UNION HAMILTON REINSURANCE, LTD.

(A wholly-owned subsidiary of Wells Fargo & Company)

FINANCIAL STATEMENTS

As of December 31, 2018 and 2017,
and for the Years then Ended

(With Independent Auditors' Report Thereon)

KPMG LLP
Duke Energy Center
Suite 3200
550 South Tryon Street
Charlotte, NC 28202-4214

Independent Auditors' Report

The Board of Directors
Union Hamilton Reinsurance, Ltd.:

We have audited the accompanying financial statements of Union Hamilton Reinsurance, Ltd., which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of income, comprehensive income, changes in stockholder's equity, and cash flows for the years then ended, 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 U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 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 auditors' 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 Union Hamilton Reinsurance, Ltd. as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Charlotte, North Carolina
May 7, 2019

UNION HAMILTON REINSURANCE, LTD.

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BALANCE SHEETS

December 31, 2018 and 2017

($ in thousands, except par value and shares)		**2018**		2017
ASSETS				
Cash and cash equivalents	**$**	**84,239**	$	116,257
Total cash, cash equivalents, and restricted cash (1)		**84,239**		116,257
Debt securities - available-for-sale	**$**	**2,631,135**	$	2,551,839
Reinsurance fee receivable		**13,950**		13,579
Reinsurance premiums receivable		**83,569**		84,357
Value of business acquired		**26,755**		29,712
Deferred acquistion costs		**9,462**		9,826
Affiliate receivable		**12,800**		1,269
Investment income due and accrued		**20,748**		14,046
Fair value hedges		—		35
Income taxes receivable		**9,653**		—
Receivable for securities		—		3,062
Other receivables		**6,551**		6,548
Total assets	**$**	**2,898,862**	$	2,830,530
LIABILITIES AND STOCKHOLDER'S EQUITY				
Liability for future policy benefits	**$**	**370,032**	$	275,753
Embedded derivative liability		**27,623**		20,831
Interest payable		**329**		427
Affiliate payable		**1,802**		3,066
Accounts payable		**226**		225
Income taxes payable		—		7,808
Deferred tax liabilities, net		**134,143**		149,657
Intercompany debt to parent		**100,140**		245,403
Total liabilities		**634,295**		703,170
Stockholder’s equity:				
Common stock, $1.00 par value; 1,000,000 shares authorized, issued and outstanding		**1,000**		1,000
Paid-in capital		**1,396,656**		1,396,656
Retained earnings		**878,686**		705,567
Accumulated other comprehensive income (loss), net		**(11,775)**		24,137
Total stockholder’s equity		**2,264,567**		2,127,360
Total liabilities and stockholder’s equity	**$**	**2,898,862**	$	2,830,530

(1) Financial information has been revised to reflect the impact of our adoption in first quarter 2018 of ASU 2016-18- Statement of Cash Flows (Topic 230): *Restricted Cash* in which we changed the presentation of our cash and cash equivalents to include both cash and due from banks as well as interest-earning deposits with banks, which are inclusive of any restricted cash. See Note 1 (Summary of Significant Accougint Policies) for more information.

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.

(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF INCOME

Years Ended December 31, 2018 and 2017

($ in thousands)	2018	2017
INCOME		
Net reinsurance premiums earned	**$ 202,104**	$ 217,545
Reinsurance fee income	**60,329**	53,955
Interest income	**88,770**	74,659
Net (loss) gain on embedded derivative	**(7,626)**	27,593
Net gain (loss) on economic hedges	**3,741**	(31,505)
Realized gain on sale of securities, net	**277**	11,745
Other miscellaneous (loss) income	**(21)**	13
Total income	**347,574**	354,005
BENEFITS AND EXPENSES		
Amortization of deferred acquisition costs / value of business acquired	**3,321**	4,464
Change in liability for future policy benefits	**95,688**	113,555
Interest expense	**4,081**	7,846
Affiliate expense	**13,998**	28,592
General expense	**4,887**	5,042
Total benefits and expenses	**121,975**	159,499
Income before income tax expense	**225,599**	194,506
Income tax (benefit) expense	**47,281**	(31,694)
Net income	**$ 178,318**	$ 226,200

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2018 and 2017

($ in thousands)		**2018**		2017
Net income	**$**	**178,318**	$	226,200
Other comprehensive (loss) income, before tax:				
Securities available for sale:				
Net unrealized gains (losses) arising during the period		**(52,316)**		(36)
Reclassification of net (gains) to net income, before tax		**(277)**		(11,745)
Other comprehensive (loss) income, before tax		**(52,039)**		11,781
Income tax (benefit) expense related to other comprehensive income		**(10,928)**		4,123
Other comprehensive (loss) income, net of tax		**(41,111)**		7,658
Total comprehensive income	**$**	**137,207**	$	233,858

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY

December 31, 2018 and 2017

($ in thousands)	Common stock	Paid-in capital	Retained earnings	Accumulated other comprehensive (loss) income, net	Total stockholder's equity
Balance, December 31, 2016	$ 1,000	$ 1,396,656	$ 479,367	$ 16,479	$ 1,893,502
Comprehensive income:					
Net income	—	—	226,200	—	226,200
Unrealized gain on securities, net of reclassification adjustments and deferred income tax expense of $4,123	—	—	—	7,658	7,658
Total comprehensive income					233,858
Balance, December 31, 2017	$ 1,000	$ 1,396,656	$ 705,567	$ 24,137	$ 2,127,360
Adoption of accounting standard related to certain tax effects stranded in accumulated other comprehensive income (loss) (1)	**—**	**—**	**(5,199)**	**5,199**	**—**
Comprehensive income:					
Net income	**—**	**—**	**178,318**	**—**	**178,318**
Unrealized loss on securities, net of reclassification adjustments and deferred income tax benefit of ($10,928)	**—**	**—**	**—**	**(41,111)**	**(41,111)**
Total comprehensive income					**137,207**
Balance, December 31, 2018	**$ 1,000**	**$ 1,396,656**	**$ 878,686**	**$ (11,775)**	**$ 2,264,567**

(1) Represents the reclassification from other comprehensive income to retained earnings as a result of our adoption of ASU 2018-02- *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* in the third quarter of 2018. For additional information, see Note 1.

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.

(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF CASH FLOWS

December 31, 2018 and 2017

($ in thousands)		**2018**		2017
OPERATING ACTIVITIES				
Net income	**$**	**178,318**	$	226,200
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Deferred income taxes		**(4,586)**		(157,622)
Accretion and amortization of securities discounts and premiums, net		**4,063**		8,664
Hedge revaluations		**6,708**		1,983
Realized gain on securities, net of OTTI		**(277)**		(11,745)
Changes in:				
Reinsurance fee receivable		**(371)**		(5,313)
Reinsurance premiums receivable		**788**		(10,720)
Value of business acquired/deferred acquisition costs		**3,321**		4,464
Affiliate receivable		**(11,531)**		8,366
Interest income due and accrued		**(6,702)**		1,723
Fair value hedges		**35**		106,615
Other receivables		**(3)**		(54)
Liability for future policy benefits		**94,279**		133,114
Interest payable		**(98)**		3
Affiliate payable		**(1,264)**		(91,420)
Accounts payable		**1**		(18,673)
Income taxes receivable/payable		**(17,461)**		18,234
Embedded derivative liability		**6,792**		(39,340)
Net cash provided by operating activities		**252,012**		174,479
INVESTING ACTIVITIES				
Proceeds from paydowns of securities		**720,207**		506,205
Purchases of securities - available-for-sale		**(874,061)**		(732,812)
Sale of securities - available-for-sale		**15,087**		205,949
Net cash used in investing activities		**(138,767)**		(20,658)
FINANCING ACTIVITIES				
Payments of Intercompany debt to parent		**(145,263)**		(249,400)
Net cash used in financing activities		**(145,263)**		(249,400)
Net decrease in cash, cash equivalents, and restricted cash		**(32,018)**		(95,579)
Cash, cash equivalents and restricted cash, beginning of year		**116,257**		211,836
Cash, cash equivalents, and restricted cash, end of year	**$**	**84,239**	$	116,257
CASH PAID FOR				
Interest paid on intercompany debt to parent	**$**	**4,024**	$	7,060
Income taxes paid		**69,327**		107,694
CHANGE IN NON CASH ITEMS				
Receivable for securities not settled	**$**	**(3,062)**	$	3,061

See accompanying notes to financial statements.

NOTE 1: GENERAL

Union Hamilton Reinsurance, Ltd. (the Company) was incorporated in Bermuda on December 11, 2000, and is a direct, wholly-owned subsidiary of Wells Fargo & Company (Wells Fargo or Parent), a Delaware Corporation. The Company engages in reinsurance activities. Reinsurance is an arrangement under which an insurance company, the reinsurer, agrees to indemnify another insurance company, the ceding company, for all or a portion of the insurance risks underwritten by the ceding company. The Company has entered into specific transactions that are described further in Note 5 in which it reinsures annuities and certain risks associated with life insurance contracts.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The Company's accounting and reporting policies conform with U.S. generally accepted accounting principles (GAAP). To prepare the financial statements in conformity with GAAP, management must make estimates based on assumptions about future economic and market conditions that affect the reported amounts of assets and liabilities at the date of the financial statements and income and expenses during the reporting period and the related disclosures. Although the Company's estimates contemplate current conditions and how we expect them to change in the future, it is reasonably possible that actual conditions could be better or worse than anticipated in those estimates, which could materially affect results of operations and financial condition.

All dollar amounts except per share amounts on the financial statements and tables are presented in thousands. All dollar amounts in the notes are presented in whole dollars, unless otherwise stated. Due to rounding to thousands, there can be slight differences between values on the financial statements and tables when compared to the notes.

DEBT SECURITIES

Debt securities that the Company might not hold until maturity and are classified as available-for-sale securities and reported at fair value. Unrealized gains and losses, after applicable income taxes, are reported in accumulated other comprehensive income (OCI).

The Company conducts other-than-temporary impairment (OTTI) analysis on a quarterly basis or more often if a potential loss-triggering event occurs. The initial indicator of OTTI for both debt and equity securities is a decline in fair value below the amount recorded for an investment and the severity and duration of the decline.

For a debt security for which there has been a decline in the fair value below amortized cost basis, the Company recognizes OTTI if (1) there is intent to sell the security, (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis, or (3) the Company does not expect to recover the entire amortized cost basis of the security.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Estimating recovery of the amortized cost basis of a debt security is based upon an assessment of the cash flows expected to be collected. If the present value of cash flows expected to be collected, discounted at the security's effective yield, is less than amortized cost, OTTI is considered to have occurred. In performing an assessment of the cash flows expected to be collected, the Company considers all relevant information including:

- the length of time and the extent to which the fair value has been less than the amortized cost basis;
- the historical and implied volatility of the fair value of the security;
- the cause of the price decline, such as the general level of interest rates or adverse conditions specifically related to the security, an industry or a geographic area;
- the issuer's financial condition, near-term prospects and ability to service the debt;
- the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future;
- for asset-backed securities, the credit performance of the underlying collateral, including delinquency rates, level of non-performing assets, cumulative losses to date, collateral value and the remaining credit enhancement compared with expected credit losses;
- any change in rating agencies' credit ratings at evaluation date from acquisition date and any likely imminent action;
- independent analyst reports and forecasts, sector credit ratings and other independent market data; and
- recoveries or additional declines in fair value subsequent to the balance sheet date.

If the Company intends to sell the security, or if it is more likely than not the Company will be required to sell the security before recovery of amortized cost basis, an OTTI write-down is recognized in earnings equal to the entire difference between the amortized cost basis and fair value of the security. For debt securities that are considered other-than-temporarily impaired that the Company does not intend to sell or it is more likely than not that the Company will not be required to sell before recovery, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to all other factors, which is recognized in OCI. The measurement of the credit loss component is equal to the difference between the debt security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of expected future cash flows is due to factors that are not credit-related and, therefore, is recognized in OCI. The Company believes that we will fully collect the carrying value of securities on which we have recorded a non-credit-related impairment in OCI.

The Company recognizes realized gains and losses on the sale of investment securities in noninterest income using the specific identification method.

Unamortized premiums and discounts are recognized in interest income over the contractual life of the security using the interest method. As principal repayments are received on securities (i.e., primarily mortgage-backed securities (MBS)) a proportionate amount of the related premium or discount is recognized in income so that the effective interest rate on the remaining portion of the security continues unchanged.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

CASH AND CASH EQUIVALENTS

Cash and cash equivalents may include cash on deposit, money market funds and certificates of deposit with maturities of less than 90 days from acquisition (see Note 3).

DEFERRED ACQUISITION COSTS AND VALUE OF BUSINESS ACQUIRED

The Company incurs significant costs in connection with acquiring new reinsurance business. The Company records the reimbursement of first year acquisition costs as deferred acquisition costs (DAC).

DAC consists of ceding commissions and other acquisition expenses that are amortized using the effective interest method. DAC is regularly reviewed to determine if it is recoverable from future premium income, including investment income, by evaluating whether or not a loss is probable on the unexpired portion of policies in force. A premium deficiency loss is recognized when it is probable that expected future claims will exceed anticipated future premiums and anticipated investment income.

The value of business acquired (VOBA) is the intangible asset representing the fair value assigned to annuity reinsurance contracts inforce at the time of a business combination. VOBA is amortized over the expected life of the contracts using the effective interest method. The carrying value is reviewed at least annually for possible impairment in value (see Note 6).

DERIVATIVES

Economic hedge assets and liabilities include derivatives such as equity futures, equity options, and interest rate swaps. These economic hedges are recorded at fair value in economic hedges - assets and liabilities on the balance sheets with realized and unrealized gains and losses recorded in net gain (loss) on economic hedges in the statements of income. The fair value of derivatives in a gain position is reported as economic hedge assets and the fair value of derivatives in a loss position is reported as economic hedge liabilities (see Notes 7 and 8).

HEDGING ACTIVITIES

The Company uses derivatives to hedge interest rate risk and recognizes all derivatives on the balance sheet at fair value. On the date the Company enters into a derivative contract, the Company designates the derivative as (1) qualifying for hedge accounting in a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment (“fair value hedge”), or (2) held for customer accommodation trading or asset/liability risk management or other purposes, including economic hedges not qualifying for hedge accounting. For derivatives not designated as a fair value or cash flow hedge, the Company reports changes in the fair values in current period noninterest income.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

For fair value hedges qualifying for hedge accounting, the Company formally documents at inception the relationship between hedging instruments and hedged items, the Company's risk management objective, strategy and the Company's evaluation of effectiveness for the Company's hedge transactions. This process includes linking all derivatives designated as fair value to specific assets and liabilities on the balance sheet or to specific forecasted transactions. The Company assesses hedge effectiveness using regression analysis, both at inception of the hedging relationship and on an ongoing basis. For fair value hedges, the regression analysis involves regressing the periodic change in fair value of the hedging instrument against the periodic changes in fair value of the asset or liability being hedged due to changes in the hedged risk(s). The assessment for fair value hedges includes an evaluation of the quantitative measures of the regression results used to validate the conclusion of high effectiveness. Periodically, as required, the Company also formally assesses whether the derivative the Company designated in each hedging relationship is expected to be and has been highly effective in offsetting changes in fair values of the hedged item using the regression analysis method.

For a fair value hedge, the Company records changes in the fair value of the derivative and the hedged asset or liability due to the hedged risk in current period net income, except for certain derivatives in which a portion is recorded to OCI. The Company presents derivative gains or losses in the same income statement category as the hedged asset or liability. For fair value hedges of interest rate risk, amounts are reflected in net interest income.

The Company discontinues hedge accounting prospectively when (1) a derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item, (2) a derivative expires or is sold, terminated or exercised, or (3) the Company elects to discontinue the designation of a derivative as a hedge. When the Company discontinues fair value hedge accounting, the Company no longer adjusts the previously hedged asset or liability for changes in fair value, and remaining cumulative adjustments to the hedged item are accounted for in the same manner as other components of the carrying amount of the asset or liability. If the derivative continues to be held after fair value hedge accounting ceases, the Company carries the derivative on the balance sheet at its fair value with changes in fair value included in noninterest income (see Notes 7 & 8).

EMBEDDED DERIVATIVE LIABILITIES

The Company reinsures certain annuity products that contain contract riders that are deemed to be embedded derivatives, specifically, variable annuities with guaranteed minimum benefits. The Company assesses each identified embedded derivative and bifurcates it from the host contract as required under Derivatives and Hedging (Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815). Such embedded derivatives are carried on the balance sheets at fair value and included in embedded derivative liabilities. Changes in the fair value of embedded derivatives are recorded in net gain on embedded derivatives in the statements of income. The Company's hedging strategy is designed to mitigate the volatility associated with its reinsurance of variable annuities with guaranteed minimum benefits. The strategy is designed so that the fair value of the hedge contracts, primarily equity

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

options, equity futures and interest rate swaps, economically offsets changes in the fair value of the embedded derivatives (see Notes 7 and 8).

COUNTERPARTY CREDIT RISK AND NETTING

By using derivatives, the Company is exposed to counterparty credit risk, which is the risk that counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, our counterparty credit risk is equal to the amount reported as a derivative asset on our balance sheet. The amounts reported as a derivative asset are derivative contracts in a gain position, and to the extent subject to legally enforceable master netting arrangements, net of derivatives in a loss position with the same counterparty and cash collateral received. The Company minimizes counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to derivatives is considered in determining fair value and the Company's assessment of hedge effectiveness. Consistent with the Parent company's counterparty netting policy, the Company received approval from internal legal counsel in 2017 that the netting provision of the master netting agreement between Wells Fargo Bank, N.A. and the Company was valid and binding. To the extent derivatives subject to master netting arrangements meet the applicable requirements, including determining the legal enforceability of the arrangement, it is the Company's policy to present derivative balances and related cash collateral amounts net on the balance sheet. For additional information on our derivatives and hedging activities, see Notes 7 & 8.

REINSURANCE

The Company enters into reinsurance agreements with direct underwriters for surplus relief and stop loss reinsurance, as well as variable annuity agreements. Reinsurance premiums and reserves related to reinsured business are accounted for on a basis consistent with that used in accounting for the original policies issued and the terms of the reinsurance contracts. The retroceding of insurance does not discharge the Company from its responsibility to the reinsured. See Note 5 for further discussion.

ADOPTED ACCOUNTING STANDARDS

ASU 2014-09 modifies the guidance used to recognize revenue from contracts with customers for transfers of goods or services and transfers of non-financial assets, unless those contracts are within the scope of other guidance. Insurance contracts within the scope of Topic 944: *Financial Services- Insurance* are excluded from Topic 606: *Revenue from Contracts with Customers* and thus has no impact on the Company.

ASU 2016-18 – Statement of Cash Flows (Topic 230): Restricted Cash. The Update requires restricted cash and cash equivalents to be included with the total cash and cash equivalents in the statement of cash flows. In addition, the nature of any restrictions is disclosed in the footnotes to the financial statements. The Company adopted the guidance in first quarter 2018 with retrospective application. The Company changed the presentation of cash and cash equivalents on the statement of cash flows to include both cash and due

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

from banks as well as interest-earning deposits with banks, which are inclusive of any restricted cash. The Company also made a corresponding change to the balance sheet. The Company has no restricted cash.

ASU 2018-02 – Income Statement-Reporting Comprehensive Income (Topic 220): *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The Update permits a one-time reclassification from accumulated other comprehensive income to retained earnings for these stranded tax effects resulting from the Tax Cuts and Jobs Act. In 2018, the Company reclassified $5,198,838 resulting in an increase in accumulated other comprehensive income and a decrease in retained earnings. The Company has finalized the provisional tax estimates based on the completion of the US tax filings in the fourth quarter of 2018.

CURRENT ACCOUNTING DEVELOPMENTS – ISSUED STANDARDS

ASU 2018-16 – Derivatives and Hedging (Topic 815): *Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*. The update expands the list of U.S. benchmark interest rates permitted in the application of hedge accounting. The Update adds the OIS rate based on SOFR as a U.S. benchmark interest rate to facilitate the LIBOR to SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. The Company adopted the guidance in first quarter 2019. The adoption did not impact existing hedges, but may impact new hedge relationships if the Company designates the SOFR OIS rate as the designated hedged benchmark interest rate for the Company's fixed-rate financial instruments.

ASU 2018-12– Financial Services – Insurance (Topic 944): *Targeted Improvements to the Accounting for Long-Duration Contracts.* The Update requires all features in long-duration insurance contracts that meet the definition of a market risk benefit to be measured at fair value through earnings with changes in fair value attributable to the Company's own credit risk recognized in other comprehensive income. Currently, two measurement models exist for these features, fair value and insurance accrual. The Update requires the use of a standardized discount rate and routine updates for insurance assumptions used in valuing the liability for future policy benefits for traditional long-duration contracts. The Update also simplifies the amortization of deferred acquisition costs. The guidance becomes effective on January 1, 2021. Certain of the Company's variable annuity reinsurance products meet the definition of market risk benefits and will be measured at fair value as of the earliest period presented. The cumulative effect of changes attributable to the market risk benefit of the liability's instrument-specific credit risk (i.e., the Company's own credit risk) will be recognized in the beginning balance of accumulated other comprehensive income. The cumulative effect of the difference between fair value and carrying value, excluding the effect of the Company's own credit, will be recognized in the opening balance of retained earnings. Changes to the liability for future policy benefits for traditional long-duration contracts and deferred acquisition costs will be applied to all outstanding contracts on the basis of their existing carrying amounts at the beginning of the earliest period presented. The impact of the Update on the Company's financial statements is still being evaluated.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU – 2017-08 – Receivables – Nonrefundable fees and Other Costs (Subtopic 310-20): *Premium Amortization on Purchased Callable Debt Securities.* The Update changes the accounting for certain purchased callable debt securities held at a premium to shorten the amortization period for the premium to the earliest call date rather than to the maturity date. Accounting for purchased callable debt securities held at a discount does not change. The discount would continue to amortize to the maturity date. The Company adopted the guidance in first quarter 2019 and recorded a cumulative-effect adjustment as of January 1, 2019, that reduced retained earnings by $17,722 and increased other comprehensive income by $17,722. In future periods, interest income recognized prior to the call date will be reduced because the premium will be amortized over a shorter time period.

ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): *Measurement of Credit Losses on Financial Instruments.* The Update changes the accounting for credit losses on debt securities and reinsurance receivables. The Update modifies the other-than-temporary impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. The guidance is effective in first quarter 2020 with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. The Company is evaluating the impact of the Update on the Company's financial statements. The Company expects the Update will result in the addition of an allowance for debt securities. The amount of the allowance for credit losses will be impacted by the portfolio composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

SUBSEQUENT EVENTS

We have evaluated the effects of subsequent events that have occurred subsequent to the period end December 31, 2018, and through May 7, 2019 which is the date we issued our financial statements.

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE

The following table provides the amortized cost and fair value by major categories of available-for-sale securities at December 31, 2018 and 2017.

($ in thousands)		Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2018:					
Securities of U.S. Treasury and federal agencies	**$**	**9,933**	**-**	**(223) $**	**9,710**
Federal agency mortgage-backed securities		**593,489**	**516**	**(15,460)**	**578,545**
Commercial mortgage-backed securities		**99,753**	**-**	**(1,069)**	**98,684**
Collateralized debt obligations		**1,313,915**	**143**	**(14,903)**	**1,299,155**
Corporate debt securities		**606,618**	**16,662**	**(968)**	**622,312**
Other debt securities		**22,332**	**427**	**(30)**	**22,729**
Total debt securities		**2,646,040**	**17,748**	**(32,653)**	**2,631,135**
December 31, 2017:					
Securities of U.S. Treasury and federal agencies	$	9,926 $	- $	(57) $	9,869
Federal agency mortgage-backed securities		675,570	1,841	(5,075)	672,336
Commercial mortgage-backed securities		92,772	16	-	92,788
Residential mortgage-backed securities		97,990	1,053	-	99,043
Collateralized debt obligations		945,296	3,776	(198)	948,874
Corporate debt securities		649,054	36,133	(894)	684,293
Other debt securities		44,096	552	(12)	44,636
Total debt securities		2,514,704	43,371	(6,236)	2,551,839

(Continued)

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

Gross Unrealized Losses and Fair Value

The following table shows the gross unrealized losses and fair value of securities in the available-for-sale securities portfolio by length of time that individual securities in each category had been in a continuous loss position.

	Less than 12 months		12 months or more		Total	
($ in thousands)	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
December 31, 2018:						
Securities of U.S. Treasury and federal agencies	**$ -**	**-**	**(223)**	**9,710**	**$ (223)**	**$ 9,710**
Federal agency mortgage-backed securities	**-**	**-**	**(15,460)**	**565,263**	**(15,460)**	**565,263**
Commercial mortgage-backed securities	**(1,069)**	**98,684**	**-**	**-**	**(1,069)**	**98,684**
Collateralized debt obligations	**(14,903)**	**1,090,385**	**-**	**-**	**(14,903)**	**1,090,385**
Corporate debt securities	**(791)**	**67,204**	**(177)**	**6,545**	**(968)**	**73,749**
Other debt securities	**-**	**-**	**(30)**	**2,774**	**(30)**	**2,774**
Total debt securities	**(16,763)**	**1,256,273**	**(15,890)**	**584,292**	**(32,653)**	**1,840,565**
December 31, 2017:						
Securities of U.S. Treasury and federal agencies	$ (57)	$ 9,869	$ -	$ -	$ (57)	$ 9,869
Federal agency mortgage-backed securities	(1,207)	209,651	(3,868)	218,973	(5,075)	428,624
Collateralized debt obligations	(198)	105,061	-	-	(198)	105,061
Corporate debt securities	(106)	12,744	(788)	19,073	(894)	31,817
Other debt securities	(12)	3,421	-	-	(12)	3,421
Total debt securities	(1,580)	340,746	(4,656)	238,046	(6,236)	578,792

The Company does not have the intent to sell any securities included in the previous table. For debt securities included in the table, it has been concluded it is more likely than not that the Company will not be required to sell prior to recovery of the amortized cost basis. The Company has assessed each security with gross unrealized losses for credit impairment. For debt securities, the Company evaluates, where necessary, whether credit impairment exists by comparing the present value of the expected cash flows to the securities' amortized cost basis.

See Note 2 – ‘Investment Securities' for the factors that the Company considers in its analysis of OTTI for debt and equity securities.

(Continued)

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

SECURITIES OF U.S. TREASURY AND FEDERAL AGENCIES AND FEDERAL AGENCY MORTGAGE-BACKED SECURITIES (MBS) The unrealized losses associated with U.S. Treasury and federal agency securities and federal agency MBS are generally driven by changes in interest rates and not due to credit losses given the explicit or implicit guarantees provided by the U.S. government.

COMMERCIAL MBS The unrealized losses associated with commercial MBS are generally driven by changes in projected collateral losses, credit spreads and interest rates. The Company assesses for credit impairment by estimating the present value of expected cash flows. The key assumptions for determining expected cash flows include default rates, loss severities and/or prepayment rates. The Company estimates security losses by forecasting the underlying mortgage loans in each transaction. The Company uses forecasted loan performance to project cash flows to the various tranches in the structure. The Company also considers cash flow forecasts and, as applicable, independent industry analyst reports and forecasts, sector credit ratings, and other independent market data. Based upon the Company's assessment of the expected credit losses and the credit enhancement level of the securities, the Company expects to recover the entire amortized cost basis of these securities.

COLLATERALIZED DEBT OBLIGATIONS The unrealized losses associated with collateralized loan and other debt obligations relate to securities predominantly backed by commercial collateral. The unrealized losses are typically driven by changes in projected collateral losses, credit spreads and interest rates. The Company assesses for credit impairment by estimating the present value of expected cash flows. The key assumptions for determining expected cash flows include default rates, loss severities and prepayment rates. The Company also considers cash flow forecasts and, as applicable, independent industry analyst reports and forecasts, sector credit ratings, and other independent market data. Based upon the Company's assessment of the expected credit losses and the credit enhancement level of the securities, the Company expects to recover the entire amortized cost basis of these securities.

CORPORATE DEBT SECURITIES The unrealized losses associated with corporate debt securities are predominantly related to unsecured debt obligations issued by various corporations. The Company evaluates the financial performance of each issuer on a quarterly basis to determine if the issuer can make all contractual principal and interest payments. Based upon this assessment, the Company expects to recover the entire amortized cost basis of these securities.

OTHER DEBT SECURITIES The unrealized losses associated with other debt securities predominantly relate to other asset-backed securities. The losses are usually driven by changes in projected collateral losses, credit spreads and interest rates. The Company assesses for credit impairment by estimating the present value of expected cash flows. The key assumptions for determining expected cash flows include default rates, loss severities and prepayment rates. Based upon the Company's assessment of the expected credit losses and the credit enhancement level of the securities, the Company expects to recover the entire amortized cost basis of these securities.

(Continued)

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

The following table shows remaining weighted average life maturities of securities available-for-sale, at fair value at December 31, 2018 and 2017. Weighted average life is the weighted average number of years an investment is expected to remain outstanding, based on its expected cash flows reflecting the estimated date the issuer will call or extend the maturity of the instrument or otherwise reflecting an estimate of the timing of an instrument's cash flows whose timing is not contractually fixed.

($ in thousands)	Less than one year	One year to five years	Five years to ten years	More than ten years	Total
December 31, 2018:					
Securities of U.S. Treasury and federal agencies	**$ -**	**-**	**9,710**	**-**	**$ 9,710**
Federal agency mortgage-backed securities	**-**	**199,253**	**379,292**	**-**	**578,545**
Commercial mortgage-backed securities	**84,086**	**-**	**14,598**	**-**	**98,684**
Collateralized debt obligations	**71,922**	**675,984**	**551,249**	**-**	**1,299,155**
Corporate debt securities	**43,546**	**288,892**	**211,374**	**78,500**	**622,312**
Other debt securities	**2,774**	**9,846**	**-**	**10,109**	**22,729**
Total debt securities	**202,328**	**1,173,975**	**1,166,223**	**88,609**	**2,631,135**
December 31, 2017:					
Securities of U.S. Treasury and federal agencies	$ -	$ -	$ 9,869	$ -	$ 9,869
Federal agency mortgage-backed securities	577	242,920	428,839	-	672,336
Commercial mortgage-backed securities	-	92,788	-	-	92,788
Residential mortgage-backed securities	99,043	-	-	-	99,043
Collateralized debt obligations	50,690	706,007	192,177	-	948,874
Corporate debt securities	-	232,297	347,045	104,951	684,293
Other debt securities	-	32,944	11,692	-	44,636
Total debt securities	150,310	1,306,956	989,622	104,951	2,551,839

(Continued)

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

Realized Gains and Losses

The following table shows the gross realized gains and losses on sales and OTTI write-downs related to the available-for-sale securities portfolio for the years ended December 31, 2018 and 2017. The Company has reviewed these securities in accordance with its accounting policy for OTTI, which is discussed in Note 2.

($ in thousands)		**2018**		2017
Gross realized gains	**$**	**281**	$	11,745
Gross realized losses		**(4)**		-
OTTI write-downs		**-**		-
Net realized gain from securities available-for-sale	**$**	**277**	$	11,745

Pursuant to the reinsurance agreements between the Company and the direct insurers, the Company is required to maintain trust accounts to protect the interests of such direct insurers. At December 31, 2018, the Company held cash and cash equivalents and investment securities in individual trust accounts in the amount of $2,060,311,377 which consisted of an amortized cost of $73,755,196 in cash and cash equivalents and $1,986,556,181 in securities available-for-sale.

At December 31, 2017, the Company held cash and cash equivalents and investment securities in individual trust accounts in the amount of $2,163,508,848, which consisted of an amortized cost of $111,311,338 in cash and cash equivalents and $2,052,197,510 in securities available-for-sale.

NOTE 4: AFFILIATED PARTY TRANSACTIONS

Due to the nature of common ownership of the Company and its affiliated parties, the following transactions could differ from those conducted with unaffiliated parties.

At December 31, 2018 and 2017, the inter-company debt to Parent was $100,140,419 and $245,402,912, respectively. The Company pays interest on the balance at the end of every month. For December 31, 2018, the basis for the rate was actual/365 using a one-calendar-month average of 3-month LIBOR plus 44.8 basis points or 3.24%. For January through June 2017, the basis for the rate was actual/365 using a one-calendar-month average of 1-month LIBOR plus 120 basis points and for July through December 2017, the basis rate was actual/365 using a one-calandar-month average of 3-month LIBOR plus 44.8 basis points, or 2.06% at December 31, 2017. The statements of income for 2018 and 2017 included $4,024,593 and $7,060,087, respectively, in interest expense associated with this note.

(Continued)

NOTE 4: AFFILIATED PARTY TRANSACTIONS (continued)

The Company regularly places trades for equity options and interest rate swaps with the Wholesale division (Wholesale) of Wells Fargo. The trades are priced in accordance with standard industry practices. The Company holds cash collateral in support of these trading positions, recorded in affiliate payable on the balance sheets of $44,800,000 and $74,620,000 as of December 31, 2018 and 2017, respectively. It is the Company's policy to present derivative balances and related cash collateral amounts net on the balance sheet when the master netting arrangements meet the applicable requirements. See Note 2. The Company pays interest on the outstanding balance at the end of every month based on the Fed Funds rate (2.40% as of December 31, 2018 and 1.33% as of December 31, 2017). The Company incurred interest expense of $56,238 and $315,293 in 2018 and 2017, respectively.

The Company uses Wells Fargo Securities (WFS), which is a subdivision of Wholesale, for its equity futures transactions. WFS acts as a broker for these transactions, however, the margin balance is recorded in affiliate receivable on the balance sheets. The balance as of December 31, 2018 and 2017 is $12,522,409 and $1,268,816, respectively. The Company pays WFS broker fees for their services. As of December 31, 2018 and 2017, broker fees of $0 and $4,697, respectively, were included in affiliate expense in the statements of income. The affiliate receivable also includes outstanding transactions with Wholesale related to the equity options and interest rate swaps. As of December 31, 2018 and 2017, there were no outstanding transactions.

The Company purchases derivatives to manage exposure to market risk, including interest rate risk and credit risk. The counterparties on these derivatives are affiliates of the Company. The Company has entered into agreements that allow netting of derivative asset and liability balances, including related cash collateral adjustments. For more information on these transactions, see Note 7.

The Company is subject to pay affiliated entities for services provided to it. In both 2018 and 2017, the Company paid Wells Fargo Bank, N.A. (WFB) $250,000, which is included in affiliate expense in the statements of income. The Company also pays Wells Fargo Treasury (Treasury) management fees related to the operating bank account. In 2018 and 2017 the Company paid Treasury $3,671 and $4,043, respectively, which is included in affiliate expense in the statements of income.

The Company has a service level agreement with Wells Fargo Wealth Brokerage Insurance Agency, LLC (WFWBIA), Wells Fargo Bank N.A. (WFB), and starting in April 2017, Wells Fargo Insurance, Inc. (WFII). Under this agreement, the Company is obligated to pay WFWBIA, WFB, and WFII for direct expenses, primarily personnel and outside professional service expenses, and indirect expenses, primarily allocated corporate support function expenses. For the years ended December 31, 2018 and 2017, $9,826,741 and $26,824,622, respectively, were included in affiliate expense in the statements of income related to this agreement. The Company has no employees. The company incurred interest expense of $0 in 2018 and $470,390 in 2017 related to these services.

(Continued)

NOTE 4: AFFILIATED PARTY TRANSACTIONS (continued)

The Company is charged under an expense sharing arrangement fees or expense allocations by various affiliate service providers which represent reimbursement for direct cost and general overhead costs incurred by the affiliate for support services to the Company. Services under these arrangements include information technology systems, support and development; operations support; and general and administrative support services. Allocation methodologies are customized by the type of product line being supported. Fees charged were $3,917,564 and $1,508,063, respectively, for the year ended December 31, 2018 and 2017.

On April 1, 2017, CGT Insurance Company, Ltd (an affiliate) novated a reinsurance agreement with Ohio National Life Insurance Company. The Company received $29,803,656 for the assumption of reserves under the term of this agreement. The agreement was completed due to the impending liquidation of CGT Insurance Company, Ltd.

The Company purchases securities from affiliates.

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NOTE 5: REINSURANCE

SURPLUS RELIEF AGREEMENTS

The Company enters into surplus relief reinsurance transactions with U.S. domiciled direct underwriting and reinsurance carriers. The types of business assumed generally consist of level premium term and yearly renewable term life insurance. Since the Company is not a U.S. authorized reinsurance carrier, the Company must provide collateral for reserve credits taken by the ceding companies by placing assets in trust accounts. The Company continues to own and consolidate its share of the trusts' invested assets on the accompanying balance sheets and recognizes gains or losses on the assets. As a result of providing the collateral needed to support the reserve credit, the Company earned reinsurance fee income of $18,797,560 and $18,487,431 in 2018 and 2017, respectively.

Commitments and assets held in trust under the surplus relief deals outstanding at December 31, 2018 and 2017 are presented in the table below.

($ in thousands)	**2018**	2017
Maximum potential reserve credit	**$ 1,840,000**	$ 1,815,000
Outstanding reserve credit	**1,591,060**	1,577,312
Associated assets held in trust (amortized cost)	**1,652,899**	1,647,351

In 2013, the Company entered into stop loss reinsurance contracts which are a subset of the surplus relief product. Stop loss reinsurance is based on an attachment point that is generally higher than that of a typical surplus relief structure. Due to the higher attachment point, the Company is required to place fewer assets in trust or none at all. The Company earned reinsurance fee income of $41,532,214 and $35,467,319 in 2018 and 2017, respectively.

(Continued)

NOTE 5: REINSURANCE (continued)

Commitments and assets held in trust under the stop loss contracts outstanding at December 31, 2018 and 2017 are presented in the table below.

($ in thousands)	2018	2017
Maximum potential reserve credit	**$ 8,636,675**	$ 8,590,100
Outstanding reserve credit	**7,806,912**	7,534,766
Associated assets held in trust (amortized cost)	**229**	207,390

The reserve credit for certain contracts are in Eurodollars. The table above reflects appropriate conversion to U.S. dollars as of December 31, 2018 and 2017.

VARIABLE ANNUITY AGREEMENTS

The Company enters into reinsurance contracts with direct underwriters for new business production of variable annuity products. The transactions are coinsurance and modified coinsurance agreements. Certain contracts offer various guaranteed minimum death, withdrawal, income and accumulation benefits. Those benefits are accounted for as derivatives under FASB ASC 815 or as insurance contracts depending on the terms of underlying policies, as discussed below.

Guaranteed minimum benefits often meet the definition of an embedded derivative; however, certain guaranteed minimum benefits settle only upon a single insurable event, such as death (guaranteed minimum death benefits (GMDB)) or living (life contingent portion of guaranteed minimum withdrawal benefits (GMWB)) and as such are accounted for as insurance contracts. For such contracts, the statements of income reflect the current period increase in the liability due to the deferral of a percentage of current period revenues. Claims recorded against the liability have no immediate impact on the statements of income unless those claims exceed the liability. Periodically, the Company unlocks its benefit assumptions, including the benefit deferral rate. The impact of this change is reflected in the change in liability for future policy benefits in the statements of income. The liability related to these benefits was $368,779,663 and $275,837,911 at December 31, 2018 and 2017, respectively, and is included in liability for future policy benefits on the balance sheets.

The Company's guaranteed minimum accumulation benefits, the portion that is not life contingent for GMWB, and the guaranteed minimum income benefits that are embedded derivatives are recorded at fair value with changes in fair value recorded in net gain (loss) on embedded derivatives in the statements of income. The embedded derivative liability balance was $27,623,217 and $20,830,498 at December 31, 2018 and 2017, respectively, and is included in embedded derivative liabilities on the balance sheets.

Changes in capital markets or policyholder behavior may increase or decrease the Company's exposure to benefits under the guarantees. As a result, the Company uses derivative instruments, included in trading account assets and liabilities on the balance sheets, to mitigate some of that exposure. See Note 7 for more information on these derivatives.

(Continued)

NOTE 5: REINSURANCE (continued)

The Company earned reinsurance premiums of $202,104,243 and $217,545,374 in 2018 and 2017, included in net reinsurance premiums earned in the statements of income.

NOTE 6: VALUE OF BUSINESS ACQUIRED / DEFERRED ACQUISITION COSTS

Acquisition costs deferred and amortized in 2018 and 2017 are presented in the table below.

($ in thousands)		DAC Amount		VOBA Amount
Deferred acquisition costs / value of business acquired, December 31, 2016		11,204		32,798
Amortized costs		(1,378)		(3,086)
Deferred acquisition costs / value of business acquired, December 31, 2017	$	9,826	$	29,712
Amortized costs		**(364)**		**(2,957)**
Deferred acquisition costs / value of business acquired, December 31, 2018	**$**	**9,462**	**$**	**26,755**

The outstanding VOBA and DAC are entirely attributable to variable annuity treaties. The VOBA and DAC are expected to be amortized as shown in the table below.

($ in thousands)		DAC Amortization	VOBA Amortization
2019	$	1,044	3,541
2020		985	3,207
2021		916	2,843
2022		876	2,580
2023		1,054	2,964
Greater than 5 years		4,587	11,620

NOTE 7: DERIVATIVES

The Company uses derivatives to manage exposure to market risk, including interest rate risk and credit risk. The Company designates certain derivatives as hedging instruments in a qualifying hedge accounting relationship (fair value hedges). The remaining derivatives consist of economic hedges that do not qualify for hedge accounting.

(Continued)

NOTE 7: DERIVATIVES (continued)

The Company's asset/liability management approach to interest rate and certain other risks includes the use of derivatives. Such derivatives are typically designated as fair value hedges, or economic hedges. The Company uses derivatives to help minimize significant, unplanned fluctuations in earnings, fair values of assets and liabilities, and other market risk volatility. This approach involves modifying the repricing characteristics of certain assets and liabilities so that changes in interest rates and other exposures, which may cause the hedged assets and liabilities to gain or lose fair value, do not have a significantly adverse effect on the net interest margin and earnings. In a fair value or economic hedge, the effect of change in fair value will generally be offset by the unrealized gain or loss on the derivatives linked to the hedged assets and liabilities.

Embedded derivatives that are required to be accounted for separately from their host contracts are included in the customer accommodation trading and other derivatives disclosures as applicable.

The table below presents the total notional or contractual amounts and fair values for the Company's derivatives. Derivative transactions can be measured in terms of the notional amount, but this amount is not recorded on the balance sheet and is not, when viewed in isolation, a meaningful measure of the risk profile of the instruments. The notional amount is generally not exchanged, but is used only as the basis on which interest and other payments are determined.

December 31, 2018 ($ in thousands)	**Notional Amount**	**Assets**	**Liabilities**
Derivatives designated as hedging instruments			
Interest rate swaps	$ 565,110	1,155	$ 6,779
Total derivatives designated as hedging instruments		1,155	6,779
Derivatives not designated as hedging instruments			
Economic hedges:			
Equity options	352,307	19,026	
Interest rate swaps	804,200	37,721	7,888
Equity futures	113,066		
Total derivatives not designated as hedging instruments	-	56,747	7,888
Embedded derivative	-	-	27,623
Total derivatives before netting		57,902	42,290
Netting (1)		(57,902)	(14,667)
Total derivatives		$ -	$ 27,623

(1) Represents balance sheet netting of derivative asset and liablity balances and related cash collateral. See the next table in this note for further information.

(Continued)

NOTE 7: DERIVATIVES (continued)

December 31, 2017 ($ in thousands)		Notional Amount		Assets		Liabilities
Derivatives designated as hedging instruments						
Interest rate swaps	$	555,481	$	18,220	$	-
Total derivatives designated as hedging instruments				18,220		-
Derivatives not designated as hedging instruments						
Economic hedges:						
Equity options		504,464		20,630		4
Interest rate swaps		964,700		44,959		9,150
Equity futures		90,190		-		-
Total derivatives not designated as hedging instruments				65,589		9,154
Embedded derivative				-		20,831
Total derivatives before netting			$	83,809	$	29,985
Netting (1)				(83,774)		(9,154)
Total derivatives			$	35	$	20,831

(1) Represents balance sheet netting of derivative asset and liablity balances and related cash collateral. See the next table in this note for further information.

The next table provides information on the gross fair values of derivative assets and liabilities, the balance sheet netting adjustments and the resulting net fair value amount recorded on the balance sheet, as well as the non-cash collateral associated with such arrangements. The Company executes all derivative transactions under master netting arrangements and reflect all derivative balances and related cash collateral subject to enforceable master netting arrangements on a net basis within the balance sheet. The “Gross amounts recognized” column in the following table includes $57,901,795 and $42,290,223 of gross derivative assets and liabilities, respectively, at December 31, 2018 and, $83,809,134 and $29,984,565 of gross derivative assets and liabilities, respectively, at December 31, 2017, with counterparties subject to enforceable master netting arrangements that are carried on the balance sheet net of offsetting amounts.

The Company determines the balance sheet netting adjustments based on the terms specified within each master netting arrangement. The Company discloses the balance sheet netting amounts within the column titled “Gross amounts offset in balance sheet” in the table below. Balance sheet netting adjustments are determined at the counterparty level for which there may be multiple contract types. For disclosure purposes, the Company allocates these netting adjustments to the contract type for each counterparty proportionally based upon the “Gross amounts recognized” by counterparty. As a result, the net amounts disclosed by contract type may not represent the actual exposure upon settlement of the contracts. .

NOTE 7: DERIVATIVES (continued)

The Company manages derivative exposure by monitoring the credit risk associated with each counterparty using counterparty specific credit risk limits, using master netting arrangements and obtaining collateral. Derivative contracts executed in over-the-counter markets include bilateral contractual arrangements that are not cleared through a central clearing organization but are typically subject to master netting arrangements. The percentage of our bilateral derivative transactions outstanding at period end in such markets, based on gross fair value, is provided within the following table. Other derivative contracts executed in over-the-counter or exchange-traded markets are settled through a central clearing organization and are excluded from this percentage.

($ in thousands)	Gross amounts recognized	Gross amounts offset in balance sheet (1)	Net amounts in balance sheet
December 31, 2018			
Derivative assets			
Interest rate swaps	**38,876**	**(38,876)**	**-**
Equity options	**19,026**	**(19,026)**	**-**
Total derivative assets	**57,902**	**(57,902)**	**-**
Derivative liablities			
Interest rate swaps	**14,667**	**(14,667)**	**-**
Embedded derivative	**27,623**	**-**	**27,623**
Total derivative liabilities	**42,290**	**(14,667)**	**27,623**

(1) Represents amounts with counterparties subject to enforceable master netting arrangements that have been offset on the balance sheet, including related cash collateral of $43,235.

($ in thousands)	Gross amounts recognized	Gross amounts offset in balance sheet (1)	Net amounts in balance sheet
December 31, 2017			
Derivative assets			
Interest rate swaps	63,179	(63,153)	26
Equity options	20,630	(20,621)	9
Total derivative assets	83,809	(83,774)	35
Derivative liablities			
Interest rate swaps	9,150	(9,150)	-
Equity options	4	(4)	-
Embedded derivative	20,831	-	20,831
Total derivative liabilities	29,985	(9,154)	20,831

(1) Represents amounts with counterparties subject to enforceable master netting arrangements that have been offset on the balance sheet, including related cash collateral of $74,620.

(Continued)

NOTE 7: DERIVATIVES (continued)

Fair Value Hedges

The Company uses interest rate swaps to convert certain of our fixed-rate long-term debt to floating rates to hedge our exposure to interest rate risk. In addition, the Company uses interest rate swaps to hedge against changes in fair value of certain investments in available-for-sale debt securities due to changes in interest rates.

The table below shows the net gains (losses) recognized in the statements of income related to derivatives in fair value hedging relationships.

($ in thousands)	**2018**	2017
Total amounts presented in the statement of income	**$ 84,310**	$ 74,659
Gains (losses) on fair value hedging relationships		
Interest Contracts		
Amounts related to interest settlements on derivatives (1)	**(44)**	(2,066)
Recognized on derivatives	**6,258**	597
Recognized on hedged items	**(6,825)**	(2,032)
Net expense recognized on fair value hedges	**$ (611)**	$ (3,501)

(1) Includes changes in fair value due to the passage of time associated with the non-zero fair value amount at hedge inception.

The table below shows the carrying amount and associated cumulative basis adjustment related to the application of hedge accounting that is included in the carrying amount of hedged assets and liabilites in fair value hedging relationships.

	Hedged items currently designated		Hedged items no longer designated (1)	
($ in thousands)	Carrying amount of assets (3)	Hedge accounting basis adjustment assets(liabilities) (2)	Carrying amount of assets (3)	Hedge accounting basis adjustment assets(liabilities) (2)
December 31, 2018				
Investments securities, Available-for sale (4)	**$ 527,597**	**$ 21,914**	**$ 27,053**	**$ 310**

(1) Represents hedged items no longer designated in qualifying fair value hedging relationships for which an associated basis adjustment exists at the balance sheet date.

(2) At December 31, 2018 and 2017, the balance includes $18,265 and $12,109, respectively, of investment securities cumulative basis adjustments on terminated hedges whereby the hedged hedged items have subsequently been re-designated into existing hedges.

(3) Represents the full carrying amount of the hedged asset item as of the balance sheet date, except for circumstances in which only a portion of the asset was designated at the hedged item in which case only the portion designated is presented.

(4) Carrying amount represents the amortized cost.

(Continued)

NOTE 7: DERIVATIVES (continued)

	Hedged items currently designated		Hedged items no longer designated (1)	
($ in thousands)	Carrying amount of assets (3)	Hedge accounting basis adjustment assets(liabilities) (2)	Carrying amount of assets (3)	Hedge accounting basis adjustment assets(liabilities) (2)
December 31, 2017				
Investments securities, Available-for sale (4)	$ 587,041	$ (8,832)	$ 33,909	$ (145)

(1) Represents hedged items no longer designated in qualifying fair value hedging relationships for which an associated basis adjustment exists at the balance sheet date.

(2) At December 31, 2018 and 2017, the balance includes $18,265 and $12,109, respectively, of investment securities cumulative basis adjustments on terminated hedges whereby the hedged hedged items have subsequently been re-designated into existing hedges.

(3) Represents the full carrying amount of the hedged asset item as of the balance sheet date, except for circumstances in which only a portion of the asset was designated at the hedged item in which case only the portion designated is presented.

(4) Carrying amount represents the amortized cost.

The embedded derivatives primarily relate to the Company's reinsurance of variable annuity contracts with guaranteed minimum benefits as described in Note 5. Embedded derivative losses of $7,625,610 and gains of $27,592,695 were reported for 2018 and 2017, respectively. Trading derivative gains of $3,740,704 and losses of $31,505,440 were reported for 2018 and 2017, respectively.

The Company maintains a margin account to support certain activities in the trading accounts above. In 2018 and 2017 the broker was Wells Fargo Securities. A U.S. Treasury Note with a fair value of $9,710,156 and $9,868,750, (included in investment securities on the balance sheet) and a cash deposit of $12,522,409 and $1,268,816 (included in affiliate receivables on the balance sheets) are held by the broker at December 31, 2018 and 2017, respectively, for the benefit of the Company.

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and derivatives are recorded at fair value on a recurring basis.

FAIR VALUE HIERARCHY

The Company groups assets and liabilities measured at fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

(Continued)

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

These levels are:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from techniques that use significant assumptions that are not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

In the determination of the classification of financial instruments in Level 2 or Level 3 of the fair value hierarchy, the Company considers all available information, including observable market data, indications of market liquidity and orderliness, and its understanding of the valuation techniques and significant inputs used. Otherwise, the classification of Level 2 or Level 3 is based upon the specific facts and circumstances of each instrument or instrument category and judgments are made regarding the significance of the Level 3 inputs to the instruments' fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3.

AVAILABLE-FOR-SALE SECURITIES

Available-for-sale securities are recorded at fair value on a recurring basis. Fair value measurement is based upon various sources of market pricing. The Company uses quoted prices in active markets, where available, and classify such instruments within Level 1 of the fair value hierarchy. Examples include some highly liquid government securities, such as U.S. Treasuries. When instruments are traded in secondary markets and quoted market prices do not exist for such securities, the Company generally relies on internal valuation techniques or on prices obtained from vendors (predominantly third-party pricing services), and accordingly, the Company classifies these instruments as Level 2 or 3.

While investment securities traded in secondary markets are typically valued using unadjusted vendor prices or vendor prices adjusted by weighting them with internal discounted cash flow techniques, these prices are reviewed and, if deemed inappropriate by a trader who has the most knowledge of a particular market, can be adjusted. These investment securities, which include those measured using unadjusted vendor prices, are generally classified as Level 2 and typically involve using quoted market prices for the same or similar securities, pricing models, discounted cash flow analyses using significant inputs observable in the market where available or a combination of multiple valuation techniques. Examples include certain residential and commercial MBS, other asset-backed securities, U.S. government and agency MBS, and corporate debt securities.

(Continued)

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

Security fair value measurements using significant inputs that are unobservable in the market due to limited activity or a less liquid market are classified as Level 3 in the fair value hierarchy. Such measurements include securities valued using internal models or a combination of multiple valuation techniques where the unobservable inputs are significant to the overall fair value measurement.

DERIVATIVES

Quoted market prices are available and used for exchange-traded derivatives, such as equity swaps, which the Company classifies as Level 1. However, substantially all of the Company's derivatives are traded in over-the-counter (OTC) markets where quoted market prices are not always readily available. Therefore, the Company values most OTC derivatives using internal valuation techniques. Valuation techniques and inputs to internally-developed models depend on the type of derivative and nature of the underlying rate, price or index upon which the derivative's value is based. Key inputs can include yield curves, credit curves, foreign exchange rates, prepayment rates, volatility measurements and correlation of such inputs. Where model inputs can be observed in a liquid market and the model does not require significant judgment, such derivatives are typically classified as Level 2 of the fair value hierarchy. Examples of derivatives classified as Level 2 include generic interest rate swaps and equity options. When instruments are traded in less liquid markets and significant inputs are unobservable, such derivatives are classified as Level 3. Examples of derivatives classified as Level 3 include embedded derivatives from the variable annuity reinsurance contracts discussed in Note 5. Additionally, significant judgments are required when classifying financial instruments within the fair value hierarchy, particularly between Level 2 and 3, as is the case for certain derivatives.

(Continued)

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

ASSETS AND LIABILITIES RECORDED AT FAIR VALUE ON A RECURRING BASIS

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2018 and 2017, for each of the fair value hierarchy levels.

($ in thousands)

December 31, 2018	Level 1	Level 2	Level 3	Total
Assets				
Securities of U.S. Treasury and federal agencies	$ 9,710	$ -	$ -	$ 9,710
Federal agency mortgage-backed securities	-	578,545	-	578,545
Commercial mortgage-backed securities	-	98,684	-	98,684
Collateralized debt obligations	-	1,299,155	-	1,299,155
Corporate debt securities	-	622,312	-	622,312
Other debt securities	-	22,729	-	22,729
Total debt securities	9,710	2,621,425	-	2,631,135
Equity options	-	19,026	-	19,026
Interest rate swaps	-	38,876	-	38,876
Total derivative assets	-	57,902	-	57,902
Total assets	$ 9,710	$ 2,679,327	$ -	$ 2,689,037
Liabilities				
Interest rate swaps	$ -	$ 14,667	$ -	$ 14,667
Total derivative liabilities	-	14,667	-	14,667
Embedded derivative liabilities	-	-	27,623	27,623
Total liabilities	$ -	$ 14,667	$ 27,623	$ 42,290

(Continued)

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

($ in thousands)

December 31, 2017	Level 1	Level 2	Level 3	Total
Assets				
Securities of U.S. Treasury and federal agencies	$ 9,869	$ -	$ -	$ 9,869
Federal agency mortgage-backed securities	-	672,336	-	672,336
Commercial mortgage-backed securities	-	92,788	-	92,788
Residential mortgage-backed securities	-	99,043	-	99,043
Collateralized debt obligations	-	948,874	-	948,874
Corporate debt securities	-	684,293	-	684,293
Other debt securities	-	44,636	-	44,636
Total debt securities	9,869	2,541,970	-	2,551,839
Equity options	-	20,630	-	20,630
Interest rate swaps	-	63,179	-	63,179
Total derivative assets	-	83,809	-	83,809
Total assets	$ 9,869	$ 2,625,779	$ -	$ 2,635,648
Liabilities				
Equity options	$ -	$ 4	$ -	$ 4
Interest rate swaps	-	9,150	-	9,150
Total derivative liabilities	-	9,154	-	9,154
Embedded derivative liabilities	-	-	20,831	20,831
Total liabilities	$ -	$ 9,154	$ 20,831	$ 29,985

The Company's policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. The Company monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended December 31, 2018 and 2017.

(Continued)

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

Material changes that affect the investment options available to policyholders related to annuity business being reinsured must be communicated by the direct underwriter. The Company may accept or reject any material changes. If the Company rejects any such change, the Company's liability will be determined as if no such change had occurred. However, if the liability is unable to be recalculated excluding any material changes, an alternative settlement can be agreed upon between the Company and the direct underwriter.

The changes in Level 3 liabilities measured at fair value on a recurring basis for the years ended December 31, 2018 and 2017 are summarized in the table below.

($ in thousands)	Balance, beginning of period	Net income	Other compehensive income	Sales	Material change settlement	Balance, end of period	Net unrealized (gains) losses included in income related to assets and liabilities held at period end
December 31, 2018							
Embedded derivative liabilities	**$ (20,831) $**	**(7,626)**	**-**	**-**	**834**	**(27,623)**	**(7,626)**
December 31, 2017							
Embedded derivative liabilities	$ (46,887) $	27,592	-	-	(1,536)	(20,831)	27,592

The embedded derivatives from the variable annuity reinsurance contracts use unobservable inputs to derive the fair value. These inputs include volatility, interest rates, equity markets and actuarial assumptions such as mortality, lapses and other policyholder behavior.

As of December 31, 2018 and 2017, the Company did not have any assets or liabilities that were measured at fair value on a nonrecurring basis. Also, the Company did not elect the Fair Value Option under Financial Instruments (FASB ASC 825).

OTHER

Other assets and liabilities such as receivables and payables are deemed to be a reasonable estimate of fair value due to the short-term nature of these instruments. Certain instruments such as deferred acquisition costs, deferred income taxes and liability for future policy benefits are excluded from the fair value disclosure, and accordingly, the fair value amounts cannot be aggregated to determine the underlying economic value of the Company. The current value approximates fair value due to the intercompany note using libor.

NOTE 9: INCOME TAX EXPENSE

BERMUDA

The Company has received an undertaking from the Minister of Finance in Bermuda that, in the event of any imposition of income taxes, the Company will be exempted from taxation until the year 2035.

UNITED STATES

The Company made an irrevocable election under Section 953(d) of the Internal Revenue Code of 1986, as amended, to treat the Company as a domestic insurance company for U.S. federal income tax purposes. As a result of the “domestic election”, the Company is subject to U.S. taxation on its worldwide income as if it were a U.S. corporation. Beginning in 2014, the Company was included in Wells Fargo’s federal consolidated income tax return, and is subject to the allocation of the tax liability (benefit) of the consolidated group. Deferred income tax assets and liabilities are established for the expected future tax consequences attributable to temporary differences between the financial statement carrying amount and the tax basis of assets and liabilities. Deferred income 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 of a change in income tax rates on deferred income tax assets and liabilities is recognized in income during the period that includes the enactment date.

On December 22, 2017, the Tax Cuts & Jobs Act (Tax Act) was enacted resulting in significant changes to domestic tax law. While many provisions of the law became effective January 1, 2018, we were required to recognize various tax impacts of the Tax Act as of December 31, 2017, in accordance with ASC Topic 740, Income Taxes and SEC Staff Accounting Bulletin 118 (“SAB 118”). Accordingly, our income tax expense for 2017 reflected $99,771,179 estimated tax benefit related to the Tax Act, as a result of re-measuring our deferred taxes for the federal tax rate reduction from 35% to 21%. In accordance with SAB 118, we disclosed the tax reserve transitional adjustment as provisional as of 12/31/2017. SAB 118 allowed for a one year computational period and as of 12/31/2018 we have finalized that provisional amount. We have re-calculated the tax reserve transitional adjustment based on more accurate data and guidance from our original provisional estimate. Our income tax expense for 2018 reflects a tax benefit in the amount of $95,131 as a result of finalization of our 2017 results.

The deferred tax asset amount reported for the transition adjustment related to loss reserves under the Tax Act in the amount of $476,705 was determined on a provisional basis as of 12/31/2017 in accordance with SAB 118. Final tax reserve valuations have been received from third party insurance companies that cede business to the Company and the amount has been calculated and finalized. The Company recorded a transition adjustment of $5.1 million to deferred tax liability related to loss reserves under the Tax Act as of December 31, 2018. There was no impact on the total income tax expense of the finalization of this provisional amount.

(Continued)

NOTE 9: INCOME TAX EXPENSE (continued)

The aggregate amount of income tax expense (benefit) included in the statements of income and in the statements of comprehensive income for each of the years in the two-year period ended December 31, 2018, is presented below.

($ in thousands)		2018		2017
STATEMENTS OF INCOME				
Income tax (benefit) expense	**$**	**47,281**	$	(31,694)
STATEMENTS OF COMPREHENSIVE INCOME				
Income tax (benefit) expense related to unrealized gains on debt securities		**(10,928)**		4,123
Total	**$**	**36,353**	$	(27,571)

Income tax (benefit) expense for 2018 and 2017 is presented below.

($ in thousands)		2018		2017
Current income tax expense	**$**	**52,104**	$	125,928
Deferred income tax (benefit)		**(4,823)**		(157,622)
Total income tax expense (benefit)	**$**	**47,281**	**$**	(31,694)

The tax effects of temporary differences that give rise to significant portions of deferred income tax assets and liabilities at December 31, 2018 and 2017 are presented in the table below.

($ in thousands)		2018		2017
DEFERRED INCOME TAX ASSETS				
Loss reserve discounting	**$**	**26,918**	$	19,514
Loss reserve tax reform transition adjustment		**-**		477
Unrealized losses on securities and foreign currency differences		**3,130**		-
Other		**6,196**		6,801
Deferred income tax assets		**36,244**		26,792
DEFERRED INCOME TAX LIABILITIES				
Unrealized gains on securities and foreign currency differences		**-**		7,798
Loss reserve tax reform transiton adjustment		**5,094**		-
Insurance reserves		**165,104**		168,633
Other		**189**		18
Deferred income tax liabilities		**170,387**		176,449
Net deferred income tax liabilities	**$**	**(134,143)**	$	(149,657)

(Continued)

NOTE 9: INCOME TAX EXPENSE (continued)

A portion of the annual change in the net deferred income tax liability relates to unrealized gains and losses on debt and equity securities available for sale. The related deferred income tax benefit of $10,928,257 in 2018 and deferred income tax expense of $4,123,621 in 2017 have been recorded in stockholder's equity as a component of accumulated other comprehensive income (loss). Accumulated other comprehensive income was not adjusted to reflect the $(5,198,838) tax benefit impact of the Tax Act recognized in 2017 tax expense for the remeasurement of deferred taxes related to items recorded in accumulated other comprehensive income (loss) in accordance with ASC 740. In 2018, we have adopted ASU 2018-02-Income Statement – Reporting Comprehensive Income (Topic 220): *Reclassificaton of Certain Tax effects from Accumulated Other Comprehensive Income.* Accordingly, $5,198,838 has been relassified to retained earnings from OCI.

Management believes that it is more likely than not that the deferred income tax assets will be realized. Accordingly, there were no valuation allowances for deferred income tax assets at December 31, 2018 or 2017.

At December 31, 2018 and 2017 respectively, the Company had no net operating loss carry forwards for federal income tax purposes.

The Company evaluates uncertain tax positions in accordance with FASB ASC 740, *Income* Taxes. Based upon its current evaluation, the Company has recorded reserves for uncertain tax positions of $9,772,991 for the periods ending December 31, 2018 and December 31, 2017. The Company does not expect the position to change significantly in the next twelve months.

The Company recognizes accrued interest and penalties, as appropriate, related to unrecognized income tax benefits in the effective tax rate. The Company recognized no interest in 2018 and 2017 and the balance of accrued interest was $0 at December 31, 2018 and 2017.

Management monitors proposed and issued tax law, regulations and cases to determine the potential impact to uncertain income tax positions. At December 31, 2018, management had not identified any potential subsequent events that would have a material impact on unrecognized income tax benefits within the next twelve months.

The Company is not subject to examinations by the Internal Revenue Service for years prior to 2014.

($ in thousands)

Reconciliation to Statutory Rate:		**2018**			2017	
		Amount	**Percent of pretax income**		Amount	Percent of pretax income
Net income before income tax expense	$	**225,599**		$	194,506	
Tax expense at federal tax rate		**47,376**	**21.00%**		68,077	35.00%
Change in deferred tax due to federal tax rate reduction effective January 1, 2018		**(95)**	**-0.04%**		(99,771)	-51.29%
Total tax (benefit) expense	$	**47,281**	**20.96%**	$	(31,694)	-16.29%

NOTE 10: STATUTORY REQUIREMENTS

The Company is required by its license to maintain capital and surplus greater than a minimum statutory amount determined as the greater of (i) the minimum solvency margin or (ii) the Bermuda Solvency Capital Requirement with respect to its long-term business. At December 31, 2018, the Company is required to maintain a minimum statutory capital and surplus of $61,483k for its long-term business.

Actual statutory capital and surplus, as determined using Bermuda statutory accounting principles, at December 31, 2018 is $2,264,567k.

Accordingly, since there is sufficient statutory capital and surplus available to satisfy minimum requirements, there are no restrictions on dividends available for distribution from retained earnings.

The Company is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets, as defined by Bermuda statutory requirements, is not less than 75 percent of the amount of its relevant liabilities, as defined by Bermuda statutory requirements. Relevant assets include cash and cash equivalents, investment deposits, investment income accrued, due from ceding company, income tax receivable and other assets. Certain categories of assets do not qualify as relevant assets under the statute.

In addition to remaining in compliance with the requirements discussed above, the Company's ability to reduce statutory capital without approval from the Bermuda Supervisor of Insurance is limited to 15 percent of the prior year end's statutory capital.