

# Sentinel Security Life Insurance Company

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## **FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT**

*For the Period June 30, 2016 (Acquisition Date) through December 31, 2016*



# SENTINEL SECURITY LIFE INSURANCE COMPANY

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## Independent Auditor's Report

The Board of Directors  
**Sentinel Security Life Insurance Company**

We have audited the accompanying financial statements of **Sentinel Security Life Insurance Company**, which comprise the balance sheet as of December 31, 2016, and the related statement of income, comprehensive income, changes in stockholder's equity, and cash flows for the period June 30, 2016 (Acquisition Date) through December 31, 2016, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of **Sentinel Security Life Insurance Company** as of December 31, 2016, and the results of its operations and its cash flows for the period June 30, 2016 (Acquisition Date) through December 31, 2016 in accordance with accounting principles generally accepted in the United States of America.

*Larson & Company, P.C.*

Salt Lake City, Utah  
October 20, 2017

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Balance Sheet  
As of December 31, 2016

## Assets

### Investments:

Bonds held to maturity, at amortized cost	\$ 5,292,614
Bonds withheld for reinsurance, at estimated fair value (cost value: \$283,941,008)	285,462,378
Bonds available for sale, at estimated fair value, (cost value: \$175,995,757)	178,831,695
Preferred stock available for sale at estimated fair value, (cost value: \$5,733,138)	5,390,582
Common stock, at fair market value	2,185,898
Mortgage loans, amortized cost	40,783,774
Other invested assets	133,868
Policy loans	1,361,116
<b>Total investments</b>	<b>519,441,925</b>
Cash and cash equivalents, at estimated fair value	34,275,517
Cash and cash equivalents withheld for reinsurance, at estimated fair value	49,549,195
Accrued investment income	2,987,266
Premiums, reinsurance, and other receivables, net of uncollectable agent balances	1,791,736
Deferred policy acquisition costs	1,252,132
Property and equipment, net	7,612,193
Value of business acquired (VOBA)	32,554,649
Related party receivables	3,300,928
Other assets	686,161
<b>Total assets</b>	<b>\$ 653,451,702</b>

## Liabilities and Stockholder's Equity

### Liabilities:

Future policy benefits and policyholder account balances	\$ 186,629,367
Other policy-related balances	6,114,125
Payables and accrued liabilities	10,759,057
Funds held under reinsurance treaties	375,956,278
Deferred income tax liability	11,530,026
Federal income taxes payable	151,061
Unearned investment income	48,369
Unearned ceding commission	240,627
Capital lease obligation	955,989
Surplus notes payable	15,000,000
<b>Total liabilities</b>	<b>607,384,899</b>

### Stockholder's equity:

Common stock, \$8 par value; 10,000,000, shares authorized; 605,289 issued, and 540,900 outstanding as of December 31, 2016	4,842,265
Treasury stock	(1,257,735)
Additional paid-in capital	38,102,965
Retained earnings	2,687,387
Accumulated other comprehensive income (loss), net of tax	1,691,921
<b>Total stockholder's equity</b>	<b>46,066,803</b>
<b>Total liabilities and stockholder's equity</b>	<b>\$ 653,451,702</b>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Statement of Income

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

<b>Revenues:</b>	
Premiums revenue	\$ 8,354,271
Net investment income	6,464,035
<b>Total</b>	<u>14,818,306</u>
<b>Net investment gains:</b>	
Realized investment gains (losses)	(155,132)
<b>Total net investment gains (losses)</b>	<u>(155,132)</u>
Other revenues	18,268
<b>Total revenues</b>	<u>14,681,442</u>
<b>Expenses:</b>	
Policyholder benefits and claims and adjustments to policyholder accounts	2,837,467
Other expenses	5,612,041
<b>Total expenses</b>	<u>8,449,508</u>
<b>Other expenses:</b>	
Interest expense	525,000
Other expenses	1,710,619
<b>Total other expenses</b>	<u>2,235,619</u>
<b>Net income (loss) before provision for income taxes</b>	3,996,315
Income tax benefit (expense)	(1,023,684)
<b>Net income (loss)</b>	<u>\$ 2,972,631</u>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Statement of Comprehensive Income

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

Net income (loss)	<u>\$ 2,972,631</u>
<b>Other comprehensive income (loss):</b>	
Unrealized investment gains (losses) arising during period	2,408,384
Less reclassification adjustment for (gains) losses included in net income	<u>155,132</u>
<b>Other comprehensive income (loss) before income tax</b>	<b>2,563,516</b>
Income tax expense (benefit) related to items of other comprehensive income (loss)	<u>871,595</u>
<b>Other comprehensive income (loss) net of income tax</b>	<b><u>1,691,921</u></b>
<b>Total comprehensive income (loss)</b>	<b><u><u>\$ 4,664,552</u></u></b>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Statement of Changes in Stockholder's Equity

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

	<u>Common Stock</u>	<u>Treasury Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholder's Equity</u>
<b>Balance at June 30, 2016</b>	\$ 4,842,265	\$ (1,257,735)	\$ 38,102,965	\$ -	\$ -	\$ 41,687,495
Net income	-	-	-	2,972,631	-	2,972,631
Other comprehensive gain, net of income tax	-	-	-	-	1,691,921	1,691,921
Dividends paid	-	-	-	(285,244)	-	(285,244)
<b>Balance at December 31, 2016</b>	<u>\$ 4,842,265</u>	<u>\$ (1,257,735)</u>	<u>\$ 38,102,965</u>	<u>\$ 2,687,387</u>	<u>\$ 1,691,921</u>	<u>\$ 46,066,803</u>

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

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Statement of Cash Flows

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

<b>Cash from operating activities:</b>	
Consolidated net income (loss)	\$ 2,972,631
<b>Adjustments to reconcile net income (loss) to net cash flows from operating activities:</b>	
Depreciation expense	474,763
Amortization of VOBA	1,739,895
Impairment of property and equipment	272,274
Amortization of premiums and discounts associated with investments	15,285
(Gains) losses on investments	(393,989)
Bad-debt expense	(89,945)
<b>Change in assets and liabilities:</b>	
Policy loans	(47,045)
Accrued investment income	(259,961)
Premiums, reinsurance, and other receivables	948,875
Deferred acquisition costs	(1,252,132)
Related party receivables	(3,300,928)
Other assets	1,008,726
Future policy benefits and policy account balances	(13,817,584)
Other policy-related balances	4,977,606
Payable and accrued liabilities	(11,675,444)
Deferred income tax liability	803,865
Federal income taxes payable	151,061
Unearned investment income	17,048
Unearned ceding commissions	(30,079)
<b>Net cash used by operating activities</b>	<u>(17,485,078)</u>
<b>Cash from investing activities:</b>	
<b>Sales, maturities and repayments of:</b>	
Net cash from acquisition	76,429,123
Bonds	149,398,652
Equity securities	800,000
Mortgage loans	6,807,247
Real estate	550,765
Other	298
<b>Purchases of:</b>	
Bonds	(183,396,083)
Equity securities	(663,700)
Mortgage loans	(23,912,529)
Property and equipment	(1,764,112)
<b>Net cash provided from investing activities</b>	<u>24,249,661</u>
<b>Cash flow from financing and miscellaneous activities:</b>	
Dividends paid	(285,244)
Payment for principal portion of capital lease	(278,316)
Funds held under reinsurance treaties	77,623,689
Cash paid for acquisition of common stock	(28,298,331)
Issuance of common stock	28,298,331
<b>Net cash provided from financing activities</b>	<u>77,060,129</u>
<b>Change in cash and cash equivalents</b>	83,824,712
<b>Cash and cash equivalents, beginning of year</b>	<u>-</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 83,824,712</u>

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



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 1. ORGANIZATION

**Sentinel Security Life Insurance Company** (the Company) a Utah corporation is organized in accordance with the Utah Insurance Code. As of December 31, 2016, the Company is a wholly owned subsidiary of Advantage West LLC. The Company's original principal lines of business consist of individual ordinary whole life and term life insurance. Over the last six years the Company began selling the following products, in order of release, Medicare supplement plans (2010), fixed annuity products (2011), hospital indemnity plans (2012), and a fixed index annuity product (2013). The Company writes its insurance under a general agency plan. All general agents, associate general agents, and special agents contract directly with the Company as independent contractors.

In the fourth quarter of 2015, a Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer, of the Company, by the StageCoach LLC (StageCoach) and Advantage West LLC (Ad West) referred to collectively as "the Acquirer", was filed with the Utah Insurance Department. Upon approval from the State of Utah Insurance Department, StageCoach purchased newly issued shares of the Company and Ad West acquired all of the remaining outstanding capital stock in the Company via a merger transaction in accordance with Utah Code, such that subsequent to the aforementioned transactions, StageCoach and Ad West owned all of the outstanding shares of the Company. The acquisition by StageCoach and Ad West of the Company was effected pursuant to a two-stage process.

In Stage One, StageCoach purchased from the Company 245,760.63 newly issued shares of the Company in accordance with the terms of the Subscription Agreements. The purchase of the Stage One shares was completed in December of 2015.

In Stage Two, Ad West acquired the remaining 295,137.95 shares via a shareholder approved merger transaction in accordance with Utah Code. Under the merger agreement, the Company merged with StageCoach II, Inc., a wholly owned direct subsidiary of Ad West, with the Company surviving as the successor Company in the merger as a subsidiary of Ad West. Stage Two was approved at the Annual Stockholders' meeting on April 15, 2016 by a majority of the stockholders'. In connection with Stage Two, the Company filed amended Articles of Incorporation which were filed and approved by the Utah Insurance Department; and were subsequently filed with the Utah Division of Corporation and Commercial Code on April 25, 2016. Additionally the Articles of Incorporation were filed with the Utah Division of Corporation and Commercial Code on April 25, 2016. The merger was completed on June 30, 2016 (Acquisition Date). Effective December 31, 2016, Ad West and Stage Coach were merged with Ad West being the surviving entity.

The acquisition of the Company was accounted for in accordance with Financial Accounting Standards Board (FASB) Accounting Standard Concept (ASC) Topic 805, *Business Combinations*. In accordance with FASB ASC Topic 805, the Company has elected the "Pushdown Accounting" accounting treatment which allows the Company to reflect in its separate financial statements the new basis of accounting established by the acquirer for the individual assets and liabilities of the Company.

The acquisition date fair value of the total consideration transferred by the acquirer totaled \$33,535,404. The amounts recognized by the Company for total assets and liabilities totaled \$588,196,652 and \$545,251,422, respectively, with assets exceeding liabilities by \$42,945,230. As such the Company was acquired at a bargain purchase amount of \$9,409,826. In connection with the pushdown accounting treatment, the acquiree has recorded this difference from the bargain purchase to additional paid-in capital.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Basis of Presentation

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The following are the Company's significant accounting policies with references to notes providing additional information on such policies and critical accounting estimates relating to such policies.

### Use of Estimates

The preparation of financial statements requires management to adopt accounting policies and make estimates and assumptions that affect amounts reported in the financial statements. In applying these policies and estimates, management makes subjective and complex judgments that frequently require assumptions about matters that are inherently uncertain. Many of these policies, estimates and related judgments are common in the insurance and financial services industries; others are specific to the Company's business and operations. Actual results could differ from estimates.

### Future Policy Benefit Liabilities and Policyholder Account Balances

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 U.S. GAAP and applicable actuarial standards.

Principal assumptions used in the establishment of liabilities for future policy benefits are mortality, morbidity, policy lapse, renewal, disability incidence, investment returns, inflation, expenses and other contingent events as appropriate to the respective product type and geographical. These assumptions are established at the time the policy is issued and are intended to estimate the experience for the period the policy benefits are payable. Utilizing these assumptions, liabilities are established on a block of business basis.

For long duration insurance contracts, assumptions such as mortality, morbidity and interest rates are "locked in" upon the issuance of new business. However, significant adverse changes in experience on such contracts may require the establishment of premium deficiency reserves. Such reserves are determined based on the then current assumptions and do not include a provision for adverse deviation.

Premium deficiency reserves may also be established for short duration contracts to provide for expected future losses. These reserves are based on actuarial estimates of the amount of loss inherent in that period, including losses incurred for which claims have not been reported. The provisions for unreported claims are calculated using studies that measure the historical length of time between the incurred date of a claim and its eventual reporting to the Company.

The Company regularly reviews its estimates of liabilities for future policy benefits 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 changes occur. Policyholder account balances relate to contract or contract features where the Company has no significant insurance risk. The Company issues directly certain annuity products with insurance risk. These annuities are accounted for as insurance liabilities.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Future Policy Benefit Liabilities and Policyholder Account Balances (Continued)

The Company waives deduction of deferred fractional premiums upon death of insured and returns any portion of the final premium beyond the death date. Surrender values are not promised in excess of the legally computed reserves. The reserve for waiver of deferred fractional premiums upon death is determined, by line of business, using total net premium and a reserve factor over the average remaining premium paying period. Since all policies are monthly pay, there is no reserve for return of premium.

As of December 31, 2016, the Company had 62 policies in force for which the gross premiums are less than the net premium according to the standard valuation set by the State of Utah. The gross premiums for these policies were \$16,518 less than net premiums for the period June 30, 2016 through December 31, 2016. Given the small number of policies where the net premiums exceed the gross premium the Company has not established a deficiency reserve.

### Other Policy-Related Balances

Other policy-related balances include policy and contract claims, unearned revenue liabilities, premiums received in advance, policyholder dividends due and unpaid, and policyholder dividends left on deposit. The liability for policy and contract claims generally relates to incurred but not reported death or accident and health claims, as well as claims which have been reported but not yet settled. The liability for these claims is based on the Company's estimated ultimate cost of settling all claims. The Company derives estimates for the development of incurred but not reported claims principally from analyses of historical patterns of claims by business line. The methods used to determine these estimates are continually reviewed. Adjustments resulting from this continuous review process and differences between estimates and payments for claims are recognized in policyholder benefits and claims expense in the period in which the estimates are changed or payments are made.

The Company accounts for the prepayment of premiums on its individual life, and accident and health contracts as premium received in advance and applies the cash received to premiums when due.

### Recognition of Premium Revenue and Related Expenses

Premiums related to traditional life, annuity policies, and long-duration accident and health policies are recognized as revenues when due from policyholders. Policyholder benefits and expenses are provided to recognize profits over the estimated lives of the insurance policies. When premiums are due over a significantly shorter period than the period over which benefits are provided, any excess profit is deferred and recognized into earnings in a constant relationship to insurance in-force or, for annuities, the amount of expected future policy benefit payments.

Deposits related to investment-type products are credited to PABs (policyholder account balances). Revenues from such contracts consist of fees for policy administration and surrender charges and are recorded in investment-type product policy fees in the period in which services are provided. Amounts that are charged to earnings include interest credited in excess of related PABs. Premiums, policy fees, policyholder benefits and expenses are presented net of reinsurance.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Recognition of Premium Revenue and Related Expenses (Continued)

Deferred and uncollected life insurance premiums as of December 31, 2016 were as follows:

	2016	
	<u>Gross</u>	<u>Net of Loading</u>
Ordinary new business	\$ 691,012	\$ 158,349
Ordinary renewal	3,733,136	2,652,619
<b>Total</b>	<b>\$ 4,424,148</b>	<b>\$ 2,810,968</b>

Uncollected life insurance premiums are included in the premiums, reinsurance, and other receivables account balance on the balance sheet.

Deferred life insurance premiums are included in the future policy benefits and policyholder account balances on the balance sheet.

### Participating Policies

For the period June 30, 2016 through December 31, 2016, participating policies account for less than 1% of total insurance, respectively. Total dividends for June 30, 2016 through December 31, 2016 were \$7,543.

### Deferred Policy Acquisition Costs and Value of Business Acquired

The Company incurs significant 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 include: (i) incremental direct costs of contract acquisition, such as commissions; (ii) the portion of an employee's total compensation and benefits related to time spent selling, underwriting or processing the issuance of new and renewal insurance business only with respect to actual policies acquired or renewed; (iii) other essential direct costs that would not have been incurred had a policy not been acquired or renewed; and (iv) in limited circumstances, the costs of direct-response advertising, the primary purpose of which is to elicit sales to customers who could be shown to have responded specifically to the advertising and that results in probable future benefits.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Deferred Policy Acquisition Costs and Value of Business Acquired (Continued)

All other acquisition-related costs, including those related to general advertising and solicitation, market research, agent training, product development, unsuccessful sales and underwriting efforts, as well as all indirect costs, are expensed as incurred. DAC is amortized over the estimated lives of the related insurance contracts in proportion to the following:

- Non-participating and non-dividend-paying traditional contracts: Historic actual and expected future gross premiums.
- Non-participating whole life insurance: Historic actual and expected future gross premiums
- Participating, dividend-paying traditional contracts: Actual and expected future gross margins.
- Fixed deferred annuity contracts: Actual and expected future gross profits.
- Medicare Supplement contracts: Actual and expected future gross profits.
- Hospital indemnity contracts: Actual and expected future gross profits.

Value of business acquired is the present value of future estimated profits of the acquired business and is amortized similar to deferred acquisition costs.

### Reinsurance

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. Cessions under reinsurance agreements do not discharge the Company's obligations as the primary insurer. The Company reviews all contractual features, particularly those that may limit the amount of insurance risk to which the reinsurer is subject or features that delay the timely reimbursement of claims. For reinsurance of existing in-force blocks of long-duration contracts that transfer significant insurance risk, the difference, if any, between the amounts paid (received), and the liabilities ceded related to the underlying contracts is considered the net cost of reinsurance at the inception of the reinsurance agreement.

The net cost of reinsurance is recorded as an adjustment to DAC and recognized as a component of other expenses on a basis consistent with the way the acquisition costs on the underlying reinsured contracts would be recognized. Subsequent amounts paid on the reinsurance of in-force blocks, as well as amounts paid related to new business, are recorded as ceded premiums and ceded future policy benefit liabilities are established.

Amounts currently recoverable under reinsurance agreements are included in premiums, reinsurance and other receivables and amounts currently payable are included in other liabilities. Assets and liabilities relating to reinsurance agreements with the same reinsurer may be recorded net on the balance sheet, if a right of offset exists within the reinsurance agreement. The Company believes that the right to offset exists under its current reinsurance agreements. In the event that reinsurers do not meet their obligations to the Company under the terms of the reinsurance agreements, reinsurance recoverable balances could become uncollectible. In such instances, reinsurance recoverable balances are stated net of allowances for uncollectible reinsurance.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Reinsurance (Continued)

If the Company determines that a reinsurance agreement does not expose the reinsurer to a reasonable possibility of a significant loss from insurance risk, the Company records the agreement using the deposit method of accounting. Deposits received are included in other liabilities and deposits made are included within premiums, reinsurance and other receivables. As amounts are paid or received, consistent with the underlying contracts, the deposit assets or liabilities are adjusted. Interest on such deposits is recorded as other revenues or other expenses, as appropriate. Periodically, the Company evaluates the adequacy of the expected payments or recoveries and adjusts the deposit asset or liability through other revenues or other expenses, as appropriate. Currently, no reinsurance agreements are accounted for using the deposit method of accounting.

### Funds Held Under Reinsurance Treaties

A provision in two of the Company's reinsurance treaties require all of the premium due the reinsurer not be paid but rather withheld by the Company. This is to enable the Company to reduce the provision for unauthorized reinsurance in its statutory statement. The reinsurer's assets are shown as funds held under reinsurance treaties in the liabilities section of the balance sheet. Although required for its statutory financial statements, the Company accounts for these funds in a consistent manner for U.S. GAAP.

### Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of acquisition to be cash equivalents. Therefore, cash and cash equivalents include demand deposits, money market funds, and funds withheld for ceded reinsurance. The carrying amounts of these assets are stated at cost which approximates fair value.

### Premiums, Reinsurance, and Other Receivables

The Company considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made. The Company has established an allowance for uncollectible agent balances. The allowance at December 31, 2016 was \$269,567.

### Investments

Bonds at December 31, 2016 consist of those that are available for sale and those that are held-to-maturity securities. Held-to-maturity securities are reported at cost, adjusted for amortization of premiums and accretion of discounts that are recognized in interest income using the interest method over the period to maturity. Available-for-sale bonds are recorded at fair value.

Common stocks and preferred stocks at December 31, 2016 consist of available-for-sale securities. Available-for-sale common and preferred stocks are recorded at fair value.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Investment Income

Investment income on mortgage-backed securities is initially based upon yield, cash flow, and prepayment assumptions at the date of purchase. Subsequent revisions in those assumptions are recorded using the retrospective method, except for adjustable rate residential mortgage-backed securities where the prospective method is used. Under the retrospective method, the amortized cost of the security is adjusted to the amount that would have existed had the revised assumptions been in place at the time of purchase. Under the prospective method, future cash flows are estimated and interest income is recognized going forward using the new effective yield to maturity. The adjustments to amortized cost under both methods are recorded as a charge or credit to net investment income. These results are based upon validations and comparisons to similar securities provided by third parties, such as rating agencies. Amounts due from, but not yet paid, are included on the balance sheet in accrued investment income.

### Mortgage Loans

Mortgage loans are stated at the outstanding principal amount, adjusted for amortization of premium and accrual of discount, less an allowance for potential future losses. A loan is considered impaired if it is probable that all contractual amounts due will not be collected. The allowance for potential future losses on mortgage loans is maintained at a level believed by management to be adequate to absorb potential future credit losses. Management's periodic evaluation and assessment of the adequacy of the allowance is based on known and inherent risks in the portfolio, historical and industry data, current economic conditions and other relevant factors, along with specific risks related to specific loans.

### Policy Loans

Policy loans are carried at the outstanding principal amount. Short-term investments are stated at cost, adjusted for amortization of premium and accrual of discount.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Property and Equipment

Property and equipment is carried at cost, net of accumulated depreciation. Maintenance and repairs which do not materially extend the useful lives of furniture and equipment and minor replacements are charged to earnings as incurred.

Electronic data processing (EDP) equipment is depreciated on the straight-line basis over an estimated useful life of three to five years. Depreciation expense was \$120,415 for the period June 30, 2016 through December 31, 2016.

Furniture and fixtures are depreciated on the straight-line basis over a five to fifteen year period. Depreciation expense for furniture and fixtures was \$0 for the period June 30, 2016 through December 31, 2016.

Buildings and improvements are depreciated on the straight-line basis between three and fifty years. Depreciation expense was \$55,429 for the period June 30, 2016 through December 31, 2016.

Capital lease assets are depreciated on the straight-line basis for the term of the lease. Depreciation expense was \$298,920 for the period June 30, 2016 through December 31, 2016.

### Guarantee Assessments

The states in which the Company operates have guaranty fund laws under which insurers doing business in the state are required to fund policyholder liabilities of insolvent insurance companies. Generally, assessments are levied within the state, up to prescribed limits, on all insurers doing business in the state on the basis of the proportionate share of the premiums written by insurers doing business in that state in the lines of business in which the impaired, insolvent or failed insurer is engaged. Guarantee assessments of \$24,376 for the period June 30, 2016 through December 31, 2016 were expensed.

### Policy and Contract Claims

The liability for life, accident, and health policyholder claims was estimated using past experience and other actuarial methods.



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Income Taxes

The Company is classified as a "C" corporation under the Internal Revenue Code and as such they are subject to income taxes. Income taxes are provided for the tax effects of transactions presented in the financial statements. Deferred income taxes are calculated using the liability method of accounting for income taxes. Under the liability method, deferred income tax assets and liabilities are provided based on the difference between the financial reporting and tax reporting bases of assets and liabilities as measured by the currently enacted tax rates in effect for the years in which these differences are expected to reverse.

Deferred income tax expense or benefit is the result of changes in deferred income tax assets and liabilities. An allowance against deferred income tax assets is recorded in whole or in part when it is more likely than not that those deferred income tax assets will not be realized.

Net cash paid for federal income taxes was \$68,758 for the period June 30, 2016 through December 31, 2016.

The Company accounts for uncertain tax positions in accordance with certain provisions of FASB ASC 740. Management has determined that the Companies do not have any uncertain tax positions and associated unrecognized benefits that materially impact the financial statements or related disclosures. Since tax matters are subject to some degree of uncertainty, there can be no assurance that the Company's tax returns will not be challenged by the taxing authorities and that the Company will not be subject to additional tax, penalties, and interest as a result of such challenge. The Company's federal income tax returns from 2016 through 2014 are subject to examination by the Internal Revenue Service, generally for three years after they are filed.

Prior to 1984, the Company was allowed certain special deductions for federal income tax reporting purposes that were required to be accumulated in a "policyholders' surplus account" (PSA). In the event that those amounts are distributed to shareholders, or the balance of the account exceeds certain limitations prescribed by the Internal Revenue code, the excess amounts would be subject to income tax at current rates. Income taxes also would be payable at current rates if the Company ceases to qualify as a life insurance company for tax reporting purposes, or if the income tax deferral status of the PSA is modified by future tax legislation. Management does not intend to take actions nor does management expect any events to occur that would cause income taxes to become payable on the PSA balance. Accordingly, the Company has not accrued income taxes on the PSA balance of \$1,220,000 at December 31, 2016. However, if such taxes were assessed the amount of the taxes payable would be approximately \$415,000. No deferred tax liabilities are recognized related to the PSA.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist of temporary cash investments, fixed maturity securities, and receivables.

### Advertising Costs

Advertising costs are charged to operations when incurred. Advertising expense was \$66,067 for the period June 30, 2016 through December 31, 2016.

### Accounting Changes

There were no changes in accounting principles as of and for the six month period ended December 31, 2016.

## 3. INVESTED ASSETS ON DEPOSIT

At December 31, 2016, bonds with a fair market value of \$3,042,625 were on deposit with state insurance departments to satisfy regulatory requirements.

## 4. INVESTMENTS

The cost/amortized cost and approximate fair values of investments are as follows:

	<u>Cost/ Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<b>December 31, 2016</b>				
<b>Bonds:</b>				
Held-to-maturity	\$ 5,292,614	\$ 4,185	\$ (235,087)	\$ 5,061,712
Available-for-sale	175,995,757	6,282,433	(3,446,495)	178,831,695
Withheld for reinsurance	283,941,008	4,821,983	(3,300,613)	285,462,378
<b>Total bonds</b>	<u>465,229,379</u>	<u>11,108,601</u>	<u>(6,982,195)</u>	<u>469,355,785</u>
<b>Preferred stock:</b>				
Available-for-sale	5,733,138	-	(342,556)	5,390,582
Withheld for reinsurance	-	-	-	-
<b>Total preferred stocks</b>	<u>5,733,138</u>	<u>-</u>	<u>(342,556)</u>	<u>5,390,582</u>
<b>Common stock</b>	<u>2,114,445</u>	<u>71,453</u>	<u>-</u>	<u>2,185,898</u>
<b>Total</b>	<u>\$ 473,076,962</u>	<u>\$ 11,180,054</u>	<u>\$ (7,324,751)</u>	<u>\$ 476,932,265</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 4. INVESTMENTS (Continued)

Maturities of bonds are as follows as of December 31, 2016:

	<u>Cost Basis</u>	<u>Fair Value</u>
2017	\$ 62,435,317	\$ 62,989,095
2018-2022	95,918,094	96,768,851
2023-2027	237,529,812	239,636,610
2028-2037	51,460,755	51,917,192
After 2037	17,885,401	18,044,037
<b>Total by maturity</b>	<b>\$ 465,229,379</b>	<b>\$ 469,355,785</b>

The expected maturities in the foregoing table may differ from the contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches including a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2—Valuations based on one or more quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The availability of observable inputs can vary from product to product and is affected by a wide variety of factors, including, for example, the type of product, whether the product is new and not yet established in the marketplace, the liquidity of markets and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 4. INVESTMENTS (Continued)

Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those that the Company believes market participants would use in pricing the asset or liability at the measurement date.

The Company has categorized its assets and liabilities into the three-level fair value hierarchy based upon the priority of the inputs to the respective valuation technique.

Fair values for assets measured on a recurring basis as of December 31, 2016 are as follows:

	<b>Assets Measured at Fair Value</b>			
	<b>Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>December 31, 2016:</b>				
<b>Assets</b>				
<b>Stocks:</b>				
Common	\$ 2,185,898	\$ 298,086	\$ -	\$ 1,887,812
Preferred	5,390,582	5,390,582	-	-
Available-for-sale bonds	464,294,073	-	446,646,079	17,647,994
<b>Total</b>	<b>\$ 471,870,553</b>	<b>\$ 5,688,668</b>	<b>\$ 446,646,079</b>	<b>\$ 19,535,806</b>
<b>Liabilities:</b>				
Securities held under reinsurance treaties	\$ 285,462,378	\$ -	\$ 285,462,378	\$ -
<b>Total</b>	<b>\$ 285,462,378</b>	<b>\$ -</b>	<b>\$ 285,462,378</b>	<b>\$ -</b>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 4. INVESTMENTS (Continued)

On a quarterly basis, the Company reviews its investment portfolio for securities in an unrealized loss position for other-than-temporary impairment. This review for potential impairment is performed on a specific identification basis and requires significant management judgment related to a number of qualitative and quantitative factors including the severity of the impairment, the duration of the impairment, recent trends and expected market performance. Management believes that the majority of the Company's unrealized losses on individual securities at December 31, 2016 represent a temporary decline in market value.

As of December 31, 2016, the Company did not have any bonds and/or common stocks in an unrealized loss position for which other-than-temporary declines in value have not been recognized.

The following tables summarize those investments that, as of December 31, 2016, were in an unrealized loss position for which other-than-temporary declines in value have not been recognized:

(\$ In Thousands)	Less Than 12 Months			12 Months or More			Total Unrealized Losses
	Number Of Issues	Fair Value	Unrealized Losses	Number Of Issues	Fair Value	Unrealized Losses	
At December 31, 2016							
<b>Bonds:</b>							
Available-for sale	306	\$ 251,700	\$ 6,747	-	\$ -	\$ -	\$ 6,747
Held-to maturity	16	4,781	235	-	-	-	235
<b>Total bonds</b>	<b>322</b>	<b>256,481</b>	<b>6,982</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>6,982</b>
<b>Equity securities:</b>							
Common stock - industrial and misc.	-	-	-	-	-	-	-
Preferred stock - industrial and misc.	23	5,391	343	-	-	-	343
<b>Total bonds     and equity securities</b>	<b>345</b>	<b>\$ 261,872</b>	<b>\$ 7,325</b>	<b>-</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 7,325</b>
Investment grade bonds	322	\$ 256,481	\$ 6,982	-	\$ -	\$ -	\$ 6,982
Below investment grade bonds	-	-	-	-	-	-	-
<b>Total bonds</b>	<b>322</b>	<b>\$ 256,481</b>	<b>\$ 6,982</b>	<b>-</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 6,982</b>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 4. INVESTMENTS (Continued)

Realized capital gains (losses) for the six month period ended December 31 on investments consisted of the following:

	<u>2016</u>
<b>Bonds:</b>	
Gross gains	\$ 691,642
Gross losses	(266,853)
<b>Other invested assets:</b>	
Gross gains	-
Gross losses	(276,847)
<b>Preferred stock:</b>	
Gross gains	-
Gross losses	(30,800)
<b>Common stock:</b>	
Gross gains	-
Gross losses	-
<b>Real estate:</b>	
Gross gains	-
Gross losses	<u>(272,274)</u>
<b>Net capital gains (loss)</b>	<u>\$ (155,132)</u>

### Mortgage Loans

In 2016, the Company participated in fifteen joint commercial mortgages with Asset Capital Management. The participated joint commercial mortgages had a minimum rate of 8 percent and a maximum rate of 15 percent. The participating mortgages had loan-to values with a minimum of 16.4% and maximum of 79.5% (participating portion versus security value).

Mortgage loans at December 31, 2016 totaled \$40,783,774. As of December 31, 2016 the Company had \$700,000 of mortgage loans with interest more than 180 days past due.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 5. NET INVESTMENT INCOME

For the period June 30, 2016 through December 31, 2016 net investment income consisted of the following:

	<u>2016</u>
<b>Investment income:</b>	
Bonds	\$ 5,376,007
Preferred stocks	188,416
Common stocks	15,118
Mortgage loans	1,021,891
Real estate	208,169
Policy loans	51,313
Cash and short-term investments	150
Other invested assets	3,208
Aggregate write-ins for investment income	<u>17,657</u>
<b>Total</b>	6,881,929
<b>Less:</b>	
Investment expenses	<u>(417,894)</u>
<b>Net investment income</b>	<u><u>\$ 6,464,035</u></u>

### 6. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consisted of the following at December 31, 2016:

Cash and cash equivalents	\$ 34,275,517
Cash and cash equivalents, withheld for reinsurance	<u>49,549,195</u>
<b>Total cash and cash equivalents</b>	<u><u>\$ 83,824,712</u></u>

### 7. CONCENTRATION OF CREDIT AND MARKET RISK

The Company maintains several bank accounts at the same institution. Accounts at this institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At times for the year ended December 31, 2016, such amounts were in excess of the FDIC insurance limit of \$250,000. The Company has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk on this balance due to the financial integrity of this institution.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 7. CONCENTRATION OF CREDIT AND MARKET RISK (Continued)

The Company invests in money market funds that are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund. As of December 31, 2016 the Company held \$36,535,303 in money market funds.

The Company maintains accounts with brokerage firms. These accounts contain bonds, preferred stocks and common stocks. These investments are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with these investments, it is reasonably possible that changes in the values of investments will occur in the near term and that such change could materially affect the amounts reported in the financial statements.

The Company's revenues and receivables are from customers located in more than 27 states. The majority of the Company's customers are located in the states of California, Colorado, Florida, North Carolina, Oklahoma, Texas, and Utah.

## 8. ACCRUED INVESTMENT INCOME RECEIVABLE

Accrued interest and other investment income receivable consisted of the following at December 31:

	<u>2016</u>
<b>Accrued investment income:</b>	
Bonds	\$ 2,152,598
Preferred stock	50,333
Mortgage loans	769,595
Other invested assets	2,400
Policy loans	<u>12,340</u>
<b>Total accrued investment income</b>	<u><u>\$ 2,987,266</u></u>



# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 9. PROPERTY AND EQUIPMENT

Property and equipment as of December 31, 2016 is summarized in the following schedules:

### **Properties occupied by the Company:**

Land	\$ 364,100
Properties occupied by the Company	4,658,020
Accumulated depreciation	<u>(55,429)</u>

### **Net properties occupied by the Company**

4,966,691

### **Properties held for the production of income:**

Buildings	<u>1,300,000</u>
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### **Net properties held for the production of income**

1,300,000

### **Other property and equipment:**

Data processing equipment	315,275
Software	250,987
Furniture and fixtures	2,894
Accumulated depreciation	<u>(120,415)</u>

### **Net other property and equipment**

448,741

### **Capital lease:**

Furniture, fixtures, and nonoperating software	1,195,681
Accumulated depreciation	<u>(298,920)</u>

### **Net capital lease**

896,761

### **Net property and equipment**

\$ 7,612,193

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 10. REINSURANCE

Certain premiums and benefits are ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. The Company remains obligated for amounts ceded in the event that the reinsurers do not meet their obligations. Amounts payable or recoverable for reinsurance on policy and contract liabilities are not subject to periodic or maximum limits.

Reinsurance ceded has reduced premiums by \$99,170,130 and contract liabilities by \$1,300,159,765 for the period June 30, 2016 through December 31, 2016 and as of December 31, 2016, respectively. For the period June 30, 2016 through December 31, 2016, the Company did not write off to operations any reinsurance balances.

The Company actively sells individual whole life insurance. The Company also maintains other blocks of insurance business; annuities, accidental death, Medicare supplements, and hospital indemnity. The accident and health insurance contracts are reinsured by Mutual of Omaha. Life insurance, annuities, deposit funds and other related benefits were reinsured by Optimum Re Insurance Company, Athene Life Re Ltd., Guggenheim Life and Annuity Company, Ability Insurance Company and Haymarket Insurance Company. Policyholder reserves and claims liabilities are stated net of the deduction for reserves and claims applicable to reinsurance ceded to other companies. However, the Company is contingently liable for these amounts in the event such companies are unable to pay their portion of the claims.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 10. REINSURANCE (Continued)

The following summarizes the amounts of reinsurance ceded for premiums, benefits paid or provided, and loss reserves presented in the accompanying financial statements as of and for the six month period ended December 31, 2016:

<b>Premiums:</b>	
Gross	\$ 107,524,401
Ceded	(99,170,130)
<b>Net</b>	<u>\$ 8,354,271</u>
<b>Net due and deferred:</b>	
Gross due and deferred	
Gross	\$ 4,424,148
Ceded	-
<b>Net</b>	<u>4,424,148</u>
Loading	
Gross	(1,613,181)
Ceded	-
<b>Net</b>	<u>(1,613,181)</u>
Net due and deferred	
Gross	2,810,967
Ceded	-
<b>Net</b>	<u>\$ 2,810,967</u>
<b>Aggregate reserves - life and deposit-type contracts:</b>	
Gross	\$ 1,485,020,766
Ceded	(1,298,646,408)
<b>Net</b>	<u>\$ 186,374,358</u>
<b>Aggregate reserves - accident and health:</b>	
Gross	\$ 1,768,364
Ceded	(1,513,357)
<b>Net</b>	<u>\$ 255,007</u>
<b>Claims payable:</b>	
Gross	\$ 9,878,724
Ceded	(3,893,028)
<b>Net</b>	<u>\$ 5,985,696</u>
<b>Claims:</b>	
Gross	\$ 24,682,254
Ceded	(20,537,554)
<b>Net</b>	<u>\$ 4,144,700</u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 11. INCOME TAXES

Income taxes for the period June 30, 2016 through December 31, 2016 consisted of the following:

<b>Current:</b>	
Federal	<u>\$ (219,819)</u>
<b>Total current income taxes</b>	<u>(219,819)</u>
<b>Deferred:</b>	
Federal	<u>(803,865)</u>
<b>Total deferred income taxes</b>	<u>(803,865)</u>
<b>Total tax benefit (expense)</b>	<u><u>\$ (1,023,684)</u></u>

A reconciliation of income tax expense at the federal statutory rate to the Company's effective rate is as follows:

		<u>Percentage</u>
Computed income tax (benefit) expense at the statutory rate of 34%	\$ 1,358,747	34.0%
Meals and entertainment	9,902	0.2%
Dividends received deduction	(8,418)	-0.2%
Tax exempt interest	(56,102)	-1.4%
Policyholder's share of tax-exempt interest	21,555	0.5%
Prior period true-ups	<u>(302,000)</u>	<u>-7.6%</u>
<b>Total tax provision</b>	<u><u>\$ 1,023,684</u></u>	<u><u>25.6%</u></u>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 11. INCOME TAXES (Continued)

The temporary differences and carryforwards which give rise to the deferred tax assets (liabilities) as of December 31, 2016 consist of the following:

<b>Deferred tax assets:</b>	
Allowance for doubtful accounts	\$ 91,653
Advanced premium	35,676
Interest income	267,112
Reserves and policyholder account balances	1,718,570
Deferred acquisition costs	1,133,284
Accrued vacation	53,470
NOL carryforward	687,041
AMT credit carryforward	1,347,946
Capital loss carryforward	109,449
Other than temporary impairment	34,768
Reinsurance treaty	102,266
Other	7,796
<b>Total deferred tax assets</b>	<b>5,589,031</b>
Valuation allowance	(34,768)
<b>Total adjusted deferred tax assets</b>	<b>5,554,263</b>
<b>Deferred tax liabilities:</b>	
Uncollected premiums	8,116
Value of business acquired (VOBA)	15,340,373
Unrealized capital gains (losses)	896,143
Dividend income	60,416
Capital gains (losses)	56,705
Fixed assets	234,070
Ceding commission allowance	488,466
<b>Total deferred tax liabilities</b>	<b>17,084,289</b>
<b>Net deferred tax assets (liabilities)</b>	<b>\$ (11,530,026)</b>

At December 31, 2016, the Company has federal alternative minimum tax (AMT) credit carryforwards of \$1,347,946, which have no expiration date.

At December 31, 2016, the Company has a net operating loss carryforward (NOL) of \$2,020,710, which is set to expire beginning in 2029.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 12. EMPLOYEE BENEFITS

### Defined Contribution Plans

The Company has a profit sharing 401(k) plan that qualifies under Section 401(a) of the Internal Revenue Code and is therefore exempt from income taxes. All eligible Company employees may participate in the plan after completing three months of service and have attained age 18. The Company's annual contribution for the year ended December 31, 2016 is a safe harbor matching contribution. In order to maintain "safe harbor" status, the Company will make a safe harbor matching contribution equal to 100% of an employee's salary deferral that does not exceed 3% of his or her compensation plus 50% of the employee's salary deferral between 3% and 5% of his or her compensation. This safe harbor matching contribution is 100% vested. All contributions to the plan are made to an independent trustee for investment and administration. The contributions become partially vested after two years and fully vested after six years of service. The Company's cost of the plan was \$155,986 for the six month period ended December 31, 2016. As of December 31, 2016, the fair value of the plan assets was \$3,213,145.

The Company's health, long-term disability, dental, and group life plans cover substantially all of its employees and qualified employee dependents. The Company makes contributions to these plans sufficient to provide for benefit payments required under the plans.

Postemployment benefits and compensated absences have been accrued in accordance with FASB ASC Topic 715. As of December 31, 2016, the Company estimated the obligation for compensated absences to be \$662,847.

## 13. CONTINGENCIES

The Company is subject to assessments for its proportionate share of liabilities of insolvent insurers in the states where the Company operates which have guaranty company statutes. A provision for future assessments has not been recorded in the accompanying financial statements because they cannot be estimated.

The Company is subject to litigation from the settlement of claims contested in the normal course of business. The losses from the actual settlement of such unknown claims are taken into consideration in the computation of the estimated claims liabilities. No contingent liabilities have been established by the Company. There is no pending litigation as of December 31, 2016.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 14. CAPITAL REQUIREMENTS

The State of Utah has adopted the National Company of Insurance Commissioners' (NAIC) risk-based capital (RBC) calculation to evaluate the minimum capital requirements for an insurance Company to support its overall business operations in consideration of its size and risk profile. The Company's risk-based capital is calculated by applying factors to various asset, premium, and reserve items.

The RBC requirements provide for four different levels of regulatory attention depending on the ratio of the Company's total adjusted capital (TAC) to its authorized control level (ACL). The four regulatory attention levels (and the associated percentage of TAC to ACL) are defined as follows: (1) Company Action (200%), (2) Regulatory Action (150%), (3) Authorized Control (100%), and (4) Mandatory Control Levels (70%). As of December 31, 2016, the Company maintained TAC in excess of 200% of ACL.

The payment of dividends by the Company to shareholders is limited and can only be made from earned profits unless prior approval is received from the Utah Insurance Commissioner. The maximum amount of dividends that may be paid by life insurance companies without prior approval of the Utah Insurance Commissioner is also subject to restrictions relating to statutory surplus and net income. The Company did not pay an ordinary dividend in 2016.

### 15. UNPAID CLAIMS, LOSSES AND LOSS ADJUSTMENT EXPENSES – ACCIDENT & HEALTH CONTRACTS

Reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years has (decreased) increased by approximately \$(87,359) for the period June 30, 2016 through December 31, 2016.

<b>Balance at January 1</b>	<u>\$ 445,293</u>
<b>Incurred, related to:</b>	
Current year	3,211,377
Prior years	<u>(87,359)</u>
<b>Total incurred</b>	<u>3,124,018</u>
<b>Paid, related to:</b>	
Current year	2,716,158
Prior years	<u>356,725</u>
<b>Total paid</b>	<u>3,072,883</u>
<b>Balance at December 31</b>	<u>\$ 496,428</u>

Management believes that the liability for unpaid claims is adequate to cover the ultimate development of claims. The liability is continually reviewed and revised to reflect current conditions and claim trends and any resulting adjustments are reflected in operating results in the year made.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 16. DIRECT PREMIUM WRITTEN/PRODUCED BY THIRD PARTY ADMINISTRATOR

The aggregate amount of direct premiums written through managing general agents or third party administrators for the six month period December 31, 2016 was:

Name and Address Managing General Agent Or Third Part Administrator	FEIN#	Exclusive Contract	Type of Business Written	Type of Activity Granted	Total Direct Prem Written/ Produced By
<b>For the year ended December 31, 2016:</b>					
Secure Administrative Solutions, LLC 1405 West 2200 South Salt Lake City, Utah 84119	46-4813559	No	Medicare	C,CA,P,U	<u>\$ 19,191,194</u>
			Supplement		
			Traditional		
			Life Insurance		<u>\$ 5,074,322</u>
			Multi-year guarantee		
			Annuities		<u>\$ 46,926,403</u>
			Deposit-Type		
			Annuities		<u>\$ 130,868,900</u>
			Fixed Income		
			Annuities		<u>\$ 36,262,301</u>

## 17. VALUE OF BUSINESS ACQUIRED

The net amortization charged to income for the six month period ended December 31, 2016, for the value of business acquired was \$1,739,901. The value of business acquired amortization is included in the general and administrative expenses on the income statement.



# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 18. STATUTORY ACCOUNTING PRINCIPLES

The Company, which is domiciled in State of Utah, prepares its statutory financial statements in accordance with accounting principles and practices prescribed or permitted by the Utah Insurance Department, which Utah recognizes for determining solvency under the Utah Insurance Law.

The following schedules reconcile the Company's statutory net income and statutory surplus and capital stock determined in accordance with accounting practices prescribed or permitted by the Utah Insurance Department with net earnings (loss) and equity on a U.S. GAAP basis as of and for the six month period ended December 31, 2016.

Statutory net income (loss)	
per the annual statement	\$(2,474,229)

#### **Adjustments:**

Future policy benefits and policyholder's account balances	1,437,136
Deferred policy acquisition costs	1,252,132
Deferred income taxes	(803,865)
Interest maintenance reserve	(355,611)
Allowance for bad-debts	89,945
Net income (loss) prior to acquisition	(139,725)
Realized gains (loss)	4,945,067
Bond amortization (accretion)	(614,656)
Ceding commission allowance	1,436,664
Capital lease obligation	(114,007)
Income tax expense	53,681
Valuation of business acquired amortization	<u>(1,739,901)</u>
<b>GAAP net income (loss)</b>	<b><u><u>\$ 2,972,631</u></u></b>

# SENTINEL SECURITY LIFE INSURANCE COMPANY

Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

## 18. STATUTORY ACCOUNTING PRINCIPLES (Continued)

	<b>2016</b>
Statutory capital and surplus as of December 31, prior year	\$ 38,694,947
<b>Adjustments:</b>	
GAAP net (loss) income	2,972,631
Surplus note	(15,000,000)
Other comprehensive income	1,691,921
Asset valuation reserve	3,248,939
Nonadmitted assets	3,358,728
Interest maintenance reserve	963,091
Future policy benefits and policyholder's account balances	(5,977,811)
Dividends	(285,244)
Capital lease obligation	54,779
Allowance for doubtful accounts	(359,512)
Tax provision	(2,136,904)
Acquisition allocation of capital and surplus	19,142,005
Ceding commission allowance reclass	(300,767)
<b>GAAP capital and surplus as of December 31, current year</b>	<b>\$ 46,066,803</b>

## 19. SURPLUS NOTES PAYABLE

During 2014, the Utah Insurance Department approved a contribution (surplus) note between the Company (issuer) and Ability Insurance Company (lender) in the amount of \$15,000,000. The scheduled maturity date of the loan is December 1, 2025. Subject to the approval of the Insurance Commissioner of the State of Utah the Company will pay interest thereon, quarterly, in arrears on March 1, June 1, September 1, and December 1 each year commencing March 1, 2014 at the rate of 7% annum. At December 31, 2016, the Company had accrued \$0 in accrued interest on the surplus note.

Interest payments on the surplus note for the six month period ended December 31, 2016 were as follows:

<u>Date Issued</u>	<u>Interest Rate</u>	<u>Par Value</u>	<u>Carrying Value of Note</u>	<u>Interest and/or Principal Paid During Current Year</u>	<u>Total Interest and/or Principal Paid</u>	<u>Unapproved Interest and/or Principal</u>	<u>Date of Maturity</u>
3/14/2014	7%	\$ 15,000,000	\$ 15,000,000	\$ 525,000	\$ 525,000	\$ -	12/25/2025
<b>Totals</b>		<b>\$ 15,000,000</b>	<b>\$ 15,000,000</b>	<b>\$ 525,000</b>	<b>\$ 525,000</b>	<b>\$ -</b>	

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 20. LEASES

The Company leases four automobiles with minimum lease terms of 6 months each. The lease expense for the automobiles for the period June 30, 2016 through December 31, 2016 was \$16,549.

The Company entered into a sales leaseback transaction on December 31, 2016. The sales price of the leaseback transaction was \$1,500,000. The lease has a 30 month term with a monthly payment of \$58,950. This lease was reported as a capital lease at December 31, 2016 and is included in property and equipment on the balance sheet.

The following is a schedule of future minimum lease payments and the present value of the net minimum lease payments as of December 31, 2016.

Total minimum lease payments	\$ 1,061,100
Less amount representing interest	<u>(105,111)</u>
<b>Present value of net minimum lease payments</b>	955,989
Less current portion	<u>(615,772)</u>
<b>Total</b>	<u><u>\$ 340,217</u></u>

Future maturities of capital lease obligations are as follows:

#### Year ending December 31:

2017	\$ 615,772
2018	<u>340,216</u>
	<u><u>\$ 955,989</u></u>

### 21. RELATED PARTIES

The Company owned a 75% interest in Secure Marketing Partners, LLC (SMP) and a 100% interest in Secure Administrative Solutions, LLC (SAS). Prior to the disposal of SAS and SMP in the form of a dividend, as described below, SAS and SMP were consolidated with the Company for financial reporting purposes. The Company had a shared services agreement with its affiliates where SMP and SAS reimbursed the Company on a monthly basis for rent, services, and salaries.

Beginning January 5, 2015, SAS began providing third party administrative (TPA) services to the Company in the form of new business processing, underwriting, billing and collection of premiums, commission payments to agents, and claims processing.

During 2016, the Company contributed to SAS amounts totaling \$1,450,000. Included in this was a noncash contribution of payables due to the Company being converted to contributed capital in the amounts of \$1,450,000.

# SENTINEL SECURITY LIFE INSURANCE COMPANY

## Notes to Financial Statements

For the Period June 30, 2016 (Acquisition Date) through December 31, 2016

### 21. RELATED PARTIES (Continued)

As of December 31, 2016 SMP owed the Company \$719,375 for the shared services.

As of December 31, 2016, SAS owed the Company \$992,346, for the shared serves. As of December 31, 2016, the Company owed SAS \$358,099 for the TPA services performed during the year.

On December 28, 2016 the Utah Department of Insurance Commissioner approved a two hundred eight five thousand two hundred and forty four dollar (\$285,244) extra ordinary dividend by the Company to its shareholder and parent company, Advantage West, LLC. This extraordinary payment was made by transferring two subsidiaries, Secure Administrative Solutions, LLC and Secure Marketing Partners, LLC at equity value. This transaction was completed as of September 30, 2016.

As of December 31, 2016, Secure Financial Solutions, LLC, a wholly owned subsidiary of SMP, owed the Company \$1,491,421 for expenses paid by the Company on behalf of Secure Financial Solution, LLC.

As of December 31, 2016, Advantage Capital Holdings, LLC, a related party affiliate, owed the Company \$97,785.

For the year ended December 31, 2016, the Company paid \$1,334,591 in management fees to Ad West. No amounts were due to Ad West at year end.

### 22. SUBSEQUENT EVENTS

On March 27, 2017, the Utah Insurance Department approved a contribution (surplus) note between the Company (issuer) and Bankers Life Insurance Company (lender) in the amount of \$15,000,000. The scheduled maturity date of the loan is December 31, 2031. Subject to the approval of the Insurance Commissioner of the State of Utah, the Company will pay interest thereon, quarterly, in arrears on March 1, June 1, September 1, and December 1 each year commencing June 1, 2017 at the rate of 6.5% per annum. The proceeds from this surplus note were used to satisfy the surplus note obligation with Ability Insurance Company as described in Note 19.

On April 3, 2017, the Utah Insurance Department – Captive Division approved the formation of Jazz Re, a wholly owned pure captive insurance company. In April of 2017, the Company funded the captive with the minimal capital requirements as required by the State of Utah. Jazz Re will reinsurer selected blocks of annuities issued by the Company. Through the date of this report the Company has not ceded any selected block of business with Jazz Re.

In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through October 20, 2017, the date the financial statements were available to be issued.