
Securities available-for-sale	\$ 132,250	449,235	(316,985)
Impact of adoption of ASU 2016-01	—	4,548	(4,548)
Unrealized losses related to closed block	(8,124)	(26,086)	17,962
Unrealized (losses)/gains on other invested assets	—	2,236	(2,236)
Future policy benefits and claims	(8,194)	(46,728)	38,534
Deferred policy acquisition costs	(9,572)	(90,841)	81,269
Other policyholder funds	(242)	17,748	(17,990)
Deferred federal income tax provision	(29,803)	(68,760)	38,957
Net unrealized gains	\$ 76,315	241,352	(165,037)
	2017	2016	Change
Securities available-for-sale	\$ 453,783	381,935	71,848
Unrealized losses related to closed block	(26,086)	(20,995)	(5,091)
Unrealized (losses)/gains on other invested assets	2,236	—	2,236
Future policy benefits and claims	(46,728)	(33,220)	(13,508)
Deferred policy acquisition costs	(90,841)	(64,022)	(26,819)
Other policyholder funds	17,748	8,885	8,863
Prior year AOCI adjustment	—	3,635	(3,635)
Deferred federal income tax provision	(68,760)	(91,278)	22,518
Net unrealized gains	\$ 241,352	184,940	56,412

(8) Derivative Financial Instruments

The Company enters into derivative contracts to economically hedge guarantees on riders for certain insurance contracts. Although these contracts do not qualify for hedge accounting or have not been designated in hedging relationships by the Company pursuant to ASC Topic 815, *Derivatives and Hedging*, they provide the Company with an economic hedge, which is used as part of its overall risk management

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strategy. The Company enters into equity futures, currency futures, equity index put options, equity index call options, interest rate swaptions and equity swaps to economically hedge liabilities embedded in certain variable annuity products such as the GMAB, GMWB, GMIB and GLWB and in fixed indexed annuity and indexed universal life products.

In December 2018, the Company replaced the interest rate swaptions used in its interest rate hedging program. Each swaption consists of a 5 year option to enter into an interest rate swap on the 10 year swap rate. Since this does not meet the definition of a hedge, it is treated as a derivative with no hedging designation under ASC 815, with the gain or loss on the derivative instrument recognized in earnings.

In October 2018, the Company purchased equity index put options to replace existing futures used to hedge the equity risk embedded in the variable annuity guarantees. One year S&P 500, Russell 2000, and NASDAQ 100 options were purchased. The Company continues to hold futures to hedge the foreign indices and currency exposure in the variable annuity guarantees. Since this does not meet the definition of a hedge, it is treated as a derivative with no hedging designation under ASC 815, with the gain or loss on the derivative instrument recognized in earnings.

In April 2018, the Company entered into S&P 500, Russell 2000, and Nasdaq 100 total return swap agreements. The swap was terminated in July 2018 and resulted in a loss of \$32,000. In July of 2018, the Company entered into S&P 500, Russell 2000, and Nasdaq 100 total return swap agreements that were terminated in October 2018 and resulted in a gain of \$19,600. Since the transactions above do not meet the definition of a hedge, it is treated as a derivative with no hedging designation under ASC 815, with the gain or loss on the derivative instrument recognized in earnings.

In October 2016, the Company entered into an equity index call option agreement. Under this agreement, three equity index call options will be purchased monthly. The S&P 500 and Russell 2000 options are one year call spread options. The custom Barclays instrument is a three year call. Starting in May 2018, the Company began purchasing one year calls for the custom Barclay instrument as well. Since this does not meet the definition of a hedge, it is treated as a derivative with no hedging designation under ASC 815, with the gain or loss on the derivative instrument recognized in earnings.

In November 2014, the Company entered into a cross currency swap agreement which qualified for hedge accounting as a cash flow hedge. The Company purchased a 10 year bond in the amount of €7 million with an annual foreign currency coupon of 1.93%. The Company concurrently entered into a matching cross currency swap effectively converting the cash flows of the Euro denominated bond into a U.S. denominated cash flows. The investment receives a fixed rate of 3.78% on the converted U.S. investment of \$9,038. Interest on the bond is paid annually. During the years ended December 31, 2019 and 2018, the Company had foreign currency swap gains of \$299 and losses of \$76, respectively, recorded in AOCI. There were no amounts reclassified to income and no amounts deemed ineffective for the years ended December 31, 2019 or 2018. As of December 31, 2019, no amounts are expected to be reclassified to income within the next 12 months.

The Company has entered into a reinsurance arrangement with a nonaffiliated reinsurer to offset a portion of its risk exposure to the GMIB rider in certain variable annuity contracts. This reinsurance contract is accounted for as a freestanding derivative.

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Embedded Derivatives

The Company has certain embedded derivatives that are required to be separated from their host contracts and accounted for as derivatives. These host contracts include variable annuities with GMAB, GMWB and GLWB riders, and fixed indexed annuities which include index features in excess of their guaranteed minimum values.

The following tables present a summary of the estimated fair value of derivatives held by the Company along with the amounts recognized in the consolidated balance sheets:

Derivatives not designated as hedging instruments under ASC 815	Balance sheet location	December 31			
		2019 Fair value	2019 Notional Amount	2018 Fair value	2018 Notional Amount
Asset derivatives:					
Equity futures	Other long-term investments	\$ —	—	5,679	244,536
Currency futures	Other long-term investments	98	53,739	1,227	30,689
Equity put options	Other long-term investments	9	5,312	57,604	870,360
Equity index call options	Other long-term investments	52,554	1,888,182	9,221	1,841,661
Cross currency swaps	Other long-term investments	1,192	9,038	736	9,038
Swaptions	Other long-term investments	60,212	2,600,000	32,437	2,600,000
GMIB reinsurance contracts	Reinsurance	1,244,029	n/a	1,280,905	n/a
GMAB/GMWB embedded derivatives ¹	Other assets	22,151	n/a	603	n/a
Total		<u>\$ 1,380,245</u>	<u>4,556,271</u>	<u>1,388,412</u>	<u>5,596,284</u>
Liability derivatives:					
GLWB embedded derivatives (variable annuity)	Future policy benefits and claims	\$ 20,034	n/a	20,032	n/a
GMAB/GMWB embedded derivatives	Future policy benefits and claims	—	n/a	2,566	n/a
Fixed indexed annuity embedded derivatives ²	Future policy benefits and claims	166,353	n/a	124,953	n/a
Currency futures	Other liabilities	2,143	215,305	2,866	265,613
Equity put options	Other liabilities	56,756	1,587,313	—	—
Total		<u>\$ 245,286</u>	<u>1,802,618</u>	<u>150,417</u>	<u>265,613</u>

¹ GMAB "W" riders. The reserve balance for these GMAB riders was negative and thus reclassified as an asset.

² Represents embedded derivative portion of the fixed indexed annuity base contracts only. There are no embedded derivatives in fixed indexed GLWB riders.

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The following table presents the effect of derivative instruments on the consolidated statements of operations for the years ended December 31:

Derivatives not designated as hedging instruments under ASC 815	Location of gain (loss) recognized in income on derivatives	Amount of (loss) gain recognized in income on derivatives		
		2019	2018	2017
Equity futures	Net realized gains (losses): derivative instruments	\$ (33,478)	(24,244)	(224,527)
Currency futures	Net realized gains (losses): derivative instruments	(1,577)	16,163	(29,713)
Equity put options	Net realized gains (losses): derivative instruments	(189,561)	55,955	(17,133)
Equity index call options	Net realized gains (losses): derivative instruments	42,429	(20,742)	4,764
Equity swaps	Net realized gains (losses): derivative instruments	173	(18,452)	(19,315)
Swaptions	Net realized gains (losses): derivative instruments	27,774	(14,661)	(5,370)
External reinsurance embedded derivative	Net realized gains (losses): derivative instruments	(203)	(19)	—
GMB reinsurance contracts	Benefits and claims	(36,876)	93,017	(122,012)
GMAB/GMWB embedded derivatives	Benefits and claims	24,114	(33,690)	36,191
GLWB embedded derivatives	Benefits and claims	(2)	(3,482)	2,579
Fixed indexed annuity embedded derivatives ¹	Benefits and claims	(41,400)	(124,953)	—
Total		<u>\$ (208,607)</u>	<u>(75,108)</u>	<u>(374,536)</u>

¹ The amounts recorded in benefits and claims reflect the change in the excess of fair value over account value. The reserve held as of December 31, 2017 was account value and therefore there was no income impact.

Credit Risk

The Company may be exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments.

Because exchange traded futures are affected through regulated exchanges and positions are marked to market on a daily basis, the Company has minimal exposure to credit-related losses in the event of nonperformance by counterparties to such derivative instruments. The Company manages its credit risk related to over-the-counter derivatives by only entering into transactions with creditworthy counterparties with long-standing performance records and requiring collateral for all derivatives in accordance with the International Swaps and Derivatives Association and Credit Support Annex (“ISDA”/“CSA”) agreements in place with all of our counterparties. The Company manages its credit risk related to the freestanding reinsurance derivative by monitoring the credit ratings of the reinsurer and requiring either a certain level of assets to be held in a trust for the benefit of the Company or a letter of credit to be held by the reinsurer and assigned to the Company. As of December 31, 2019 and 2018, a non-affiliated reinsurer held assets in trust with an estimated fair value of \$953,387 and \$891,834, respectively, and a letter of credit of \$178,888 and \$299,602, respectively.

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(9) Deferred Policy Acquisition Costs

The deferred policy acquisition costs and changes thereto for the years ended December 31, 2019 and 2018 were as follows:

	2019	2018
Balance - beginning of year	\$ 1,966,022	1,807,505
Acquisition costs deferred	156,827	231,828
Amortization	(269,610) ¹	(154,006)
DAC recorded as benefits and claims	(59,249) ²	—
Unrealized investment (gains) losses	(114,252)	81,269
Effect of foreign currency translation and other	(317)	(574)
Balance - end of year	\$ 1,679,421	1,966,022

1. During 2019, the unlocking of the whole life product line decreased DAC and earnings by \$96,900. The sustained lower interest rate environment necessitated lowering the earned rate, which lowers future margins, increases the k-factors used to amortize DAC and resulted in a lower DAC balance.

2. As part of the external BOLI and SPDA reinsurance treaty executed on July 1, 2019, the Company recorded the DAC transferred to the external reinsurer, which was part of the cost of reinsurance asset, to future policy benefits and claims. DAC amortization on the consolidated statements of income reflects the amount of DAC amortized, net of the transfer impact. The balance of the DAC asset, shown in the table above, includes adjustments for both the amortization and the transfer.

(10) Future Policy Benefits and Claims

The liability for future policy benefits and claims is comprised of basic and benefit reserves for traditional life products, group life and health policies, universal life policies, and investment contracts, including riders.

The liability for future policy benefits for traditional life products has been established based upon the net level premium method using interest rates varying from 2.0% to 6.0%.

The liability for future policy benefits and claims for ONSP's group life and health insurance policies is comprised of claims and expense reserves and incurred but not reported ("IBNR"). The claims and expense reserves have been calculated using the present values of expected future cash flows of known claims using discount rates that vary by currency ranging from 2.4% to 5.7%. IBNR reserves have been estimated using historical claim reporting information.

The liability for future policy benefits for universal life policies and investment contracts represents approximately 69.3% and 66.3% of the total liability for future policy benefits as of December 31, 2019 and 2018, respectively. The liability has been established based on accumulated contract values without reduction for surrender penalty provisions. The average interest rate credited on investment product policies was 3.3%, 3.3% and 3.3% for the years ended December 31, 2019, 2018 and 2017, respectively. Approximately 29.5% and 33.7%, as of December 31, 2019 and 2018, respectively, of the universal life policies and investment contracts were at their guaranteed minimum interest rate.

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The Company has established a reserve for three universal life plans with lifetime secondary guarantees, which the Company discontinued. At December 31, 2019 and 2018, this reserve balance was \$58,841 and \$50,590, respectively.

The liability for future policy benefits for ONSV's universal life policies has been established based on accumulated account values without reduction for surrender penalty provisions. The average interest rate on these policies was 5.0% and 4.6% for the years ended December 31, 2019 and 2018, respectively.

The liability for future policy benefits for ONSP's universal life policies has been established based on accumulated account values without reduction for surrender penalty provisions. The average interest rate on these policies was 3.5% for the years ended December 31, 2019 and 2018.

Reserves are calculated using withdrawal, mortality, and morbidity rates. Withdrawal rates vary by issue age, type of coverage and policy duration and are based on Company experience. Mortality and morbidity rates which are guaranteed within insurance contracts are based on published tables and Company experience.

As discussed in Note 3, the Company has five main types of rider benefits offered with individual variable annuity contracts: GMDBs, GMIBs, GLWBs, GMABs, and GMWBs. The Company also issued fixed indexed annuity contracts with an enhanced GLWB rider.

Variable Annuity Riders

GMDB Riders

Certain variable annuity contracts include GMDB riders with the base contract and offer additional death and income benefits through riders that can be added to the base contract. These GMDB riders typically provide that upon the death of the annuitant, the beneficiaries could receive an amount in excess of the contract value. The GMDB rider benefit could be equal to the premiums paid into the contract, the highest contract value as of a particular time, e.g., every contract anniversary, or the premiums paid into the contract times an annual interest factor. The Company assesses a charge for the GMDB riders and prices the base contracts to allow the Company to recover a charge for any built-in death benefits.

The Company's GMDB claim reserves are determined by estimating the expected value of death benefits and recognizing the excess ratably over the accumulation period based on total expected assessments. The Company regularly evaluates estimates used and adjusts the additional liability balance as appropriate, with a related charge or credit to benefits and claims in the period of evaluation if actual experience or other evidence suggests that earlier assumptions should be revised. Additionally, a decline in the stock market, causing the contract value to fall below the amount defined in each contract, could result in additional claims.

GMIB Riders

Certain variable annuity contracts include GMIB riders with the base contract. These riders allow the policyholder to annuitize the contract after ten years and to receive a guaranteed minimum monthly income for life. The amount of the payout is based upon a guaranteed income base that is typically equal to the greater of the premiums paid increased by 5% annually (6% for riders sold before May 2009) or the highest contract value on any contract anniversary. In some instances, based upon the age of the annuitant, the terms of this rider may be less favorable for the contract purchaser. The amount of the monthly income is tied to annuitization tables that are built into the GMIB rider. In the event that the policyholder could receive a higher monthly income by annuitization based upon the Company's current annuitization rates, the annuitant

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will automatically receive the higher monthly income. The Company discontinued offering the GMIB rider in virtually all states in May 2010. NSLAC continued to sell the GMIB rider in the state of New York until August 2012.

GMIB claim reserves are determined each period by estimating the expected value of annuitization benefits in excess of the projected account balance at the date of annuitization and recognizing the excess ratably over the accumulation period based on total assessments. The Company regularly evaluates estimates used and adjusts the additional liability balance as appropriate, with a related charge or credit to benefits and claims in the period of evaluation, if actual experience or other evidence suggests that earlier assumptions should be revised.

GLWB Riders

The GLWB rider allows the owner to take withdrawals from the contract at a guaranteed percentage of the GLWB base every year even if the contract value goes to zero. Such guaranteed withdrawals may start any time after the annuitant reaches age 59 1/2. The percentage withdrawal amount guaranteed increases if the annuitant attains a higher age band before the owner starts taking withdrawals. In some versions of GLWB riders sold in 2013 and later, there is a guaranteed minimum percentage withdrawal amount for the first 15 years of the contract; if the policyholder's account value goes to zero subsequent to the 15 year guarantee period, the percentage withdrawal amount is then calculated per a specified formula based on the 10 year treasury rate from the preceding 90 calendar days, with the calculated treasury linked rate subject to a specified cap and floor.

At policy inception, the GLWB base is set at the amount of the purchase payments and it is increased by the amount of future purchase payments. It increases (roll-up) by up to eight percent simple interest every year for the first ten years, as long as no withdrawal is made. If a withdrawal is made in any year during the first ten years, there is no roll-up at all for that year. If the contract value exceeds the GLWB base on any contract anniversary prior to the first contract anniversary after the annuitant reaches age 95, the GLWB base resets to the contract value and a new ten-year roll-up period begins.

In addition to the roll-up feature, some versions of the GLWB rider also provide for a top-off of the GLWB base at the end of the tenth contract year subject to attained age restrictions where applicable if the owner has not made any withdrawals in the first ten years. The top-off is equal to two hundred percent of the first-year purchase payments. Policyholders are eligible for only one top-off during the contractual term. A reset to the contract value does not start a new top-off period. A top-off will typically not occur if there is any reset in the first ten years.

The GLWB may also contain a step-up feature which preserves potential market gain by ratcheting up to the contract value, if higher, on each anniversary. If the contract has both a roll-up and step-up feature, the GLWB base will be the greater of: 1) the GLWB base on the previous anniversary plus any additional purchase payments; 2) the step-up base; or 3) the roll-up base.

The initial GLWB riders (issued May 1, 2010 through December 31, 2010) had a built-in death benefit. This death benefit is reduced dollar for dollar for withdrawals. It differs from most of the other death benefits that decline pro rata for withdrawals. Thus, when the contract value is less than the death benefit, withdrawals will reduce the death benefit under the GLWB rider by a smaller amount than the reduction for other death benefits.

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The Company also offers single life and joint life versions of the GLWB rider. Under the joint life version, if the annuitant dies after the owner has started taking withdrawals the surviving spouse may elect a spousal continuation under the rider and continue to receive the same payment. Under the single life version, the guaranteed amount that may be withdrawn could decline either because 1) the contract value is less than the GLWB base and under the single life GLWB rider the contract value then becomes the new GLWB base and/or 2) the surviving spouse is in a different age band.

The initial GLWB riders, which are a closed block, represent an embedded derivative in the variable annuity contract that is required to be separated from, and valued apart from, the host variable annuity contract. The embedded derivative is carried at estimated fair value and reported in future policy benefits and claims. The estimated fair value of the GLWB embedded derivative was calculated based on actuarial assumptions related to the projected benefit cash flows, incorporating numerous assumptions, including but not limited to, expectations of contract holder persistency, market returns, correlations of market returns and market return volatility.

For GLWB riders issued beginning January 1, 2011, claim reserves are determined each period by estimating the expected value of withdrawal benefits in excess of the projected account balance at the date of the rider entering the lifetime annuity period and recognizing the excess ratably over the accumulation period based on total assessments as the later generation riders do not meet the definition of a derivative. The Company regularly evaluates estimates used and adjusts the additional liability balance as appropriate, with a related charge or credit to benefits and claims in the period of evaluation, if actual experience or other evidence suggests that earlier assumptions should be revised.

GMAB Riders

Certain variable annuity contracts include a GMAB rider. On the eighth or tenth anniversary, depending on the version of the rider, the policyholder's account value will increase to the amount of the initial deposit if the account value at that anniversary is less than the initial deposit. A GMAB rider represents an embedded derivative in the variable annuity contract that is required to be separated from, and valued apart from, the host variable annuity contract. The embedded derivative is carried at estimated fair value and reported in future policy benefits and claims.

The estimated fair value of the GMAB embedded derivative is calculated based on actuarial assumptions related to the projected benefit cash flows, incorporating numerous assumptions, including but not limited to, expectations of contract holder persistency, market returns, correlations of market returns and market return volatility.

GMWB Riders

Certain variable annuity contracts include a GMWB rider, which is similar to the GMAB rider noted above except the policyholder is allowed to make periodic withdrawals instead of waiting for the benefit in a lump sum at the end of the tenth year. A GMWB rider represents an embedded derivative in the variable annuity contract that is required to be separated from, and valued apart from, the host variable annuity contract. The embedded derivative is carried at estimated fair value and reported in future policy benefits and claims.

The estimated fair value of a GMWB embedded derivative is calculated based on actuarial assumptions related to projected benefit cash flows, incorporating numerous assumptions including, but not limited to, expectations of contract holder persistency, market returns, correlations of market returns and market return

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volatility. The Company discontinued the sale of its GMWB rider in 2009. The activity associated with GMWB riders is included with GMAB riders and labeled “GMAB.”

The following tables summarize the account values and net amount at risk, net of reinsurance, for variable annuity contracts with guarantees invested in both general and separate accounts as of December 31 (note that most contracts contain multiple guarantees):

	2019			
	Death benefits	Living benefits		
	GMDB	GMIB	GLWB	GMAB
Return of net deposit				
Total account value	\$ 6,404,612	—	—	3,207,226
Separate account value	\$ 6,080,923	—	—	3,205,824
Net amount at risk ¹	\$ 32,880	—	—	10
Weighted average attained age of contract holders	69	—	—	67
Return of net deposits accrued at a stated rate				
Total account value	\$ 892,336	—	—	8,018
Separate account value	\$ 878,652	—	—	6,872
Net amount at risk ¹	\$ 160,820	—	—	—
Weighted average attained age of contract holders	74	—	—	72
Highest of return of net deposits accrued at a stated rate and return of highest anniversary value				
Total account value	\$ 2,511,305	6,790,521	8,910,042	—
Separate account value	\$ 2,501,216	6,693,607	8,909,500	—
Net amount at risk ¹	\$ 540,086	370,742	103,342	—
Weighted average attained age of contract holders	70	69	68	—
Return of highest anniversary value				
Total account value	\$ 9,537,277	—	—	—
Separate account value	\$ 9,347,848	—	—	—
Net amount at risk ¹	\$ 6,296	—	—	—
Weighted average attained age of contract holders	68	—	—	—
Total				
Total account value	\$ 19,345,530	6,790,521	8,910,042	3,215,244
Separate account value	\$ 18,808,639	6,693,607	8,909,500	3,212,696
Net amount at risk ¹	\$ 740,082	370,742	103,342	10
Weighted average attained age of contract holders	69	69	68	67

¹ Death benefit net amount at risk and living benefit net amount at risk are not additive at the contract level.

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	2018			
	Death benefits	Living benefits		
	GMDB	GMIB	GLWB	GMAB
Return of net deposit				
Total account value	\$ 6,304,533	—	—	3,189,635
Separate account value	\$ 5,948,929	—	—	3,186,119
Net amount at risk ¹	\$ 124,807	—	—	8,758
Weighted average attained age of contract holders	68	—	—	66
Return of net deposits accrued at a stated rate				
Total account value	\$ 845,451	—	—	8,489
Separate account value	\$ 832,660	—	—	6,819
Net amount at risk ¹	\$ 229,320	—	—	149
Weighted average attained age of contract holders	73	—	—	73
Highest of return of net deposits accrued at a stated rate and return of highest anniversary value				
Total account value	\$ 2,549,366	6,891,179	8,452,408	—
Separate account value	\$ 2,535,941	6,782,520	8,443,673	—
Net amount at risk ¹	\$ 828,741	448,715	92,534	—
Weighted average attained age of contract holders	69	68	67	—
Return of highest anniversary value				
Total account value	\$ 9,192,906	—	—	—
Separate account value	\$ 8,972,703	—	—	—
Net amount at risk ¹	\$ 462,894	—	—	—
Weighted average attained age of contract holders	67	—	—	—
Total				
Total account value	\$ 18,892,256	6,891,179	8,452,408	3,198,124
Separate account value	\$ 18,290,233	6,782,520	8,443,673	3,192,938
Net amount at risk ¹	\$ 1,645,762	448,715	92,534	8,907
Weighted average attained age of contract holders	68	68	67	66

¹ Death benefit net amount at risk and living benefit net amount at risk are not additive at the contract level.

For guarantees of benefits that are payable in the event of death (GMDB), the net amount at risk is generally defined as the current guaranteed minimum death benefit in excess of the account balance as of the balance sheet date.

For benefit guarantees that are payable at annuitization (GMIB), the net amount at risk is generally defined as the present value of the minimum guaranteed annuity payments available to the contract holder,

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determined in accordance with the terms of the contract and best estimate assumptions, where applicable, in excess of the account balance as of the balance sheet date.

For benefit guarantees that are payable upon withdrawal (GLWB), the net amount at risk is generally defined as the present value of the current maximum guaranteed withdrawal available to or taken by the contract holder, determined in accordance with the terms of the contract and best estimate assumptions, where applicable, in excess of the account balance as of the balance sheet date.

For accumulation guarantees (GMAB), the net amount at risk is generally defined as the guaranteed minimum accumulation balance in excess of the account balance as of the balance sheet date.

The assets supporting the variable portion of all variable annuities are carried at fair value and reported as assets held in separate accounts, with an equivalent amount reported as liabilities related to separate accounts. All separate account assets associated with these contracts are invested in shares of various mutual funds offered by the Company and its sub advisors. Some riders require that separate account funds be invested in asset allocation models, managed volatility models and/or have other investment restrictions. The Company did not transfer assets from the general account to the separate account for any of its variable annuity contracts during 2019 and 2018.

The following table summarizes account balances of variable annuity contracts with guarantees that were invested in separate accounts as of December 31:

	<u>2019</u>	<u>2018</u>
Mutual funds:		
Bond	\$ 5,250,098	5,164,084
Equity	12,853,796	12,308,626
Money market	704,745	817,523
Total	<u>\$ 18,808,639</u>	<u>18,290,233</u>

The following table summarizes the reserve balances, net of reinsurance, for variable annuity contracts with guarantees as of December 31:

	<u>GMDB</u>	<u>GMIB</u>	<u>GLWB</u>	<u>GMAB</u>
Balance at December 31, 2017	\$ 117,441	(515,127)	60,367	(31,727)
Incurred claims	16,506	6,237	25	42
Paid claims	(16,506)	(6,237)	(25)	(42)
Other ¹	16,267	47,025	20,262	33,689
Balance at December 31, 2018	<u>\$ 133,708</u>	<u>(468,102)</u>	<u>80,629</u>	<u>1,962</u>
Incurred claims	18,776	12,172	1,022	—
Paid claims	(18,776)	(12,172)	(1,022)	—
Other ¹	6,354	98,874	33,212	(24,113)
Balance at December 31, 2019	<u>\$ 140,062</u>	<u>(369,228)</u>	<u>113,841</u>	<u>(22,151)</u>

1. The components that make up the Other line item above include items affecting reserve balances outside of paid and incurred claims.

This includes, but is not limited to, interest, accrual, true-up, unlockings and market factors.

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The reserve balances in the above table include reserves for both direct and reinsurance ceded balances. As of December 31, 2019, direct G reserves were \$1,156,379, ceded G reserves were \$1,293,855 and net G reserves were \$(137,476). As of December 31, 2018, direct G reserves were \$1,075,689, ceded G reserves were \$1,327,492 and net G reserves were \$(251,803). The direct reserves were calculated in accordance with FASB ASC Topic 944, *Financial Services* and the reinsurance ceded reserves were calculated in accordance with FASB ASC Topic 815, *Derivatives*. See Note 6 for a reconciliation of the change in the reinsurance ceded reserve.

Fixed Indexed Annuity Riders

GLWB Riders

Certain fixed indexed annuity contracts include a GLWB rider. The GLWB rider allows the owner to take withdrawals from the contract at a guaranteed percentage of the GLWB base every year even if the contract value goes to zero. There are two versions of GLWB rider offered: a single life GLWB with the annuitant as the covered person, and a joint life GLWB with the annuitant and the annuitant's spouse as the covered persons.

The rider provides for a guaranteed payment of the maximum allowable withdrawal ("MAW") each index year during the lifetime withdrawal period. Such guaranteed withdrawals may start any time after the annuitant/youngest covered spouse reaches age 59 1/2. The percentage withdrawal amount guaranteed increases if the annuitant/youngest covered spouse attains a higher age band before the guarantee is elected.

At the policy's initial sweep date, the GLWB base is set at the amount of the purchase payments. After the initial sweep date, the GLWB base will be the greatest of the step-up GLWB base and the annual credit GLWB base. On each anniversary of the initial sweep date, except under excess withdrawal, the step-up GLWB base is equal to the greater of the GLWB base on the prior day, and the then current contract value, after deducting any applicable charges for the contract and credited interest. The annual credit base is the GLWB base just prior to the index year processing, plus the annual credit calculation base just prior to index processing, multiplied by an index or bonus credit rate. Upon a step-up, the annual credit calculation base will reset to the contract value at the time of step-up.

For the period from January 2, 2018 through April 6, 2018, and for the period from June 4, 2018 through September 7, 2018 in the state of California, the Company offered an exchange program, which provided certain variable annuity policyholders with a GMIB rider the opportunity to exchange the policy and associated rider for a fixed indexed annuity policy with an enhanced GLWB rider. The notable difference of the enhanced GLWB rider is the calculation of the initial GLWB benefit base. At the policy's initial sweep date, the GLWB base is set to equal the contract value on the sweep date multiplied by the GLWB enhancement percentage, which is set based on the ratio of GMIB benefit base to AV at the time of exchange. After the initial sweep date, the GLWB base will be the greatest of the step-up GLWB base and the annual credit GLWB base.

For these GLWB riders, claim reserves are determined each period by estimating the expected value of withdrawal benefits in excess of the projected account balance at the date of the rider entering the lifetime annuity period, and comparing this to the expected value of assessments for the contract, where assessments are contract fees and interest margins. Liabilities are accrued as a proportion to the accumulated assessments. The Company regularly evaluates estimates used and adjusts the additional liability balance as appropriate.

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The base account reserve balances, net of reinsurance, for fixed indexed annuity contracts were \$166,353 of embedded derivative and \$931,394 of host and other liability as of December 31, 2019. The balances were \$124,953 of embedded derivative and \$954,862 of host and other liability as of December 31, 2018. The G reserve balances, net of reinsurance, for fixed indexed annuity contracts with guarantees were \$12,990 and \$6,360 as of December 31, 2019 and December 31, 2018, respectively. The components that make up the reserve include items affecting reserve balances outside of paid and incurred claims. This includes, but is not limited to, interest, accrual, true-up, unlockings, and market factors.

The total account value of the fixed indexed annuities was approximately \$1,077,000 and \$1,096,000 as of December 31, 2019 and 2018, respectively. The account value specific to the GLWB riders was approximately \$567,000 and \$586,000 as of December 31, 2019 and 2018, respectively.

Direct and net G reserves were \$12,990 and \$6,360 as of December 31, 2019 and 2018, respectively. No G reserves were ceded to external parties during 2019 and 2018.

(11) Reinsurance

The Company participates in reinsurance activities in order to limit losses, minimize exposure to significant risks and provide additional capacity for future growth. The Company routinely enters into reinsurance transactions with other insurance companies, third parties and subsidiaries. This reinsurance involves either ceding certain risks to or assuming risks from other insurance companies. The Company's consolidated financial statements reflect the effects of assumed and ceded reinsurance transactions.

External Reinsurance

For the Company's life insurance products, the Company reinsures a percentage of the mortality or morbidity risk on a quota share basis or on an excess of retention basis. The Company also reinsures risk associated with their disability and health insurance policies. Ceded premiums approximated 16%, 16% and 17% of gross earned life and accident and health premiums during 2019, 2018 and 2017, respectively.

For the Company's individual variable annuity products, the Company reinsures the various living and death benefit riders, including GMDB, GMIB and GLWB. For the Company's fixed annuity products, the Company has coinsurance agreements in place to reinsure fixed annuity products sold between 2001 and 2006. Ceded amounts under these coinsurance agreements range from one-third to two-thirds of the business produced. The ceded reserves attributable to fixed annuity coinsurance agreements were \$198,600 and \$276,138 as of December 31, 2019 and 2018, respectively.

Reinsurance agreements that do not transfer significant insurance risk are recorded using deposit accounting. The Company enters into such agreements with unaffiliated reinsurers. Effective April 1, 2016, the Company entered into an agreement to cede certain whole life blocks of business written between January 1, 2016 and December 31, 2016. Effective January 1, 2017, the Company entered into an additional agreement to cede certain whole life blocks of business written between January 1, 2017 and December 31, 2017. Effective October 1, 2017, these agreements were amended and restated to combine the previous treaties from 2014 through 2016, and add 2017 as well as 2018 prospectively. This combined treaty is accounted for using deposit accounting. At the inception of each of these deposit accounting agreements, a risk charge liability was recorded in other liabilities on the consolidated balance sheets, with a corresponding risk charge expense recorded in other operating expenses on the consolidated statements of operations. The risk charge liabilities and expenses related to these agreements were \$2,395, \$2,022 and \$1,405 at and as of December 31, 2019, 2018 and 2017, respectively.

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Effective December 31, 2018, the Company entered into an agreement to cede its quota share of the net liability on certain term life policies issued between June 4, 2007 through December 31, 2017, and in force as of the effective date. This treaty is accounted for using deposit accounting. The risk charge liabilities and expenses related to this agreement settle quarterly, beginning March 31, 2019. The risk charge expense related to this agreement was \$435 at and as of December 31, 2019.

Effective July 1, 2019, the Company entered into a reinsurance agreement to coinsure 100% of its retained inforce BOLI and SPDA blocks of business with a third party reinsurer licensed as an authorized reinsurer in the State of Ohio. As a result of this transaction, available-for-sale securities and cash of \$2,797,281 were transferred to the reinsurer, resulting in a realized gain of \$197,876 for the year ended December 31, 2019. This transaction resulted in a \$1,929,233 increase included in reinsurance recoverable on the consolidated balance sheets as of December 31, 2019. The BOLI block of business met the requirements for reinsurance accounting, however, because the SPDA block qualifies as investment contracts, the SPDA portion of the agreement did not meet the criteria for reinsurance accounting and was accounted for under deposit accounting. As a result, a reinsurance deposit asset of \$935,792 was recorded in the consolidated balance sheets at the inception of the treaty. The asset is carried at a net amortized value of \$905,770 on the consolidated balance sheets as of December 31, 2019.

Affiliate Reinsurance

As it relates to reinsurance among affiliates, to mitigate the volatility of statutory surplus for ONLIC, ONLIC ceded variable annuity-related risks, living and death benefits to SYRE for the GMIB, GMDB, and GLWB riders. Effective April 1, 2019, ONLIC recaptured its direct business previously ceded to SYRE. ONLIC now cedes these variable annuity-related risks and certain additional guarantee risks, which were previously retained, to SUNR, which retrocedes GMIB and associated risks and riders to SYRE. Additionally, to consolidate the management of such living benefit risks, ONLIC assumes GMIB and associated riders issued by NSLAC, which are correspondingly retroceded to SYRE as discussed above. Effective January 2018, ONLIC ceded 100% of the fixed indexed annuities exchange program business and associated GLWB riders to SYRE. ONLIC assumes BOLI policies issued by ONLAC, but ceased reinsuring new policies in October 2016.

ONLAC writes a significant amount of term and universal life insurance that requires statutory reserves in excess of the Company's best estimate economic reserves (i.e. redundant reserves). To efficiently manage the statutory surplus impact to ONLAC and improve capacity to write new business, the Company established two affiliated Vermont captive insurers, MONT and KENW, and an Ohio captive, CMGO. ONLAC cedes certain term life policies and certain death benefit guarantee universal life policies to MONT. ONLAC cedes certain term life policies to KENW and CMGO. MONT, KENW and CMGO entered into external reinsurance covering certain of the assumed blocks of business. Additionally, MONT, KENW and CMGO retrocede term life policies on a yearly renewable term basis to ONLIC, which ONLIC cedes to external reinsurers.

ONSV entered into a proportional quota share agreement with ONSP whereby the Company assumes 50% of the premiums and claims related to ONSP's participation in the Peruvian survival, disability and burial group insurance program. This agreement applies to premiums and claims incurred between January 1, 2015 and December 31, 2016.

All of the affiliated reinsurance transactions eliminate in consolidation at the ONFS and ONMH levels.

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The reconciliation of traditional life and accident and health total premiums to net premiums for the years ended December 31, were as follows:

	2019	2018	2017
Direct premiums	\$ 1,083,857	1,050,888	977,421
Reinsurance assumed - external	1,075	1,219	1,363
Reinsurance assumed - intercompany	257,514	238,704	234,812
Reinsurance ceded - external	(197,528)	(183,327)	(188,256)
Reinsurance ceded - intercompany	(257,514)	(238,704)	(234,812)
Net premiums earned	\$ 887,404	868,780	790,528

(12) Long-Term Debt Obligations

Long-term debt obligations outstanding were as follows as of December 31:

	2019	2018
Surplus notes		
6.875% fixed rate due 2042	\$ 247,504	247,393
5.000% fixed rate due 2031	4,019	3,979
5.800% fixed rate due 2027	5,897	5,883
8.500% fixed rate due 2026	49,798	49,767
Senior notes		
6.625% fixed rate due 2031	247,411	247,264
6.375% fixed rate due 2020	—	299,218
Term Loan		
3.96% variable rate due 2022	399,249	—
Total long-term debt obligations	\$ 953,878	853,504

Surplus Notes

In June 2012, ONLIC issued a \$250,000, 6.875% fixed rate surplus note due June 15, 2042. Interest on this surplus note is payable semi-annually on June 15 and December 15. ONLIC may redeem this surplus note at its option. This surplus note is unsecured and subordinated to all present and future indebtedness and policy claims of ONLIC.

In December 2011, ONLIC issued a \$4,500, 5.000% fixed rate surplus note to Security Mutual Life Insurance Company of New York (“SML”), as payment for the purchase of additional shares of NSLAC. This note matures on December 15, 2031. Interest on this surplus note is payable semi-annually on December 15 and June 15. ONLIC may redeem this surplus note at its option. This surplus note is unsecured and subordinated to all present and future indebtedness and policy claims of ONLIC.

In April 2007, ONLIC issued a \$6,000, 5.800% fixed rate surplus note to SML, as payment for the purchase of a portion of the shares of NSLAC. This note matures on April 1, 2027. Interest on this surplus note is payable semi-annually on April 1 and October 1. ONLIC may redeem this surplus note at its option. This

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surplus note is unsecured and subordinated to all present and future indebtedness and policy claims of ONLIC.

In May 1996, ONLIC issued \$50,000, 8.500% fixed rate surplus note, due May 15, 2026. Interest on this surplus note is payable semi-annually on May 15 and November 15. ONLIC may redeem this surplus note at its option. This surplus note is unsecured and subordinated to all present and future indebtedness and policy claims of ONLIC.

The surplus notes have been issued in accordance with Section 3941.13 of the Ohio Revised Code. Interest payments, scheduled semi-annually, must be approved for payment by the Ohio Department of Insurance (“Department”). All issuance costs have been capitalized and are being amortized over the terms of the notes.

Senior Notes

In April 2011, ONFS issued a \$250,000, 6.625% fixed rate senior note due May 1, 2031. Interest is payable semi-annually on May 1 and November 1. ONFS may redeem this senior note at its option.

In April 2010, ONFS issued a \$300,000, 6.375% fixed rate senior note due April 30, 2020. Interest is payable semi-annually on April 30 and October 30. ONFS may redeem this senior note at its option. During April 2019, ONFS redeemed this senior note. This included a make-whole payment to note holders of \$10,263 included in loss on debt retirement on the income statement.

The senior notes are obligations of ONFS and are not subject to Department approval for payments of principal or interest. Claims of the policyholders of ONLIC and ONLAC have priority over these senior notes if either company is unable to pay policyholder claims.

Term Loan

On April 5, 2019, the Company issued a \$400,000 term loan due April 5, 2022. Interest is payable quarterly based on a variable base rate or the London Inter-bank Offered Rate (“LIBOR”) plus the applicable margin. The rate selected at December 31, 2019 was LIBOR. The average interest rate paid for the year ended December 31, 2019 was 3.96%. This loan was retired in January, 2020 with the issuance of a new senior note. See Note 3(w) for more information.

Interest Expense

Total interest expense, including amortization of debt discounts and issuance costs, on all obligations was \$58,571, \$58,576 and \$58,533 during the years ended December 31, 2019, 2018, and 2017, respectively. Total interest expense is included in investment expenses as a component of net investment income.

(13) Bank Line of Credit

In April 2016, ONFS obtained a \$525,000 senior unsecured, syndicated credit facility. The credit facility was established for the purpose of issuing letters of credit and loans for general corporate purposes and matured in April 2021. In March 2017, ONFS increased this credit facility by \$50,000 to \$575,000. On March 29, 2018, ONFS increased this credit facility by \$325,000 to \$900,000. The credit facility now matures in March 2023.

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ONFS utilized \$565,000 of this facility as of December 31, 2019 to secure a letter of credit for SYRE, with SUNR as the beneficiary, in order to recognize reserve credit under statutory accounting principles.

ONFS utilized \$110,000 and \$810,000 of this facility as of December 31, 2019 and 2018, respectively, to secure a letter of credit for SYRE, with ONLIC as the beneficiary, in order to recognize reserve credit under statutory accounting principles. ONFS borrowed \$75,000 against the facility in December 2017 for the benefit of SYRE, which is recorded in short-term borrowings in the consolidated balance sheets. The \$15,000 ONFS borrowed to fund the 2014 intercompany sale transaction of ONSP to the Dutch holding company from ONSA was transferred to the new facility. During 2019, these borrowings were repaid.

On December 31, 2019, ONFS entered into a \$50,000, 364-Day letter of credit facility with two banks in order to finance and to support the reserve requirements of SYRE, ONLIC and SUNR. ONLIC and SUNR are the only beneficiaries of the related letters of credit. ONFS utilized \$30,000 of this facility as of December 31, 2019 to secure a letter of credit for SYRE, with SUNR as the beneficiary, in order to recognize reserve credit under statutory accounting principles.

In December 2018, ONFS entered into a \$50,000, 364-Day letter of credit facility with a bank in order to finance and to support the reserve requirements of SYRE. ONLIC is the only beneficiary of the related letters of credit. ONFS utilized \$50,000 of this facility as of December 31, 2018 to secure a letter of credit for SYRE, with ONLIC as the beneficiary, in order to recognize reserve credit under statutory accounting principles. ONFS terminated the facility during 2019.

In December 2018, ONFS entered into a \$150,000, 364-Day letter of credit facility with two banks in order to finance and to support the reserve requirements of SYRE and ONLIC (related to NSLAC). ONLIC and NSLAC are the only beneficiaries of the related letters of credit. ONFS utilized \$75,000 of this facility as of December 31, 2018 to secure a letter of credit for SYRE, with ONLIC as the beneficiary, in order to recognize reserve credit under statutory accounting principles. ONFS terminated the facility during 2019.

Total interest and fees paid on these credit facilities were \$14,429, \$11,565 and \$3,978 in 2019, 2018 and 2017, respectively.

(14) Income Taxes

The provision for income taxes is as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Current expense (benefit)	\$ 895	(972)	(15,119)
Deferred (benefit) expense	<u>(34,830)</u>	<u>(5,056)</u>	<u>(189,720)</u>
Provision for income taxes	<u>\$ (33,935)</u>	<u>(6,028)</u>	<u>(204,839)</u>

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The following table is the reconciliation of the provision for income taxes based on enacted U.S. federal income tax rates to the provision for income taxes reported in the consolidated financial statements for the years ended December 31:

	2019	2018	2017
Pre-tax income times U.S. enacted tax rate	\$ (21,220)	14,066	(62,436)
Tax-preferred investment income	(12,359)	(22,579)	(43,093)
Foreign subsidiaries statutory tax differential	(2,531)	(590)	(2,208)
Deemed income from foreign operations	—	(3,314)	8,369
U.S. Tax reform rate change - Non-equity	—	4,137	(77,549)
U.S. Tax reform rate change - Equity	—	—	(33,329)
Tax contingencies	(298)	126	(51)
Other, net	2,569	2,202	5,635
	<u>\$ (33,839)</u>	<u>(5,952)</u>	<u>(204,662)</u>
Provision for income taxes	\$ (33,839)	(5,952)	(204,662)
Effective tax rate	33.5%	(8.9)%	114.7%

The Company files income tax returns in the U.S. federal jurisdiction, foreign countries and various state jurisdictions.

As discussed in Note 4, the United States enacted new tax legislation effective January 1, 2018. The effects of the tax rate change on deferred taxes are reflected in the tax rate reconciliation above. The primary impact on our 2017 financial results was associated with the effect of reducing the U.S. income tax rate from 35% to 21% on our deferred tax balances as of December 31, 2017, and a one-time deemed repatriation tax on certain unremitted earnings of foreign subsidiaries. Other material provisions of the U.S. tax reform impacting the Company effective January 1, 2018 include, but are not limited to provisions: 1) reducing the dividends received deduction; 2) increasing the tax deferred acquisition cost rates (Tax DAC); 3) modifying the tax reserve calculation; and 4) eliminating the corporate alternative minimum tax (AMT).

The largest component of tax-preferred investment income in the rate reconciliation above is the Dividends Received Deduction (“SA DRD”) on separate account assets held in connection with variable annuity and life contracts. For 2019, 2018 and 2017 tax returns, the Company recognized an income tax benefit of \$6,866, \$9,754 and \$35,950, respectively.

The Company has made the decision to permanently re-invest the foreign subsidiaries’ earnings, thus local foreign country tax rules and tax rates govern the reporting of taxes rather than the U.S. tax rules and tax rate. In 2014, the Chilean government passed legislation increasing the enacted tax rate each year and is currently 27% in 2018 and thereafter. The impact of this legislation is reflected in the above rate reconciliation table.

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The tax effects of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities that give rise to significant components of the net deferred tax liability relate to the following as of December 31:

	2019	2018
Deferred tax assets:		
Pension and benefit obligations	\$ 21,023	23,647
Future policy benefits	1,542,728	871,286
Derivatives	41,907	34,590
Net operating loss carryforwards	143,021	164,989
Tax credits	39,750	40,203
Fixed Asset Capitalization and Depreciation	33,585	21,090
Other	2,544	3,590
Total gross deferred tax assets	1,824,558	1,159,395
Valuation allowance on deferred tax assets	—	—
Net deferred tax assets	1,824,558	1,159,395
Deferred tax liabilities:		
Investments	118,924	19,001
Deferred policy acquisition costs	248,152	311,272
Section 481(a) adjustment	4,709	16,673
Reinsurance recoverable	1,583,632	911,781
Other	8,395	6,983
Total gross deferred tax liabilities	1,963,812	1,265,710
Net deferred tax liability	\$ 139,254	106,315

In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. The Company considers the scheduled reversal of deferred tax liabilities, projected future income, and prudent and feasible tax planning strategies in making this assessment. Based upon the level of historical taxable income, projections for future income over the periods in which the deferred tax assets are deductible and available tax planning strategies, the Company believes it is more likely than not that it will realize the benefits of these deductible differences.

As of December 31, 2019, the Company has non-life net operating loss carryforwards of \$475,668 expiring in years 2028 through 2037. As of December 31, 2018, the Company has non-life net operating loss carryforwards of \$486,170 expiring in years 2027 through 2037. As of December 31, 2019, SYRE has a net operating loss of \$188,967 expiring in 2033, to be carried forward and used only to offset future taxable income of SYRE. As of December 31, 2018, SYRE had a net operating loss of \$202,628 expiring in 2033, to be carried forward and used only to offset future taxable income of SYRE. All loss carryforwards are expected to be fully utilized before expiring.

As of December 31, 2019 and 2018, the Company had no federal valuation allowances recorded. As of December 31, 2019 and 2018, the Company had no net capital loss carryforwards. As of December 31, 2019, the Company has \$2,059 of uncertain tax positions related to the SA DRD company share

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percentage(s) for tax return years 2013-2017. As of December 31, 2019, the Company has tax credit carryforwards of \$39,750 expiring in years 2023 through 2038. As of December 31, 2019, the Company had tax credit carryforwards of \$40,203 expiring in years 2019 through 2038. As of December 31, 2019, the Company had alternative minimum tax credits of \$8,049 that now reside in the current tax receivable as a result of tax reform.

The U.S. tax reform imposed a one-time deemed repatriation tax in 2017 on the greater of unremitted earnings and profits from foreign operations of our subsidiaries determined as of November 2, 2017 or December 31, 2017, which amounted to \$5,055. Deferred tax liabilities are recognized for taxes payable on the unremitted earnings from foreign operations of our subsidiaries, except where it is our intention to indefinitely reinvest a portion or all of these undistributed earnings. We currently do not intend to repatriate these unremitted earnings. As of December 31, 2019 and 2018, it was not practicable to determine the amount of the unrecognized deferred tax liability that would arise if foreign earnings were remitted.

(15) Pensions and Other Post-Retirement Benefits

a) Home Office Pension Plan

The Company sponsors a funded qualified pension plan covering all home office employees hired prior to January 1, 1998. This plan was amended effective December 31, 2019, to freeze the accrual of future benefits. The impact of the curtailment is included below. This plan includes participants who are employees of the Company and devote substantially all of their time to service for the Company. Retirement benefits are based on years of service and the highest average earnings in five of the last ten years.

The Company also sponsors unfunded pension plans covering certain home office employees where benefits exceed Code 401(a)(17) and Code 415 limits.

The Company also has other deferred compensation and supplementary plans. One of the supplementary plans was also amended effective December 31, 2019, to freeze the accrual of future benefits. The impact of the curtailment is included below.

The measurement dates were December 31, 2019 and 2018.

b) Home Office Post-Retirement Benefit Plans

The Company currently offers eligible retirees the opportunity to participate in a post-retirement health and group life plan. This plan was amended effective July 1, 2013, to provide participants younger than age 65, a fixed portion of the health insurance contract premium and for participants age 65 and older, a fixed dollar amount which the participant must use to independently purchase their own insurance. Previously, this plan provided all participants a fixed portion of the health insurance contract premium. The portion the Company pays is periodically increased and is a function of participant service. Only home office employees hired prior to January 1, 1998 may become eligible for these benefits provided that the employee meets the retirement age and years of service requirements.

This plan includes participants who are employees of the Company and devote substantially all of their time to service for the Company.

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The post-retirement health plan does not provide benefits which are actuarially equivalent to Medicare Part D benefits. Therefore, the Company does not receive the associated federal Medicare subsidy.

The measurement dates were December 31, 2019 and 2018.

c) General Agents' Pension Plan

The Company sponsors an unfunded, nonqualified defined benefit pension plan covering its general agents hired prior to January 1, 2005. This plan provides benefits based on years of service and average compensation during the final five and ten years of service.

The measurement dates were December 31, 2019 and 2018.

d) Agents' Post-Retirement Benefits Plans

The Company sponsors a post-retirement health and group life plan. Only agents with contracts effective prior to January 1, 1998 who meet the retirement age and service requirements are eligible for these benefits. The health and group life plans are contributory, with retirees contributing approximately 50% of premium for coverage. As with all plan participants, the Company reserves the right to change the retiree premium contribution at renewal.

The post-retirement health plan does not provide benefits which are actuarially equivalent to Medicare Part D benefits. Therefore, the Company does not receive the associated federal Medicare subsidy.

The measurement dates were December 31, 2019 and 2018.

e) Obligations and Funded Status

Information regarding the funded status of the pension plans as a whole and other benefit plans as a whole as of December 31 is as follows:

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	Pension benefits		Other benefits	
	2019	2018	2019	2018
Change in projected benefit obligation:				
Projected benefit obligation at beginning of year	\$ 94,331	127,704	6,306	6,764
Service cost	2,121	3,107	25	43
Interest cost	4,711	4,859	280	261
Actuarial loss (gain)	24,333	(17,650)	1,404	565
Benefits paid*	(5,561)	(23,689)	(457)	(1,327)
Settlement/curtailment	(24,328)	—	—	—
Projected benefit obligation at end of year	\$ 95,607	94,331	7,558	6,306
Accumulated benefit obligation	\$ 93,092	80,143		
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 50,703	66,945	—	—
Plan sponsor contribution	—	—	—	—
Actual return on plan assets	10,365	(5,687)	—	—
Benefits and expenses paid	(4,459)	(10,555)	—	—
Fair value of plan assets at end of year	\$ 56,609	50,703	—	—
Funded status**	\$ (38,998)	(43,628)	(7,558)	(6,306)

* Benefits paid include amounts paid from both funded and unfunded benefit plans.

** Funded status is recorded in other liabilities in the consolidated balance sheets.

The following tables show the funded status of the pension plans as of December 31:

	Qualified Pension Plan	Unfunded pension plan	Total
2019			
Projected benefit obligation	\$ 70,897	24,710	95,607
Fair value of plan assets	56,609	—	56,609
Funded status	\$ (14,288)	(24,710)	(38,998)
2018			
Projected benefit obligation	\$ 64,093	30,238	94,331
Fair value of plan assets	50,703	—	50,703
Funded status	\$ (13,390)	(30,238)	(43,628)

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	Pension benefits		Other benefits	
	2019	2018	2019	2018
Amounts recognized in the balance sheet consist of:				
Other liabilities	\$ (38,998)	(43,628)	(7,558)	(6,306)

Amounts recognized in other comprehensive income (loss) arising during the period consist of the following:

	Pension benefits			Other benefits		
	2019	2018	2017	2019	2018	2017
Net actuarial loss (gain)	\$ 17,535	(7,237)	7,290	1,404	565	(1,146)

	Pension benefits		Other benefits	
	2019	2018	2019	2018
Amounts recognized in accumulated other comprehensive income:				
Net actuarial loss	\$ 28,691	32,220	2,588	1,278
Prior service credit	—	—	—	(127)
Total	\$ 28,691	32,220	2,588	1,151

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2020 are \$2,634 and \$0, respectively. The estimated net loss and prior service cost for the other post-retirement benefit plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2020 are \$266 and \$0, respectively. There are no plan assets that are expected to be returned to the Company during the next twelve months.

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	Pension benefits		
	2019	2018	2017
Components of net periodic benefit cost:			
Service cost	\$ 2,121	3,107	3,378
Interest cost	4,711	4,859	5,163
Expected return on plan assets	(3,568)	(4,726)	(4,375)
Amortization of net loss/(gain)	3,194	4,158	4,097
Settlement/curtailment	60	2,596	5,710
Net periodic benefit cost	<u>\$ 6,518</u>	<u>9,994</u>	<u>13,973</u>

	Other benefits		
	2019	2018	2017
Components of net periodic benefit cost:			
Service cost	\$ 25	43	58
Interest cost	280	261	299
Amortization of prior service cost	(127)	(128)	(128)
Amortization of net loss/(gain)	95	29	40
Net periodic benefit cost	<u>\$ 273</u>	<u>205</u>	<u>269</u>

Information for defined benefit pension plans with an accumulated benefit obligation in excess of fair value of plan assets as of December 31:

	Pension benefits	
	2019	2018
Projected benefit obligation	\$ 95,607	94,331
Accumulated benefit obligation	93,092	80,143
Fair value of plan assets	56,609	50,703

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f) Assumptions

	Pension benefits		Other benefits	
	2019	2018	2019	2018
Weighted average assumptions used to determine net periodic benefit cost at January 1:				
Discount rate	4.80%	4.03%	4.74%	4.04%
Expected long-term return on plan assets	7.50%	7.50%	—	—
Rate of compensation increase	4.19%	4.35%	4.25%	4.25%
Health care cost trend rate assumed for next year:				
Before 65	—	—	6.90%	7.80%
Age 65 and older	—	—	0.70%	0.70%
Rate to which the health cost trend rate is assumed to decline (the ultimate trend rate):				
Before 65	—	—	6.80%	7.70%
Age 65 and older	—	—	0.60%	0.60%
Year that the rate reaches the ultimate trend rate	—	—	2023	2023
Weighted average assumptions used to determine benefit obligations at December 31:				
Discount rate	3.61%	4.81%	3.49%	4.74%
Rate of compensation increase	4.10%	3.83%	4.25%	3.50%

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects:

	1 Percentage point increase	1 Percentage point decrease
Effect on total of 2019 service cost and interest cost	\$ 13	(11)
Effect on 2019 other post-retirement benefit obligation	314	(277)

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g) Plan Assets

The following table presents the hierarchy of the Company's pension plan assets at fair value as of December 31:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
2019				
Bond funds	\$ 19,152	—	—	19,152
Equity funds	<u>37,457</u>	<u>—</u>	<u>—</u>	<u>37,457</u>
Total assets	<u>\$ 56,609</u>	<u>—</u>	<u>—</u>	<u>56,609</u>
2018				
Bond funds	\$ 17,640	—	—	17,640
Equity funds	<u>33,063</u>	<u>—</u>	<u>—</u>	<u>33,063</u>
Total assets	<u>\$ 50,703</u>	<u>—</u>	<u>—</u>	<u>50,703</u>

The Company categorizes pension benefit plan assets consistent with the Fair Value Hierarchy described in Note 6.

The Company's other post-retirement benefit plans were unfunded at December 31, 2019 and 2018.

The assets of the Company's defined benefit pension plan ("the Plan") are invested in group variable annuity contracts with ONLIC offering specific investment choices from various asset classes providing diverse and professionally managed options. As of December 31, 2019 and 2018, \$35,245 and \$29,430, respectively, of the Plan assets are funds that are affiliated with the Company. The assets are invested in a mix of equity securities, debt securities and real estate securities in allocations as determined from time to time by the Pension Plan Committee. The target allocations are designed to balance the Plan's short-term liquidity needs and its long-term liabilities. The target allocations are currently 70% equity securities and 30% debt securities.

For diversification and risk control purposes, where applicable, each asset class is further divided into sub classes such as large cap, mid cap and small cap and growth, core and value for equity securities and U.S. domestic, global and high yield for debt securities. To the extent possible, each sub asset class utilizes multiple fund choices and no single fund contains more than 25% of Plan assets (exclusive of any short term increases in assets due to any Plan funding). The Plan performance is measured by a weighted benchmark consisting of equity and debt benchmarks in weights determined by the Plan committee.

The overall expected long term rate of return on assets is determined by a weighted average return of fixed income and equity indexes. Fixed income securities (including cash) make up 35% of the weighted average return and equity securities make up 65% of the weighted average return.

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The following table shows the weighted average asset allocation by class of the Company's qualified pension plan assets as of December 31:

	2019	2018
Equity securities	66%	65%
Debt securities	34	35
Total	100%	100%

h) Cash Flows

(i) Contributions

The minimum funding requirement under The Employee Retirement Income Security Act of 1974 for 2019 and 2018 was \$0. The Plan Sponsor contributed \$0 and \$0 to the qualified pension plan for the years ended December 31, 2019 and 2018, respectively. The contribution to the qualified pension plan is estimated to be \$6,000 for the 2020 plan year.

(ii) Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension benefits	Other benefits
2020	\$ 8,550	537
2021	7,327	564
2022	9,694	587
2023	7,693	602
2024	8,409	574
2025 - 2029	32,420	2,455

i) Other Plan Expenses

The Company also maintains a qualified contributory defined contribution profit-sharing plan covering substantially all employees. Company contributions to the profit-sharing plan are based on the net earnings of the Company and are payable at the sole discretion of management. The expense for contributions to the profit-sharing plan for 2019, 2018 and 2017 was \$6,011, \$7,281 and \$5,925, respectively.

Employees hired on or after January 1, 1998 are covered by a defined contribution pension plan. The expense reported for this plan was \$2,615, \$2,956 and \$2,900 in 2019, 2018 and 2017, respectively.

The Company has other deferred compensation and supplemental pension plans not included in the above tables. The expenses for these plans were \$14,345, \$(6,268) and \$18,336 in 2019, 2018 and 2017, respectively. In 2018, a portion of the liability was released resulting in a negative expense during the year.

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(16) Closed Block

Effective August 1, 1998, ONLIC was reorganized with approval of the Board of Directors, the Company's policyholders, and the Ohio Department of Insurance under provisions of the Ohio Revised Code to become a stock company 100% owned by ONFS. This reorganization contained an arrangement, known as a closed block (the "Closed Block"), to provide for dividends on policies that were in force on the effective date and were within classes of individual policies for which the Company had a dividend scale in effect at the time of the reorganization. The Closed Block was designed to give reasonable assurance to owners of affected policies that assets will be available to support such policies, including maintaining dividend scales in effect at the time of the reorganization, if the experience underlying such dividend scales continues. The assets, including revenue therefrom, allocated to the Closed Block will accrue solely to the benefit of the owners of policies included in the Closed Block until the Closed Block is no longer in effect. The Company is not required to support the payment of dividends on the Closed Block policies from its general funds.

The financial information of the Closed Block is consolidated with all other operating activities, and is prepared in conformity with FASB ASC 944-805, *Financial Services-Insurance-Business Combinations*. This presentation reflects the contractual provisions and not the actual results of operations and financial position. Many expenses related to the Closed Block operations are charged to operations outside the Closed Block; accordingly, the contribution from the Closed Block does not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside of the Closed Block are, therefore, disproportionate to the business outside of the Closed Block.

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Summarized financial information of the Closed Block as of December 31, 2019 and 2018, and for each of the years in the three-year period ended December 31, 2019 follows:

	<u>2019</u>	<u>2018</u>
Closed Block liabilities:		
Future policy benefits and claims	\$ 566,456	581,984
Policyholders' dividend accumulations	32,216	33,633
Other policyholder funds	28,912	9,946
Deferred federal income taxes	6,934	1,706
Other liabilities	1,320	1,329
Total Closed Block liabilities	<u>\$ 635,838</u>	<u>628,598</u>
Closed Block assets:		
Fixed maturity securities available-for-sale, at fair value (amortized cost of \$420,536 and \$378,831 as of December 31, 2018 and 2017, respectively)	\$ 448,860	428,660
Mortgage loans on real estate, net	29,751	38,641
Policy loans	78,844	82,788
Cash and short-term investments	11,314	6,071
Accrued investment income	4,065	4,249
Deferred policy acquisition costs	29,777	32,851
Reinsurance recoverable	1,231	895
Other assets	431	694
Total Closed Block assets	<u>\$ 604,273</u>	<u>594,849</u>
Excess of reported Closed Block liabilities over Closed Block assets	<u>\$ 31,565</u>	<u>33,749</u>
Amounts included in accumulated other comprehensive income:		
Unrealized investment gains, net of tax	34,437	10,056
Allocated to policyholder dividend obligation, net of tax	<u>(1,417)</u>	<u>(1,932)</u>
Maximum future earnings to be recognized from Closed Block assets and liabilities	<u>\$ 64,585</u>	<u>41,873</u>

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	<u>2019</u>	<u>2018</u>	<u>2017</u>
Change in policyholder dividend obligation:			
Balance at beginning of year	\$ 33,633	35,565	37,697
Net unrealized investment activity	<u>(1,417)</u>	<u>(1,932)</u>	<u>(2,132)</u>
Balance at end of year	<u>\$ 32,216</u>	<u>33,633</u>	<u>35,565</u>
Closed Block revenues and expenses:			
Traditional life insurance premiums	\$ 16,922	18,284	20,101
Net investment income	26,979	28,788	30,318
Net realized gains (losses) on investments	425	463	(275)
Benefits and claims	(27,989)	(31,104)	(33,082)
Provision for policyholders' dividends on participating policies	(6,312)	(7,201)	(8,211)
Amortization of deferred policy acquisition costs	(3,089)	(3,015)	(3,028)
Other operating costs and expenses	<u>(1,635)</u>	<u>(1,660)</u>	<u>(1,927)</u>
Income before federal income taxes	<u>5,301</u>	<u>4,555</u>	<u>3,896</u>
Income tax expense	<u>(50)</u>	<u>1,382</u>	<u>506</u>
Closed Block net income	<u>\$ 5,351</u>	<u>3,173</u>	<u>3,390</u>

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(17) Regulatory RBC and Dividend Restrictions

The Company is required to comply with statutory accounting practices prescribed or permitted by regulatory authorities. Annual Statements for the Company's domestic insurance subsidiaries ONLIC, ONLAC, NSLAC, MONT, KENW, CMGO and SUNR, filed with their respective insurance departments, are prepared on a basis of accounting practices prescribed or permitted by such regulatory authority in their respective states of domicile. Prescribed statutory accounting practices include a variety of publications of the National Association of Insurance Commissioners ("NAIC"), as well as state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting practices not prescribed.

The Company's Ohio domiciled life insurance subsidiaries, ONLIC, ONLAC, CMGO and SUNR, do not have any permitted statutory accounting practices as of December 31, 2019 or 2018. NSLAC, a New York domiciled life insurance company, does not have any permitted statutory accounting practices as of December 31, 2019 or 2018.

The Company's subsidiary, SUNR, applies a prescribed practice which values assumed GMDB and GLWB risks on variable annuity contracts from ONLIC using separate alternative reserving bases from the Statutory Accounting Principles detailed within the NAIC *Accounting Practices and Procedures manual* ("NAIC SAP") pursuant to Ohio Revised Code Chapter 3964 and approved by the Ohio Department of Insurance. The prescribed practice related to ONLIC guaranteed risks decreased the Company's carrying value of SUNR, included in common stocks – affiliates on the statutory statements of admitted assets, liabilities, capital and surplus, by \$164,187 as of December 31, 2019. If the prescribed practices were not applied, the Company's risk-based capital would continue to be above regulatory action levels.

The Company's Vermont domiciled life insurance subsidiary, MONT, received approval from the Vermont Insurance Department regarding the use of a permitted practice in the statutory financial statements as of December 31, 2014. The approval continues indefinitely. The Company was given approval by the Vermont Commissioner of Insurance to recognize as an admitted asset the value of a stop loss agreement. This stop loss agreement is from a third party unauthorized reinsurer and is used to fund the reinsurer's obligation to the Company. There is no difference in net loss between NAIC statutory accounting practices and practices permitted by the Vermont Department.

The Company's Vermont domiciled life insurance subsidiary, KENW, received approval from the Vermont Insurance Department regarding the use of a permitted practice in the statutory financial statements as of December 31, 2013. The approval continues indefinitely. The Company was given approval by the Vermont Commissioner of Insurance to recognize as an admitted asset the value of a letter of credit and a stop loss agreement. This stop loss agreement is from a third party unauthorized reinsurer and is used to fund the reinsurer's obligation to the Company. There is no difference in net loss between NAIC statutory accounting practices and practices permitted by the Vermont Department.

In 2015, the Company redomiciled SYRE to the Cayman Islands from the State of Delaware. The Company received approval from the Cayman Islands Monetary Authority ("CIMA") regarding the use of permitted practices to use GAAP as the basis of accounting and to recognize, as an admitted asset, a letter of credit. The approval continues indefinitely.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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(Dollars in thousands)

Statutory Surplus and Income

State insurance regulators and the NAIC have adopted RBC requirements for life insurance companies to evaluate the adequacy of statutory capital and surplus in relation to investment and insurance risks. The requirements provide a means of measuring the minimum amount of statutory surplus appropriate for an insurance company to support its overall business operations based on its size and risk profile. As of December 31, 2019, ONLIC, ONLAC, NSLAC, MONT, KENW, CMGO and SUNR, exceeded the minimum RBC requirements.

A company's risk-based statutory surplus is calculated by applying factors and performing calculations relating to various asset, premium, claim, expense and reserve items. Regulators can then measure the adequacy of a company's statutory surplus by comparing it to the RBC. Under specific RBC requirements, regulatory compliance is determined by the ratio of a company's total adjusted capital, as defined by the insurance regulators, to its company action level of RBC (known as the RBC ratio), also as defined by insurance regulators. As of December 31, 2019, the Company's primary life insurance subsidiary ONLIC's total adjusted capital and company action level RBC were \$1,137,229 and \$222,139, respectively, providing an RBC ratio of 512%. Additionally, as of December 31, 2019, ONLIC's authorized control level RBC was \$111,070.

The combined statutory basis net income of ONLIC, ONLAC, NSLAC, MONT, KENW, CMGO and SUNR, after intercompany eliminations, was \$(204,121), \$(91,843) and \$48,308 for the years ended December 31, 2019, 2018 and 2017, respectively.

The combined statutory basis capital and surplus of ONLIC, ONLAC, NSLAC, MONT, KENW, CMGO and SUNR, after intercompany eliminations, was \$1,019,863 and \$1,019,073 as of December 31, 2019 and 2018, respectively.

The primary reasons for the difference between statutory and GAAP accounting for reporting purposes include the following provisions for GAAP:

- the costs related to successful efforts to acquire business, principally commissions and certain policy issue expenses, are amortized over the period benefited rather than charged to operations in the year incurred;
- future policy benefit reserves are based on anticipated Company experience for lapses, mortality and investment yield, rather than statutory mortality and interest requirements, without consideration of withdrawals;
- investments in fixed maturity available-for-sale securities are carried at fair value rather than amortized cost;
- certain assets designated as non-admitted under statutory accounting are excluded from the balance sheet; under GAAP, these assets would be included in the consolidated balance sheets, net of any valuation allowance;
- the asset valuation reserve and interest maintenance reserve are not recorded;

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2019, 2018 and 2017

(Dollars in thousands)

- separate account seed money is classified as a trading security recorded at estimated fair value as opposed to a component of separate account assets;
- the fixed maturity securities that are related to NSLAC's funds withheld reinsurance arrangement are classified as trading securities recorded at estimated fair value as opposed to amortized cost;
- changes in deferred taxes are recognized in operations;
- there is a presentation of other comprehensive (loss) income and comprehensive (loss) income;
- consolidation for GAAP is based on whether the Company has voting control, or for certain VIEs, has the power to direct the activities most significant to the VIE while for statutory, consolidation is not applicable; and
- surplus notes are presented as part of notes payable within liabilities and are not presented as a component of capital and surplus.

Additionally, state regulators and rating agencies do not always use the same methodologies for calculating RBC ratios. There is a risk that a rating agency will not give us credit for certain regulatory RBC rules or permitted practices, which could result in a reduced rating even though the Company's RBC ratio and those of our insurance subsidiaries remain high based upon state regulatory rules and practices.

Dividend Restrictions

The payment of dividends by ONLIC to ONFS is limited by Ohio insurance laws. The maximum dividend that may be paid to ONFS without prior approval of the Director of Insurance is limited to the greater of ONLIC's statutory net income of the preceding calendar year or 10% of statutory surplus as of the preceding December 31. Any dividend that exceeds the earned surplus of ONLIC, even if it is within the above parameters, would be deemed extraordinary under Ohio law. Therefore, dividends of approximately \$102,000 may be paid by ONLIC to ONFS in 2020 without prior approval. Dividends of \$55,000, \$60,000 and \$70,000 were declared and paid by ONLIC to ONFS in 2019, 2018 and 2017, respectively.

The payment of dividends by ONLAC to ONLIC is limited by Ohio insurance laws. The maximum dividend that may be paid without prior approval of the Director of Insurance is limited to the greater of ONLAC's statutory net income of the preceding calendar year or 10% of statutory surplus as of the preceding December 31. Any dividend that exceeds the earned surplus of ONLAC, even if it is within the above parameters, would be deemed extraordinary under Ohio law. Therefore, dividends of approximately \$63,000 may be paid by ONLAC to ONLIC in 2020 without prior approval. ONLAC declared and paid ordinary dividends to ONLIC of \$30,857, \$27,000 and \$27,000 in 2019, 2018 and 2017, respectively. Extraordinary dividends of \$75,143 were paid by ONLAC to ONLIC during 2019. No extraordinary dividends were declared or paid during 2018 or 2017.

The payment of dividends by CMGO to ONLIC is limited by Ohio insurance laws. CMGO may pay to their stockholder, ONLIC, a dividend from unassigned surplus at the end of any calendar quarter where CMGO's unassigned surplus is equal to the amount required for CMGO to have company action level RBC of 200%, after adjusting its capital level and its RBC level for such dividend. No dividends were declared or paid by CMGO in 2019, 2018 or 2017.

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The payment of dividends by SUNR to ONLIC is limited by the SUNR plan of operations, which was approved by the Ohio Department of Insurance. SUNR is not permitted to pay dividends to its parent, ONLIC, until 2021.

The payment of dividends by NSLAC to ONLIC is limited by New York insurance laws. The maximum ordinary dividend that may be paid without prior approval of the Superintendent of Financial Services is limited to the lesser of 10% of NSLAC's statutory surplus (defined by New York Insurance Law, Section 4207a as page 3, line 37 of the Annual Statement) as of the immediate preceding calendar year or NSLAC's net gain from operations for the immediately preceding calendar year, not including realized capital gains. Therefore, dividends of approximately \$2,000 may be paid by NSLAC to ONLIC in 2020 without prior approval. No dividends were declared or paid by NSLAC in 2019, 2018 or 2017.

MONT and KENW are subject to limitations, imposed by the State of Vermont, on the payment of dividends to their stockholder, ONLIC. Generally, dividends during any year may not be paid, without prior regulatory approval. No dividends were declared or paid by MONT to ONLIC in 2019, 2018 or 2017. No dividends were declared or paid by KENW to ONLIC in 2019, 2018 or 2017.

SYRE is subject to limitations, imposed by CIMA, on the payment of dividends to its stockholder, ONFS. Dividends shall only be paid out of the SYRE's retained earnings and any paid-in capital in excess of par, provided that, after giving effect to each such dividend, the remaining capital is in excess of any capital requirements as prescribed by the CIMA. SYRE cannot pay any dividends without prior approval from CIMA. No dividends were declared or paid by SYRE in 2019, 2018 or 2017.

(18) Additional Financial Instruments Disclosure

Financial Instruments with Off Balance Sheet Risk

The Company is a party to financial instruments with off balance sheet risk in the normal course of business through management of its investment portfolio. The Company had outstanding commitments to fund mortgage loans, bonds, common stocks and venture capital partnerships of \$60,873 and \$89,518 as of December 31, 2019 and 2018, respectively. These commitments involve, in varying degrees, elements of credit and market risk in excess of amounts recognized in the consolidated financial statements. The credit risk of all financial instruments, whether on or off balance sheet, is controlled through credit approvals, limits, and monitoring procedures.

(19) Leases

The Company determines if an arrangement is, or contains, a lease at the inception date. Operating and finance lease liabilities are recognized based on the present value of the remaining lease payments, discounted using the discount rate for the lease at the commencement date. As the rate implicit in the lease is not readily determinable for operating leases, an incremental borrowing rate based on information available at the commencement date to determine the present value of future lease payments is utilized. Variable components of the lease payments such as fair value adjustments, utilities and maintenance costs are expensed as incurred and not included in determining the present value. Lease terms include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense is recognized on a straight-line basis over the lease term. The Company accounts for lease and non-

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

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(Dollars in thousands)

lease components separately and does not apply the lease guidance under ASC 842 to short-term lease arrangements.

Operating leases are included in operating lease right-of-use assets and operating lease liabilities on the consolidated balance sheet. Finance leases are included in other assets and other liabilities on the consolidated balance sheet.

The Company has operating leases for hardware, software and transportation equipment, and finance leases for office equipment.

Additional information related to leases is as follows:

The components of lease expense for the year ended December 31, 2019, are as follows:

Financing lease cost		
Amortization of right-of-use assets	\$	33
Interest on lease liabilities		9
Operating lease cost		1,825
Short term lease cost		<u>30</u>
Total lease expense	\$	<u><u>1,897</u></u>

Maturity of lease liabilities under non-cancelable operating and finance leases as of December 31, 2019, are as follows:

	Operating leases	Financing leases
2020	\$ <u>1,858</u>	<u>43</u>
2021	1,590	43
2022	1,331	33
2023	1,257	—
2024	906	—
Thereafter	<u>2,047</u>	<u>—</u>
Total future minimum lease payments	8,989	119
Less imputed interest	<u>(882)</u>	<u>(9)</u>
Total	<u><u>\$ 8,107</u></u>	<u><u>110</u></u>

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

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(Dollars in thousands)

Payments due under non-cancelable operating leases under ASC 840 as of December 31, 2018 were as follows:

2019	\$	4,162
2020		4,007
2021		3,201
2022		923
2023		849
Thereafter		<u>2,477</u>
Total minimum lease payments	\$	<u><u>15,619</u></u>

The following table provides a summary of our lease terms and discount rates for the year ended December 31, 2019:

Weighted-average remaining lease term (years) - financing leases	2.84
Weighted-average remaining lease term (years) - operating leases	6.22
Weighted-average discount rate - financing leases	6.82%
Weighted-average discount rate - financing leases	3.25%

Supplemental information related to our leases for the year ended December 31, 2019, is as follows:

Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from financing leases	\$	9
Operating cash flows from operating leases		1,825
Financing cash flows from financing leases		34
Right-of-use assets obtained in exchange for new finance lease liabilities		—
Right-of-use assets obtained in exchange for new operating lease liabilities		479

Information as Lessor

The Company adopted ASC 842 using the modified retrospective approach whereby the cumulative effect of adoption was recognized on the adoption date and prior periods were not restated. On adoption of the standard, the Company elected the package of practical expedients provided for under ASC 842 as a single election and was consistently applied to all existing leases as of January 1, 2019. The Company also elected the practical expedient related to separating lease and non-lease components, provided certain conditions are met. Under ASC 842, the Company is required to account for leases using an approach that is substantially equivalent to ASC 840's guidance for operating leases.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

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December 31, 2019, 2018 and 2017

(Dollars in thousands)

As a lessor, the Company leases office properties to lessees in exchange for monthly payments that cover rent and certain cost recoveries. The Company's operating leases qualify for single component accounting, and the non-lease components follow the same timing and pattern of transfer as the lease payments; therefore, all revenue from operating leases is accounted for under the new lease accounting standard and is classified within net investment income in the consolidated statements of operations. The Company's operating lease income does not include material amounts of variable payments.

Some of the Company's leases have termination options and/or extension options. Termination options allow the customer to terminate the lease prior to the end of the lease term under certain circumstances. Lease agreements generally do not contain an option to purchase the office property at the end of the lease term.

The Company recognized rental revenues related to operating lease payments of \$6,199 during the year ended December 31, 2019. The following table sets forth the undiscounted cash flows for future minimum base rents to be received from customers for leases in effect at December 31 2019 for operating leases:

2020	\$	4,272
2021		2,781
2022		1,874
2023		1,392
2024		994
Thereafter		<u>2,716</u>
Total undiscounted future minimum cash flows	\$	<u><u>14,029</u></u>

(20) Commitments and Contingencies

Several subsidiaries of the Company are a party to eleven federal court cases and eight FINRA arbitrations stemming from the strategic changes announced in September 2018, specifically the termination of certain variable annuity selling agreements with broker dealers related to the annuity business. The core issue in all of the cases is a disputed interpretation of certain language in Ohio National Life's contracts with the broker dealers who sold Ohio National Life's annuities. One case purports to be on behalf of a class, but no motions for class certification have yet been filed and no class has been certified. The Company sought early dismissal in five of the court cases claiming that the contract meaning is clear on its face, but three of the courts have declined to dismiss without trial. One previously pending case has been resolved. The first case currently set for trial is in July, 2020. The Company expects to continue to vigorously defend itself against these allegations. However, litigation is inherently uncertain and the outcome thereof cannot be predicted. Accordingly, it is possible that the ultimate outcome in one or more of the proceedings may be material to the Company's results of operations for a particular period depending upon, among other factors, the size of the loss and the level of the Company's results of operations for the period.

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Schedule 1

Consolidating Information - Balance Sheet

December 31, 2019

(Dollars in thousands)

Assets	ONLIC Non Insurance Subsidiaries	Montgomery Re. Inc.	Kenwood Re. Inc.	Camargo Re. Inc.	Sunrise Re. Inc.	National Security Life and Annuity Company	Ohio National Life Assurance Company	Ohio National Life Insurance Company	ONLIC Eliminations	ONLIC Consolidated	ONFS Consolidated	ONMH Consolidated
Investments:												
Securities available-for-sale at fair value:												
Fixed maturities	\$ -	300,364	316,179	152,207	378,255	55,366	1,856,146	5,486,015	-	8,544,533	9,745,959	9,745,959
Fixed maturities - on loan	-	-	-	-	-	-	71,590	167,062	-	238,652	238,652	238,652
Investment in subs	-	-	-	-	-	-	-	933,199	(933,199)	-	-	-
Fixed maturities held-to-maturity, at amortized cost	-	-	-	-	-	-	-	75,000	(75,000)	-	-	-
Fixed maturities, trading securities	-	-	-	-	-	160	-	-	-	160	160	160
Equity securities, at fair value	70	-	-	-	-	-	1	5,928	-	5,998	40,468	40,468
Equity securities - on loan, at fair value	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage loans on real estate, net	-	-	-	-	9,119	-	435,087	929,115	-	1,373,321	1,446,093	1,446,093
Real estate, net	-	-	-	-	-	-	-	25,758	-	25,758	52,270	52,270
Policy loans	-	-	-	-	-	-	124,930	744,694	-	869,624	875,097	875,097
Other long-term investments	-	-	-	-	-	-	12,113	159,174	-	171,286	272,204	272,204
Short-term investments securities lending collateral	-	-	-	-	-	-	74,080	172,498	-	246,578	246,578	246,578
Short-term investments	-	7,541	4,384	4,622	-	1,000	-	131,749	-	149,296	213,529	213,529
Total investments	70	307,905	320,563	156,829	387,374	56,526	2,573,947	8,830,192	(1,008,199)	11,625,206	13,131,010	13,131,010
Cash	17,071	2,110	5,954	8,333	250	2,935	29,954	141,066	-	207,672	287,223	288,218
Accrued investment income	-	2,800	2,680	1,178	3,045	391	17,982	48,880	(229)	76,726	77,849	77,849
Deferred policy acquisition costs	-	-	14,559	18,713	-	18,747	308,349	1,046,671	(10,032)	1,397,007	1,679,421	1,679,421
Reinsurance recoverable	-	17,929	17,611	11,322	581,329	8,860	2,904,941	3,910,391	(2,448,755)	5,003,628	3,946,180	3,946,180
Reinsurance deposit asset	-	-	-	-	-	-	23,850	881,920	-	905,770	905,770	905,770
Derivative funds withheld due from affiliate	-	-	-	-	64,161	-	-	58,931	(93,715)	29,377	-	-
Reinsurance funds withheld due from affiliate, net	-	-	-	-	-	-	-	-	-	-	-	-
Operating lease right-of-use assets	-	-	-	-	-	-	-	18,689	-	18,689	8,115	8,115
Other assets	8,553	30	37	38	92,515	3,982	10,127	305,832	(137,815)	283,298	386,324	386,324
Assets held in separate accounts	-	-	-	-	-	402,036	268,295	19,255,771	-	19,926,103	19,926,103	19,926,103
Federal income tax recoverable	-	82	3,004	3,639	-	247	-	-	(4,985)	1,988	17,715	17,811
Deferred federal income taxes	83	-	-	-	70,832	-	5,429	-	(76,344)	-	-	-
Total assets	\$ 25,777	330,856	364,408	200,052	1,199,506	493,724	6,142,874	34,498,343	(3,780,074)	39,475,464	40,365,710	40,366,801
Liabilities and Equity												
Future policy benefits and claims	\$ -	154,128	233,980	140,516	948,649	30,594	5,136,914	10,450,768	(2,456,905)	14,638,644	15,724,764	15,724,764
Policyholders' dividend accumulations	-	-	-	-	-	-	-	32,964	-	32,964	32,964	32,964
Other policyholder funds	-	5,777	-	-	-	-	69,963	90,174	-	165,914	170,779	170,779
Short-term debt	-	-	-	-	-	-	-	-	-	-	1,675	1,675
Long-term debt obligations	-	75,000	-	-	-	-	-	307,218	(75,000)	307,218	953,878	953,878
Accrued Federal income taxes:												
Current	100	-	-	-	454	-	358	4,072	(4,985)	-	-	-
Deferred	-	33,587	69,840	19,236	-	2,866	-	250,639	(76,569)	299,598	139,253	139,253
Payable to affiliate for derivative funds withheld program	-	-	-	-	63,792	-	-	34,784	(93,716)	4,860	-	-
Reinsurance funds withheld due to affiliate, net	-	-	-	-	-	-	-	525,879	-	525,879	-	-
Operating lease liabilities	-	-	-	-	-	-	-	18,689	-	18,689	8,107	8,107
Other liabilities	12,965	494	812	(2,511)	30,879	1,167	50,026	478,631	(138,042)	434,419	543,620	543,617
Payables for securities lending collateral	-	-	-	-	-	-	74,080	172,498	-	246,578	246,578	246,578
Liabilities related to separate accounts	-	-	-	-	-	402,036	268,295	19,255,771	-	19,926,103	19,926,103	19,926,103
Total liabilities	13,065	268,986	304,632	157,241	1,043,774	436,663	5,599,636	31,622,087	(2,845,217)	36,600,866	37,747,721	37,747,718
Equity:												
Common stock and additional paid-in-capital	10,830	34,250	5,000	25,250	137,404	33,345	97,577	298,076	(343,655)	298,076	9,592	-
Accumulated other comprehensive income	-	12,240	14,181	6,073	11,079	1,912	69,363	208,660	(112,549)	210,961	234,779	234,922
Retained earnings	1,882	15,380	40,595	11,488	7,249	21,804	376,298	2,369,520	(478,653)	2,365,561	2,373,618	2,384,161
Total equity excluding non-controlling interest	12,712	61,870	59,776	42,811	155,732	57,061	543,238	2,876,256	(934,857)	2,874,598	2,617,989	2,619,083
Non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	-
Total equity	12,712	61,870	59,776	42,811	155,732	57,061	543,238	2,876,256	(934,857)	2,874,598	2,617,989	2,619,083
Total liabilities and equity	\$ 25,777	330,856	364,408	200,052	1,199,506	493,724	6,142,874	34,498,343	(3,780,074)	39,475,464	40,365,710	40,366,801

See accompanying Independent Auditor's Report

OHIO NATIONAL MUTUAL HOLDINGS, INC. AND SUBSIDIARIES

Schedule 2

Consolidating Information - Statement of Income

Year to date December 31, 2019

(Dollars in thousands)

	ONLIC Non Insurance Subsidiaries	Montgomery Re. Inc.	Kenwood Re. Inc.	Camargo Re. Inc.	Sunrise Re. Inc.	National Security Life and Annuity Company	Ohio National Life Assurance Company	Ohio National Life Insurance Company	ONLIC Eliminations	ONLIC Consolidated	ONFS Consolidated	ONMH Consolidated
Revenues:												
Traditional life insurance premiums												
Direct	\$ -	(5,584)	-	-	-	6	1,308,426	1,549,284	-	2,852,132	2,901,330	2,901,330
Reinsurance premiums	-	(3,188)	5,627	45,904	-	-	(1,364,048)	(722,617)	-	(2,038,322)	(2,039,164)	(2,039,164)
Traditional life insurance premiums	\$ -	(8,772)	5,627	45,904	-	6	(55,622)	826,667	-	813,810	862,166	862,166
Accident and health insurance premiums	-	-	-	-	-	-	19,466	5,773	-	25,238	25,238	25,238
Annuity premiums and charges	-	-	-	-	419,634	6,489	18	(33,820)	-	392,321	445,085	445,085
Universal life policy charges	-	8,047	-	-	-	-	131,980	4,340	-	144,368	147,999	147,999
Group life and health insurance premiums	-	-	-	-	-	-	-	-	-	-	113,099	113,099
Change in value of trading fixed maturity securities	-	-	-	-	-	(4)	-	-	-	(4)	(4)	(4)
Change in value of equity securities	-	-	-	-	-	-	84	(505)	-	(421)	4,819	4,819
Change in value of reinsurance derivatives	-	-	-	-	-	-	-	-	-	-	-	-
Net investment income	75	6,016	11,405	4,899	8,562	1,945	139,872	404,610	(80,697)	496,688	524,787	524,794
Net realized (losses) gains on investments												
Investment gains (losses):												
Total other-than-temporary impairment losses on securities	-	-	-	-	-	-	1,286	1,140	-	2,426	2,426	2,426
Portion of impairment losses recognized in other comprehensive income	-	-	-	-	-	-	(3,435)	(3,951)	-	(7,386)	(7,386)	(7,386)
Net other-than-temporary impairment losses on securities recognized in earnings	-	-	-	-	-	-	(2,149)	(2,811)	-	(4,960)	(4,960)	(4,960)
Realized gains (losses), excluding other-than-temporary losses on securities	-	(31)	575	(9)	348	(55)	85,179	133,537	(6,393)	213,151	215,334	215,334
Investment (losses) gains	-	(31)	575	(9)	348	(55)	83,030	130,726	(6,393)	208,191	210,374	210,374
Derivative instruments	-	-	-	-	(47,094)	-	1,214	(5,831)	-	(51,711)	(154,443)	(154,443)
Gain (loss) on debt retirement	-	-	-	-	-	-	-	-	-	-	(10,263)	(10,263)
Investment management fees	45,181	-	-	-	-	-	-	-	-	45,181	45,181	45,181
Other income	45,752	-	-	-	-	1,107	2,598	83,449	(6,982)	125,924	126,424	126,424
	91,008	5,260	17,607	50,794	381,450	9,488	322,640	1,415,409	(94,072)	2,199,585	2,340,462	2,340,469
Benefits and expenses:												
Benefits and claims	-	11,762	7,286	37,970	371,720	777	154,587	712,095	478	1,296,676	1,578,810	1,578,810
Provision for policyholders' dividends on participating policies	-	-	-	-	-	-	-	114,298	-	114,298	114,298	114,298
Amortization of deferred policy acquisition costs	-	-	2,011	1,768	-	2,876	46,162	248,484	(1,159)	300,143	265,038	265,038
Impairment of goodwill and intangible assets	-	-	-	-	-	-	-	-	-	-	-	-
Commissions, net	64,860	2,836	6,649	8,651	-	1,678	(20,168)	79,266	(6,411)	137,362	175,902	175,902
Other operating costs and expenses	18,198	382	337	365	566	1,078	56,177	180,815	-	257,920	307,494	307,959
	83,058	14,980	16,283	48,754	372,286	6,409	236,758	1,334,958	(7,092)	2,106,399	2,441,542	2,442,007
Income (loss) before income tax	7,950	(9,720)	1,324	2,040	9,164	3,079	85,882	80,451	(86,980)	93,186	(101,080)	(101,538)
Income taxes:												
Current expense (benefit)	1,240	(1,856)	(4,651)	(9,457)	75,691	513	19,746	(62,678)	-	18,547	991	895
Deferred expense (benefit)	82	(259)	4,914	9,881	(73,777)	(245)	(4,165)	43,643	(1,056)	(20,983)	(34,830)	(34,830)
	1,322	(2,115)	263	424	1,914	268	15,581	(19,035)	(1,056)	(2,436)	(33,839)	(33,935)
Net income (loss)	6,628	(7,605)	1,061	1,616	7,250	2,811	70,301	99,486	(85,924)	95,622	(67,241)	(67,603)
Less: net income attributable to non-controlling interest	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss) attributable to ONMH	\$ 6,628	(7,605)	1,061	1,616	7,250	2,811	70,301	99,486	(85,924)	95,622	(67,241)	(67,603)

See accompanying Independent Auditor's Report