

**American Life & Security Corp.**

Statutory Financial Statements and  
Supplemental Schedules  
December 31, 2012 and 2011  
(With Independent Auditors' Report Thereon)

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## Independent Auditor's Report

The Board of Directors  
American Life & Security Corp.

### Report on the Financial Statements

We have audited the accompanying statutory financial statements of American Life & Security Corp. (the Company), which comprise the statutory statements of admitted assets, liabilities, and capital stock and surplus of American Life & Security Corp. as of December 31, 2012 and 2011, and the related statutory statements of operations, capital stock and surplus, and cash flows for the years then ended and the related notes to the statutory financial statements.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these statutory financial statements in accordance with the accounting practices prescribed or permitted by the Arizona Department of Insurance; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of statutory 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 statutory 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 statutory financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the statutory financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the statutory 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 statutory 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 statutory financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 2 to the statutory financial statements, American Life & Security Corp. prepared these financial statements using accounting practices prescribed or permitted by the Arizona Department of Insurance, which is a basis of accounting other than accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between these statutory accounting practices and accounting principles generally accepted in the United States of America are material and are disclosed in Note 2.

### **Adverse Opinion on U.S. Generally Accepted Accounting Principles**

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of American Life & Security Corp. as of December 31, 2012 and 2011, or the results of its operations or its cash flows thereof for the years then ended.

### **Opinion on Regulatory Basis of Accounting**

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and surplus of American Life & Security Corp. as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 2.

### **Report on Supplemental Information**

Our audits were conducted for the purpose of forming an opinion on the basic statutory financial statements taken as a whole. The accompanying Summary Investment Schedule as of December 31, 2012 and Supplemental Investment Risks Interrogatories and Selected Financial Data as of December 31, 2012 and for the year then ended (Supplemental Information) are presented for purposes of additional analysis and are not a required part of the basic statutory financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the statutory financial statements. The effects on the Supplemental Information of the variances between the statutory accounting practices and accounting principles generally accepted in the United States of America is material and are described in Note 2. As a consequence, the Supplemental Information do not present fairly, in conformity with accounting principles generally accepted in the United States of America, such information of the Company as of December 31, 2012 and for the year then ended. The Supplemental Information has been subjected to the auditing procedures applied in the audit of the statutory financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the statutory financial statements or to the statutory financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Supplemental Information is fairly stated in all material respects in relation to the statutory financial statements taken as a whole.

*McGladrey LLP*

Omaha, Nebraska  
May 31, 2013

**American Life & Security Corp.**

**Statutory Statements of Admitted Assets, Liabilities, and Capital Stock and Surplus  
December 31, 2012 and 2011**

| <b>Admitted Assets</b>  | <b>2012</b>                 | <b>2011</b>                 |
|---|-----------------------------|-----------------------------|
| Cash and invested assets:   |                             |                             |
| Bonds   | \$ 8,400,541                | \$ 8,273,111                |
| Preferred stock   | 75,000                      | 137,680                     |
| Common stock of affiliates  | 1,588,775                   | 2,079,965                   |
| Common stock of nonaffiliates   | 103,652                     | 113,000                     |
| Mortgage loans on real estate   | 647,139                     | 683,441                     |
| Properties held for the production of income  | 565,889                     | 578,010                     |
| Policy loans  | 274,664                     | 325,138                     |
| Cash  | 914,345                     | 649,506                     |
| Total cash and invested assets  | <u>12,570,005</u>           | 12,839,851                  |
| Interest and dividends due and accrued  | 122,938                     | 143,351                     |
| Premiums and considerations   | 226,664                     | 168,025                     |
| Equipment, net of accumulated depreciation of \$126,725 and<br>\$74,701, respectively           | 111,072                     | 62,347                      |
| Other assets  | 46,333                      | 31,634                      |
| Total admitted assets   | <u><u>\$ 13,077,012</u></u> | <u><u>\$ 13,245,208</u></u> |
| <br><b>Liabilities and Capital Stock and Surplus</b>  |                             |                             |
| Liabilities:  |                             |                             |
| Reserve for life contracts  | \$ 9,759,226                | \$ 8,345,304                |
| Reserve for accident and health contracts   | 18,225                      | 20,338                      |
| Liability for deposit-type contracts  | 455,236                     | 394,043                     |
| Contract claims   | 138,925                     | 112,052                     |
| Accrued expenses and taxes  | 275,920                     | 136,692                     |
| Amounts payable on reinsurance assumed  | 113,696                     | 67,498                      |
| Advance premiums and amounts held or due agents   | 8,250                       | 41,650                      |
| Interest maintenance reserve  | 211,156                     | 62,290                      |
| Remittances and items not allocated   | 45,357                      | 79,035                      |
| Asset valuation reserve   | 69,408                      | 55,409                      |
| Payable to parent company   | -                           | 159,916                     |
| Total liabilities   | <u>11,095,399</u>           | 9,474,227                   |
| Capital stock and surplus:  |                             |                             |
| Surplus notes   | <u>550,000</u>              | 950,000                     |
| Capital stock:  |                             |                             |
| Common stock, \$420 par value. 10,000 shares authorized;<br>issued and outstanding 2,500 shares | 1,050,000                   | 1,050,000                   |
| Gross paid-in and contributed surplus   | 9,975,221                   | 9,975,221                   |
| Total capital stock   | <u>11,025,221</u>           | 11,025,221                  |
| Unassigned surplus  | <u>(9,593,608)</u>          | (8,204,240)                 |
| Total capital stock and surplus   | <u>1,981,613</u>            | 3,770,981                   |
| Total liabilities and capital stock and surplus   | <u><u>\$ 13,077,012</u></u> | <u><u>\$ 13,245,208</u></u> |

See Notes to Statutory Financial Statements.

**American Life & Security Corp.**

**Statutory Statements of Operations  
Years Ended December 31, 2012 and 2011**

|  | <b>2012</b>         | <b>2011</b>    |
|--|---------------------|----------------|
| Income:  |                     |                |
| Premiums earned  | <b>\$ 4,764,505</b> | \$ 4,736,893   |
| Investment income earned, net of investment expenses<br>of \$24,163 and \$147,232, respectively                          | <b>426,869</b>      | 266,293        |
| Amortization of interest maintenance reserve   | <b>22,417</b>       | 6,375          |
| Miscellaneous income   | <b>14,072</b>       | 1,393          |
| <b>Total income</b>  | <b>5,227,863</b>    | 5,010,954      |
| Benefits and expenses:   |                     |                |
| Increase in aggregate reserves for life contracts  | <b>1,453,972</b>    | 1,589,197      |
| Benefits to policyholders  | <b>1,250,327</b>    | 1,054,118      |
| Interest and adjustments on deposit-type contract funds  | <b>12,480</b>       | 14,348         |
| Commissions  | <b>1,111,244</b>    | 1,672,778      |
| Taxes, licenses and fees   | <b>191,739</b>      | 170,121        |
| General expenses   | <b>2,117,536</b>    | 2,249,295      |
| <b>Total benefit and expenses</b>  | <b>6,137,298</b>    | 6,749,857      |
| <b>Net loss from operations before income taxes<br/>and net realized investment (loss) gain</b>                          | <b>(909,435)</b>    | (1,738,903)    |
| Income taxes   | -                   | -              |
| <b>Net loss from operations after income taxes<br/>and before net realized investment (loss) gain</b>                    | <b>(909,435)</b>    | (1,738,903)    |
| Net realized (loss) gain on investments, excluding amounts<br>transferred to IMR of \$171,283 and \$77,607, respectively | <b>(1,614)</b>      | 18,999         |
| <b>Net loss</b>  | <b>\$ (911,049)</b> | \$ (1,719,904) |

See Notes to Statutory Financial Statements.

**American Life & Security Corp.**

**Statutory Statements of Capital Stock and Surplus  
Years Ended December 31, 2012 and 2011**

|   | 2012                | 2011                |
|---|---------------------|---------------------|
| <b>Capital stock:</b>                           |                     |                     |
| Balance at beginning of year                    | \$ 1,050,000        | \$ 2,550,000        |
| Transfer to surplus                             | -                   | (1,500,000)         |
| Balance at end of year                          | <u>1,050,000</u>    | <u>1,050,000</u>    |
| <b>Surplus notes:</b>                           |                     |                     |
| Balance at beginning of year                    | 950,000             | 450,000             |
| Payments  | (400,000)           | -                   |
| Issuances                                       | -                   | 500,000             |
| Balance at end of year                          | <u>550,000</u>      | <u>950,000</u>      |
| <b>Gross paid-in and contributed surplus:</b>   |                     |                     |
| Balance at beginning of year                    | 9,975,221           | 9,975,221           |
| Paid in surplus                                 | -                   | -                   |
| Balance at end of year                          | <u>9,975,221</u>    | <u>9,975,221</u>    |
| <b>Unassigned surplus:</b>                      |                     |                     |
| Balance at beginning of year                    | (8,204,240)         | (5,812,437)         |
| Net loss  | (911,049)           | (1,719,904)         |
| Change in unrealized capital losses, net of tax | 32,190              | (277,408)           |
| Change in nonadmitted assets                    | (468,991)           | 19,458              |
| Change in deferred taxes                        | -                   | (10,516)            |
| Change in asset valuation reserve               | (13,999)            | (14,052)            |
| Transfer from capital stock                     | -                   | 1,500,000           |
| Purchase of Old Reliance                        | -                   | (1,842,138)         |
| Amortization of goodwill                        | (27,519)            | (47,243)            |
| Balance at end of year                          | <u>(9,593,608)</u>  | <u>(8,204,240)</u>  |
| <b>Total capital stock and surplus</b>          | <u>\$ 1,981,613</u> | <u>\$ 3,770,981</u> |

See Notes to Statutory Financial Statements.

**American Life & Security Corp.**

**Statutory Statements of Cash Flows  
Years Ended December 31, 2012 and 2011**

|   | 2012              | 2011               |
|---|-------------------|--------------------|
| Cash from operations:                                       |                   |                    |
| Premiums collected, net                                     | \$ 4,716,801      | \$ 4,587,067       |
| Benefit and loss related payments                           | (1,231,899)       | (1,083,900)        |
| Underwriting expenses paid                                  | (3,432,913)       | (4,009,492)        |
| Investment income, net                                      | 479,879           | 317,291            |
| Miscellaneous income  | 14,072            | 1,393              |
| <b>Net cash provided by (used in) operations</b>            | <b>545,940</b>    | <b>(187,641)</b>   |
| Cash from investments:                                      |                   |                    |
| Proceeds from bonds sold or called                          | 11,503,693        | 4,508,898          |
| Proceeds from stocks sold                                   | 159,120           | 135,684            |
| Proceeds from sale of affiliate                             | -                 | 228,801            |
| Proceeds from mortgage loans repaid                         | 6,430             | 7,996              |
| Cost of bonds acquired                                      | (11,531,914)      | (5,337,647)        |
| Cost of stocks acquired                                     | (47,527)          | -                  |
| Cost of real estate acquired                                | -                 | (2,010)            |
| Net change in contract loans                                | 50,474            | (2,877)            |
| <b>Net cash provided by (used in) investments</b>           | <b>140,276</b>    | <b>(461,155)</b>   |
| Cash provided by financing and miscellaneous sources:       |                   |                    |
| (Payments) issuances of surplus notes                       | (400,000)         | 500,000            |
| Net deposits on deposit type contracts                      | 61,193            | 98,108             |
| Purchase of Old Reliance                                    | -                 | (2,315,512)        |
| Other cash (uses) sources                                   | (82,570)          | 46,081             |
| <b>Net cash used in financing and miscellaneous sources</b> | <b>(421,377)</b>  | <b>(1,671,323)</b> |
| <b>Net increase (decrease) in cash</b>                      | <b>264,839</b>    | <b>(2,320,119)</b> |
| Cash at beginning of year                                   | 649,506           | 2,969,625          |
| Cash at end of year   | <b>\$ 914,345</b> | <b>\$ 649,506</b>  |

See Notes to Statutory Financial Statements.



## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 1. Company Overview

American Life & Security Corp. (American Life or the Company) is a wholly-owned subsidiary of Midwest Holding Inc. (MHI). The Company is the surviving entity of the August 2011 merger of Old Reliance Insurance Company (Old Reliance) and American Life & Security Corp. Old Reliance was a Life and Accident and Health Insurance Company organized in 1960 under the laws of the State of Arizona.

The Company was incorporated on May 7, 2009. The Company was also granted a certificate of authority to write insurance in the State of Nebraska on September 1, 2009. In August 2011, MHI acquired the outstanding stock of Old Reliance. The sole shareholder of Old Reliance received: (i) approximately \$1.6 million in cash, (ii) \$500,000 in the form of a surplus note issued by the American Life, and (iii) 150,000 shares of voting common stock of the Company (\$750,000 fair value). In accordance with SSAP No. 68, the transaction was accounted for as a statutory purchase.

Immediately following the purchase, MHI merged American Life into Old Reliance and renamed the new entity American Life & Security Corp. As a result of the transaction, American Life was domiciled in the state of Arizona. Subsequently, as a result, the Company's statutory financial statements have been presented as if this statutory merger had taken place as of January 1, 2010, the earliest date presented, except for certain capital stock and surplus transactions which have been presented in 2011, the period in which the transactions occurred. The Company is licensed in fourteen states and engaged in the business of underwriting, selling, and servicing life insurance and annuity policies.

The Company owns 100% of the common stock of Capital Reserve Life Insurance Company (Capital Reserve). Capital Reserve is a stock life insurance company domiciled in Missouri and is authorized to write business in Missouri and Kansas. The Company purchased Capital Reserve on June 20, 2010 for \$1,956,433.

#### Note 2. Summary of Significant Accounting Policies

Basis of presentation: The accompanying statutory financial statements of the Company have been prepared in conformity with accounting practices prescribed or permitted by the Arizona Department of Insurance, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP). Prescribed statutory accounting policies include a variety of publications of the National Association of Insurance Commissioners (NAIC), as well as state laws, regulations, and general administrative rules. Permitted statutory accounting practices encompass all accounting policies other than those prescribed. The NAIC *Accounting Practices and Procedures Manual*, version 2012, effective March 1, 2012 (NAIC SAP) has been adopted as a component of prescribed practices by the State of Arizona. The Company does not employ any practices not prescribed by the NAIC or the Arizona Department of Insurance in the preparation of its statutory financial statements.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

The more significant differences between statutory accounting practices and GAAP are as follows:

- Investments in bonds with an NAIC rating of 1 through 5 are carried at amortized cost; whereas bonds with an NAIC rating of 6 are written down to the lower of amortized cost or fair value by charging statutory surplus. Under GAAP, bonds are classified into three categories: held to maturity, available for sale, or trading. Bonds held to maturity are stated at amortized cost; bonds available for sale are stated at fair value and the resulting unrealized gains or losses, net of applicable income taxes, are charged or credited to surplus; and bonds held for trading are reported at fair value and the resulting unrealized gains and losses are reported in earnings, net of related taxes.

The fair value of investments on a statutory basis is determined by the SVO, whereas for GAAP, the fair value of investments is determined based on the expected exit price.

- Assets having economic value other than those that can be used to fulfill policyholder obligations are categorized as “nonadmitted assets” and are not permitted to be included in the statutory financial statements of admitted assets, liabilities, and capital and surplus, whereas, for GAAP, these assets are recognized in the balance sheet. Included with nonadmitted assets are furniture, equipment and supplies, prepaid expenses, receivables over 90 days outstanding, certain deferred tax assets and other items that do not meet statutory criteria for admitted assets.
- Deferred federal income taxes are provided for the tax effects of certain income and expense items recognized for income tax purposes in different years than for financial reporting purposes. The change in the deferred tax asset or liability is reflected in surplus. GAAP requires the change to be reported in earnings. Admittance testing may result in a charge to capital and surplus for nonadmitted portions of the deferred tax asset. State taxes are not considered for statutory purposes in calculating a deferred tax asset or liability, however, they are considered for GAAP purposes.

Both statutory and GAAP guidance requires a valuation allowance be established where the deferred tax asset is reduced, if based on the weight of available evidence it is more likely than not that some portion or all of a gross deferred tax asset will not be realized, to its realizable value. Changes in valuation allowance are reported in a similar manner to which changes in deferred tax assets and liabilities are reported, as noted above.

- The statutory financial statements are presented net of the effects of reinsurance, whereas, for GAAP, the financial statements are presented gross of the effects of reinsurance.
- Deferred and uncollected premiums represent premiums receivable in installments (semiannually, quarterly, and monthly) not yet due or collected, but for which policy reserves based on full annual premiums have been provided. Such premiums are reported net of loading expenses, whereas for GAAP, such balances are reported gross.
- Benefits for universal life policies and annuity contracts consist of premiums received as opposed to GAAP, which records policy and contract fees charged for the cost of insurance, policy administrative charges, amortization of policy initiation fees, and surrender contract charges as revenues.
- Premium receipts and benefits on universal life policies and annuities are recorded as revenue and expense for statutory purposes. Under GAAP, revenues on universal life policies comprised of contract charges and fees, which are recognized when assessed against the policyholder’s account balance. Additionally, under GAAP, premium receipts on universal life policies and annuities are considered deposits and are recorded as interest-bearing liabilities.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

- Capital contributions can be made after the reporting period and, with approval from the Arizona Commissioner of Insurance, can be classified as capital contributions for a prior reporting period for statutory purposes. Under GAAP, these capital contributions are recorded as capital contributions on the date they are made.
- Incremental direct cost of contract acquisition that result directly from and are essential to the contract transaction and would not have been incurred by the insurance entity had the contract transaction not occurred are charged against statutory earnings as such costs are incurred, while under GAAP, such costs, to the extent recoverable, would be deferred and amortized over the effective periods covered by the related contracts.
- Commissions allowed by reinsurers on business ceded are reported as income when received rather than being deferred and, to the extent recoverable, amortized with deferred policy acquisition costs, as required under GAAP.
- Comprehensive income is not determined for statutory reporting purposes, whereas, for GAAP, such income is presented.
- The statutory statement of cash flows differs in certain respects from the presentation required within GAAP literature, including the presentation of changes in cash and short-term investments instead of cash and cash equivalents and a reconciliation of net income to net cash provided by operating activities. Short-term investments include securities with original maturities of one year or less. For GAAP, cash equivalents include highly liquid investments with a maturity of three months or less at acquisition.
- The statutory financial statements are prepared in a form using language and groupings substantially the same as the annual statements of the Company filed with the NAIC and the state regulatory authorities, which differ from the presentation and disclosures of financial statements presented under GAAP reporting.
- The accounts of wholly owned subsidiaries are not consolidated with those of the Company as would be required under GAAP but are recorded at the equity of statutory basis net assets. Under NAIC SAP, goodwill created from a statutory merger is limited in the aggregate to 10% of the acquiring entity's statutory capital and surplus. Goodwill is amortized to unrealized gains and losses over a period not to exceed 10 years. Under GAAP, goodwill is not subject to any such limitation and there is no amortization of goodwill. Under both STAT and GAAP, goodwill is subject to periodic impairment evaluation.
- The Company is required to establish an asset valuation reserve (AVR) and an interest maintenance reserve (IMR). The AVR provides for a standardized statutory investment valuation reserve for bonds, common stocks, mortgage loans, short-term investments, and other invested assets. Changes in this reserve are recorded as charges or credits to surplus. The IMR is designed to defer net realized capital gains and losses resulting from changes in interest rates in the market and to amortize them into income over the remaining life of the bond or mortgage loan sold. The IMR represents the unamortized portion not yet taken into income. AVR and IMR are not recorded for GAAP.
- The statutory financial statements present surplus notes as a component of capital stock and surplus, whereas, for GAAP, the financial statements present surplus notes as a liability.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

#### Note 2. Summary of Significant Accounting Policies (Continued)

A reconciliation of net loss and capital and surplus, as presented in the accompanying statutory financial statements, and GAAP as of and for the years ended December 31, 2012 and 2011 is as follows:

|   | Net Loss     |                | Capital and Surplus |              |
|---|--------------|----------------|---------------------|--------------|
|   | 2012         | 2011           | 2012                | 2011         |
| Amounts stated in conformity with NAIC SAP                        | \$ (911,049) | \$ (1,719,904) | \$ 1,981,613        | \$ 3,770,981 |
| Gains on sale, net of IMR net of IMR amortization                 | 148,866      | 71,232         | 211,156             | 62,290       |
| Asset valuation reserve   | -            | -              | 69,408              | 55,409       |
| Investments   | 123,077      | -              | 767                 | (90,120)     |
| DAC   | 494,897      | 624,650        | 2,603,292           | 2,108,395    |
| Nonadmitted assets  | -            | -              | 152,450             | 137,109      |
| Surplus notes   | -            | -              | (550,000)           | (950,000)    |
| VOBA  | (163,976)    | (113,854)      | 964,557             | 1,128,533    |
| Intangible assets   | -            | -              | 700,000             | 700,000      |
| Goodwill  | -            | -              | 1,129,824           | 673,797      |
| Property and equipment  | (52,254)     | -              | 199,505             | 251,759      |
| Carrying value of reserves  | (422,732)    | (391,860)      | (2,154,221)         | (1,731,489)  |
| Old Reliance net losses prior to acquisition not included in GAAP | -            | 202,943        | 202,943             | 202,943      |
| Miscellaneous   | 312,288      | (70,537)       | (134,956)           | (697,573)    |
| Amounts stated in conformity with GAAP                            | \$ (470,883) | \$ (1,397,330) | \$ 5,376,338        | \$ 5,622,034 |

**Risk and uncertainties:** Certain risks and uncertainties are inherent in the Company's day-to-day operations and in the process of preparing its statutory financial statements. The more significant of those risks and uncertainties, as well as the Company's method for mitigating the risks, are presented below and throughout the notes to the statutory financial statements.

- *Use of Estimates* – The preparation of statutory financial statements requires management to make estimates and assumptions that affect the reported amounts of admitted assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates are particularly susceptible to significant change in the near term include reserves for future policy benefits, fair value investments, and deferred income taxes.
- *Reinsurance* – Reinsurance contracts do not relieve the Company from its obligations to insureds. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies. Management believes that any liability arising from this contingency would not be material to the Company's financial position.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

- *Investments* – The Company is exposed to risks that issuers of securities owned by the Company will default or that interest rates will change and cause a decrease in the fair value of its investments.
- *Loss Reserves* – The reserves for policy and contract claims consist of case-basis estimates for reported claims and estimates for unreported claims based on past claims-reporting experience. The management of the Company believes reserves for policy and contract claims are adequate to cover the ultimate liability. However, the ultimate claim costs may vary from the amounts presently provided.
- *External Factors* – The Company is highly regulated by the state in which it is domiciled. Such regulations, among other things, may limit the amount of rate increases on policies and impose restrictions on the amount and type of investments made and the minimum surplus required to conduct business in the state. The impact of regulatory initiatives in response to the recent financial crisis, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, could subject the Company to substantial additional regulation.
- *Risk-Based Capital* – The NAIC has developed life risk-based capital (RBC) standards that relate an insurer's reported statutory surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated surplus level to protect the Company from various risks that it faces. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. The Company continues to monitor its internal requirements and the NAIC's RBC requirements. The Company has determined that its surplus levels are in excess of the minimum capital requirements for all RBC action levels. Management believes that the Company's surplus levels are sufficient to support the level of risk inherent in its operations.

The credit quality of the bond portfolio at December 31, 2012 and 2011 is presented in the following table:

|                              | 2012                |             | 2011                |             |
|------------------------------|---------------------|-------------|---------------------|-------------|
|                              | Amortized Cost      | Percentage  | Amortized Cost      | Percentage  |
| Class 1 - highest quality    | \$ 4,646,684        | 55%         | \$ 6,041,300        | 73%         |
| Class 2 - high quality       | 3,753,857           | 45%         | 2,231,811           | 27%         |
| Class 3 - medium quality     | -                   | 0%          | -                   | 0%          |
| Class 4 - low quality        | -                   | 0%          | -                   | 0%          |
| Class 5 - lower quality      | -                   | 0%          | -                   | 0%          |
| Class 6 - in or near default | -                   | 0%          | -                   | 0%          |
|                              | <b>\$ 8,400,541</b> | <b>100%</b> | <b>\$ 8,273,111</b> | <b>100%</b> |

Bonds with ratings from AAA to BBB as assigned by Standard & Poor's Corporation are generally considered as investment grade securities. Some securities issued by the U.S. government or an agency thereof are not rated but are considered to be investment grade. The NAIC regards U.S. Treasuries and agencies and all A ratings as Class 1 (highest quality), BBB ratings as Class 2 (high quality), BB ratings as Class 3 (medium quality), B ratings as Class 4 (low quality), C ratings as Class 5 (lower quality), and D ratings as Class 6 (in or near default).

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

Investments: Investments are valued as prescribed by the NAIC and are generally reported as follows:

- Bonds and redeemable preferred stocks are recorded at amortized cost using the scientific method (constant yield method) with bonds containing a call provision being amortized to the call or maturity date, whichever results in a lower asset value. Bonds and redeemable preferred stocks assigned a rating by NAIC of 6 are adjusted to the lower of amortized cost or fair value as published by the NAIC, with the offset reported as a change in surplus.
- Redeemable preferred stocks are stated at the lower of amortized cost or NAIC fair values. Perpetual preferred stocks are carried at NAIC fair value.
- Unaffiliated common stocks are carried at the fair value. The change in the stated value is recorded as a change in net unrealized gains (losses), a component of unassigned surplus, net of applicable taxes or as a realized loss through operations if considered to be other-than-temporarily impaired.
- Mortgage loans are carried at the aggregate unpaid balance. The portion of loans in excess of 80% of the loan to value ratio are nonadmitted. Management believes that the Company's historic collection experience supports this practice. As of December 31, 2012 and 2011, the amount of nonadmitted mortgage loans was \$29,872 and \$0, respectively.
- Properties held for the production of income are comprised of ten condominiums in Hawaii. The Company provides for depreciation of properties held for the production of income using the straight-line method over 50 years which is the estimated useful life of the assets. Expenditures resulting in significant betterment or improvement to a property are included in the cost of the property. Repairs and renewals of a minor nature are charged to operations as incurred. Depreciation expense was \$12,121 and \$12,000, for the years ended December 31, 2012 and 2011, respectively.
- Policy loans are recorded at the aggregate unpaid balances and are collateralized by the cash surrender value of the policyholder's underlying life insurance policy.
- Stocks of insurance affiliates in which the Company has an interest of 10% or more are recorded based on the underlying audited statutory equity of the respective entities' statutory financial statements. The change in the stated value is recorded as a change in net unrealized capital gains (losses), a component of unassigned surplus.

The assessment of other-than-temporary impairments is performed on a case-by-case basis. Factors considered by management in determining whether an other-than-temporary impairment exists (in other than loan-backed or structured investment securities) include: the financial condition, business prospects and creditworthiness of the issuer, the length of time and extent to which fair value has been less than cost for equity securities or amortized cost for fixed income securities, and the Company's intent and ability to retain such investments until the fair value recovers. If it is determined that the decline in fair market value is other than temporary, the carrying amount of the investment is written down to fair value as its new basis and the amount of the write-down is recorded as a realized loss.

Investment income consists primarily of interest and dividends and amortization of premiums and discounts. Interest is recognized on the accrual basis and dividends are recorded as earned at the ex-dividend date for stocks other than mandatorily redeemable, preferred stocks which are accrued to the redemption price.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

Dividends or distributions received from affiliates are recognized in investment income when declared to the extent that they are not in excess of the undistributed accumulated earnings attributable to the investee. Dividends or distributions declared in excess of the undistributed accumulated earnings attributable to the investee shall reduce the carrying amount of the investment.

Investment income due and accrued 90 days past due is nonadmitted. There was no investment income due and accrued excluded from surplus at December 31, 2012 and 2011.

Realized gains and losses on securities transactions are determined on a specific identification basis and are included in the statutory statements of operations, net of federal income tax, subject to the provisions of the interest maintenance reserve.

The Company may, from time to time, sell invested assets subsequent to the financial statement date that were considered temporarily impaired at the financial statement date for several reasons. For all subsequent sales of invested assets that were considered temporarily impaired at the financial statement date, the Company contemporaneously documents its rationale for its change in intent or ability to hold to recovery. The rationale for the change in the Company's ability or intent generally focuses on changes in the economic facts and circumstances related to the invested asset subsequent to the financial statement date, significant unforeseen changes in the Company's liquidity needs, or changes in tax laws or the regulatory environment.

Cash and short-term investments: Cash and short-term investments consist of cash on deposit with financial institutions and investments with original maturities of less than one year at the date of acquisition. These investments are carried at cost, which approximates fair value. At December 31, 2012 and 2011, the Company had substantially all of its cash on deposit with a bank and had no short term investments. The Company has cash on deposit with financial institutions which at times may exceed the Federal Deposit Insurance Corporation limits. The Company has not suffered any losses in the past and does not believe it is exposed to any significant credit risk in these balances.

Revenue recognition and related expenses: Life premiums are recognized as income over the premium-paying period of the related policies. Premium income includes reinsurance assumed and is reduced by premiums ceded. Increases in policy benefit reserves, policy acquisition costs, and other period expenses are charged to operations as incurred. Reinsurance commissions, administration, and expense allowances are recognized when incurred in accordance with the contract terms.

Reserves: Policy reserves for traditional and flexible premium insurance are computed principally by using the commissioners' reserve valuation method (CRVM) or the net level premium method with assumed interest rates and mortality as prescribed by regulatory authorities. Tabular interest, tabular less actual reserves released, and tabular cost for all life contracts are determined based upon statutory regulations.

The Company's deposit-type contracts include supplemental contracts, dividend accumulations, and deposit funds. Interest on deposit-type funds is compounded annually.

Policy reserves for life insurance include claim reserves and unearned premiums. Claims reserves, including incurred but not reported claims, represent management's estimate of the ultimate liability associated with unpaid policy claims, based upon analysis of past experience. To the extent that the ultimate liability differs from the amounts recorded, such differences are reflected in operations when additional information becomes known.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

Property, furniture, fixtures, equipment and leasehold improvements: Property and equipment are carried at cost less accumulated depreciation. The Company provides for depreciation of property and equipment using the straight-line method over the estimated useful lives of the assets. Furniture and fixtures are generally depreciated over 3 to 10 years. Depreciation expense was \$52,116 and \$16,856, respectively, for the years ended December 31, 2012 and 2011. Certain property and equipment is nonadmitted through a charge against surplus. Maintenance and repairs are charged to expense as incurred.

Federal income taxes: Current income taxes incurred are recognized in the statutory statements of operations based on tax returns for the current year and tax contingencies for the current and all prior years, to the extent not previously provided.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the statutory financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Gross deferred tax assets and liabilities are measured using enacted tax rates and are considered for admitted asset status according to the admissibility tests as set forth by the NAIC. Changes in deferred tax assets and deferred tax liabilities, including changes attributable to changes in tax rates, are recognized as a component of unassigned surplus.

Gross deferred income tax assets are reduced by a valuation allowance if the Company determines it is more likely than not that some portion or all of the gross deferred tax assets will not be realized. Adjusted deferred income tax assets are limited to (1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years, plus (2) the lesser of the remaining gross deferred income tax assets expected to be realized within three years of the balance sheet date or 15% of capital and surplus (subject to certain limitations), excluding any net deferred income tax assets, electronic data processing equipment and operating software and any net positive goodwill, plus (3) the amount of remaining gross deferred income tax assets that can be offset against existing deferred income tax liabilities. The remaining deferred income tax assets in excess of the above are non-admitted. Deferred income taxes do not include amounts for state taxes.

For 2011, the Company had an option to admit the incremental deferred tax asset based on the expanded provisions above, however and the Company elected not to admit additional deferred tax assets. This election expired January 1, 2012 at which time the Company adopted SSAP No. 101, *Income Taxes, a Replacement of SSAP No. 10R and SSAP No. 10* which removed the Company's option of admitting certain incremental deferred tax assets.

Asset Valuation Reserve and Interest Maintenance Reserve: An Asset Valuation Reserve (AVR) is maintained as prescribed by the NAIC for the purpose of stabilizing the surplus of the Company against fluctuations in the market value of assets.

An Interest Maintenance Reserve (IMR) is maintained as prescribed by the NAIC for the purpose of stabilizing the surplus of the Company against gains and losses on sales of fixed income investments that are primarily attributable to changing interest rates. The interest-related gains and losses are deferred and amortized into income over the remaining term of the securities that were sold.



## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 2. Summary of Significant Accounting Policies (Continued)

Fair values of financial instruments: The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

- *Cash and Short-Term Investments* – The carrying amounts for these instruments approximate their fair values due to their short duration to maturity.
- *Bonds* – The fair values for bonds are based on NAIC-prescribed market values or quoted market prices, where available.
- *Preferred Stocks and Common Stocks of Nonaffiliates* – The fair values are based on quoted market prices.
- *Common Stocks of Affiliates* – The fair values of common stocks of affiliates approximate carrying value and are invested in privately-held life insurance companies. These securities have no active trading. The carrying value of common stocks of affiliates is recorded as the underlying equity of affiliates.
- *Policy Loans* – Policy loans are stated at unpaid principal balances. As these loans are fully collateralized by the cash surrender value of the underlying insurance policies, the carrying value of the policy loans approximates their fair value.
- *Mortgage Loans on Real Estate* – The fair values of mortgage loans on real estate, held for investment are estimated by discounting scheduled cash flows through the scheduled maturities of the loans, using interest rates currently being offered for similar loans to borrowers with similar credit ratings. As part of the Old Reliance purchase agreement, the seller guaranteed the performance of the mortgage loans. The Company periodically evaluates the financial condition of the seller and his guarantee. The Company knows of no circumstances that indicated that the guarantor would be unable to perform nor are any loans non-performing such that his guarantee would be triggered.
- *Liability for Deposit-Type Contracts* – The carrying values of the liability for deposit-type contracts is assumed to be fair value. The Company does not believe an estimate of the fair value of the liability for deposit-type contracts can be made without incurring excessive costs. Because of the numerous assumptions that would have to be made to estimate fair value, the Company believes that such information would not be meaningful.

Recently adopted pronouncements: In 2011, the NAIC adopted SSAP No. 101, *Income Taxes, a Replacement of SSAP No 10R and SSAP 10*. SSAP 101 establishes statutory accounting principles for current and deferred federal and foreign taxes and current state income taxes. SSAP No. 101 adopts the concepts of Accounting Standards Codification 740, *Income Taxes*, with some modifications, including admissibility criteria based on RBC thresholds as well as an entity's ratio of adjusted gross deferred tax assets to adjusted surplus and capital and the treatment of uncertain tax positions. This statement was effective for interim and annual periods beginning after January 1, 2012. The Company adopted SSAP No. 101 as of January 1, 2012 which did not result in an increase to surplus.

American Life & Security Corp.

Notes to Statutory Financial Statements

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**Note 3. Investments**

The amortized cost and estimated fair value of investments in investment securities as of December 31, 2012 and 2011 are as follows:

|   | Amortized<br>Cost   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|---|---------------------|------------------------------|-------------------------------|-------------------------|
| <b>December 31, 2012:</b>   |                     |                              |                               |                         |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 1,338,720        | \$ 159,570                   | \$ -                          | \$ 1,498,290            |
| States and political subdivisions – general obligations                               | 945,083             | 1,419                        | 16,379                        | 930,123                 |
| States and political subdivisions – special revenue                                   | 1,176,182           | 201                          | 34,697                        | 1,141,686               |
| Corporate and miscellaneous securities  | 4,940,556           | 21,458                       | 108,389                       | 4,853,625               |
|   | <u>\$ 8,400,541</u> | <u>\$ 182,648</u>            | <u>\$ 159,465</u>             | <u>\$ 8,423,724</u>     |
| Common stock of affiliates  | \$ 1,873,877        | \$ -                         | \$ 285,102                    | \$ 1,588,775            |
| Common stock of nonaffiliates   | 135,800             | -                            | 32,148                        | 103,652                 |
|   | <u>\$ 2,009,677</u> | <u>\$ -</u>                  | <u>\$ 317,250</u>             | <u>\$ 1,692,427</u>     |
| Preferred stock   | <u>\$ 75,000</u>    | <u>\$ -</u>                  | <u>\$ -</u>                   | <u>\$ 75,000</u>        |

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 3. Investments (Continued)**

|   | Amortized<br>Cost   | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|---|---------------------|------------------------------|-------------------------------|-------------------------|
| December 31, 2011:  |                     |                              |                               |                         |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 2,384,591        | \$ 179,670                   | \$ 2,774                      | \$ 2,561,487            |
| States and political subdivisions – general obligations                               | 1,197,485           | 17,845                       | 23,787                        | 1,191,543               |
| States and political subdivisions – special revenue                                   | 566,804             | 11,080                       | 10,546                        | 567,338                 |
| Corporate and miscellaneous securities  | 4,124,231           | 45,207                       | 305,469                       | 3,863,969               |
|   | <u>\$ 8,273,111</u> | <u>\$ 253,802</u>            | <u>\$ 342,576</u>             | <u>\$ 8,184,337</u>     |
| Common stock of affiliates  | \$ 2,355,047        | \$ -                         | \$ 275,082                    | \$ 2,079,965            |
| Common stock of nonaffiliates   | 187,358             | -                            | 74,358                        | 113,000                 |
|   | <u>\$ 2,542,405</u> | <u>\$ -</u>                  | <u>\$ 349,440</u>             | <u>\$ 2,192,965</u>     |
| Preferred stock   | <u>\$ 137,680</u>   | <u>\$ -</u>                  | <u>\$ 9,840</u>               | <u>\$ 127,840</u>       |

American Life & Security Corp.

Notes to Statutory Financial Statements

Note 3. Investments (Continued)

The following tables present the estimated fair value and the gross unrealized losses, aggregated by investment category and length of time that individual investment securities have been in an unrealized loss position, at December 31, 2012 and 2011:

|   | Investments with Unrealized Losses |                      |                         |                      |                         |                      |
|---|------------------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|
|   | Less than 12 Months                |                      | Greater than 12 Months  |                      | Total                   |                      |
|   | Estimated<br>Fair Value            | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses |
| <b>December 31, 2012:</b>   |                                    |                      |                         |                      |                         |                      |
| <b>Bonds:</b>   |                                    |                      |                         |                      |                         |                      |
| States and political subdivisions –<br>general obligation                                   | \$ 621,353                         | \$ 8,963             | \$ 227,236              | \$ 7,416             | \$ 848,589              | \$ 16,379            |
| States and political subdivisions –<br>special revenue                                      | 858,902                            | 26,043               | 202,562                 | 8,654                | 1,061,464               | 34,697               |
| Corporate and miscellaneous<br>securities   | 2,844,197                          | 108,389              | -                       | -                    | 2,844,197               | 108,389              |
|   | <u>\$ 4,324,452</u>                | <u>\$ 143,395</u>    | <u>\$ 429,798</u>       | <u>\$ 16,070</u>     | <u>\$ 4,754,250</u>     | <u>\$ 159,465</u>    |
| Common stock of affiliates  | \$ -                               | \$ -                 | \$ 1,588,775            | \$ 285,102           | \$ 1,588,775            | \$ 285,102           |
| Common stock of nonaffiliates   | -                                  | -                    | 103,652                 | 32,148               | 103,652                 | 32,148               |
|   | <u>\$ -</u>                        | <u>\$ -</u>          | <u>\$ 1,692,427</u>     | <u>\$ 317,250</u>    | <u>\$ 1,692,427</u>     | <u>\$ 317,250</u>    |
|   |                                    |                      |                         |                      |                         |                      |
|   | Investments with Unrealized Losses |                      |                         |                      |                         |                      |
|   | Less than 12 Months                |                      | Greater than 12 Months  |                      | Total                   |                      |
|   | Estimated<br>Fair Value            | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses | Estimated<br>Fair Value | Unrealized<br>Losses |
| <b>December 31, 2011:</b>   |                                    |                      |                         |                      |                         |                      |
| <b>Bonds:</b>   |                                    |                      |                         |                      |                         |                      |
| U.S. Treasury securities and<br>obligations of U.S. government<br>corporations and agencies | \$ -                               | \$ -                 | \$ 175,166              | \$ 2,774             | \$ 175,166              | \$ 2,774             |
| States and political subdivisions –<br>general obligation                                   | 714,137                            | 23,787               | -                       | -                    | 714,137                 | 23,787               |
| States and political subdivisions –<br>special revenue                                      | 201,150                            | 10,546               | -                       | -                    | 201,150                 | 10,546               |
| Corporate and miscellaneous<br>securities   | 2,716,783                          | 152,082              | 902,617                 | 153,387              | 3,619,400               | 305,469              |
|   | <u>\$ 3,632,070</u>                | <u>\$ 186,415</u>    | <u>\$ 1,077,783</u>     | <u>\$ 156,161</u>    | <u>\$ 4,709,853</u>     | <u>\$ 342,576</u>    |
| Common stock of affiliates  | \$ -                               | \$ -                 | \$ 2,079,965            | \$ 275,082           | \$ 2,079,965            | \$ 275,082           |
| Common stock of nonaffiliates   | 113,000                            | 74,358               | -                       | -                    | 113,000                 | 74,358               |
|   | <u>\$ 113,000</u>                  | <u>\$ 74,358</u>     | <u>\$ 2,079,965</u>     | <u>\$ 275,082</u>    | <u>\$ 2,192,965</u>     | <u>\$ 349,440</u>    |
| Preferred stock   | \$ -                               | \$ -                 | \$ 127,840              | \$ 9,840             | \$ 127,840              | \$ 9,840             |

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 3. Investments (Continued)

The majority of the unrealized losses on securities is due to interest rate changes and market segments that are experiencing temporary value declines. The Company regularly monitors its investment portfolio for securities where the unrealized losses may indicate an other-than-temporary impairment (OTTI) in the value of its securities. This review for impairment considers a number of qualitative and quantitative factors, as well as significant management judgment. There were no realized losses due to OTTI at December 31, 2012 and 2011.

The amortized cost and estimated fair value of debt securities at December 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|  | Statement<br>Value  | Estimated<br>Fair Value |
|--|---------------------|-------------------------|
| Due in one year or less                  | \$ 212,249          | \$ 213,645              |
| Due after one year through five years    | 1,302,226           | 1,356,749               |
| Due after five years through ten years   | 4,156,186           | 4,199,981               |
| Due after ten years through twenty years | 2,729,880           | 2,653,349               |
| Due after twenty years                   | -                   | -                       |
|  | <u>\$ 8,400,541</u> | <u>\$ 8,423,724</u>     |

Net investment income reflected in the results of operations for the years ended December 31, 2012 and 2011 are as follows:

|                                    | 2012              | 2011              |
|------------------------------------|-------------------|-------------------|
| Bonds                              | \$ 317,336        | \$ 323,181        |
| Cash and short-term investments    | 550               | -                 |
| Preferred stock                    | 2,071             | 5,092             |
| Common stock                       | 1,109             | 1,278             |
| Mortgage loans                     | 49,747            | 47,572            |
| Real estate                        | 52,500            | 30,000            |
| Contract loans and policy interest | 27,719            | 6,402             |
|                                    | <u>451,032</u>    | <u>413,525</u>    |
| Less investment expenses           | (24,163)          | (147,232)         |
|                                    | <u>\$ 426,869</u> | <u>\$ 266,293</u> |

American Life & Security Corp.

Notes to Statutory Financial Statements

**Note 3. Investments (Continued)**

Gross realized gains and losses from investment securities consist of the following:

| <b>Year Ended December 31, 2012</b>  | <b>Gross Realized<br/>Gains</b> | <b>Gross Realized<br/>Losses</b> | <b>Net Realized<br/>Gains (Losses)</b> |
|--------------------------------------|---------------------------------|----------------------------------|--|
| Bonds                                | \$ 201,942                      | \$ (30,659)                      | \$ 171,283                             |
| Common stock of affiliates           | -                               | (3,880)                          | (3,880)                                |
| Preferred stock                      | 2,573                           | (307)                            | 2,266                                  |
|                                      | <u>\$ 204,515</u>               | <u>\$ (34,846)</u>               | <u>\$ 169,669</u>                      |
| Transfer to IMR, net of taxes of \$0 |                                 |                                  | (171,283)                              |
| Net realized capital losses          |                                 |                                  | <u>\$ (1,614)</u>                      |

  

| Year Ended December 31, 2011         | Gross Realized<br>Gains | Gross Realized<br>Losses | Net Realized<br>Gains (Losses) |
|--------------------------------------|-------------------------|--------------------------|--------------------------------|
| Bonds                                | \$ 94,933               | \$ (16,860)              | \$ 78,073                      |
| Common stock of affiliates           | 18,999                  | -                        | 18,999                         |
| Common stock of nonaffiliates        | -                       | (466)                    | (466)                          |
|                                      | <u>\$ 113,932</u>       | <u>\$ (17,326)</u>       | <u>\$ 96,606</u>               |
| Transfer to IMR, net of taxes of \$0 |                         |                          | (77,607)                       |
| Net realized capital losses          |                         |                          | <u>\$ 18,999</u>               |

Proceeds from sales of investments during 2012 and 2011 were \$11,462,813 and \$4,873,383, respectively. Gross gains of \$204,515 and \$113,932 and gross losses of \$34,846 and \$17,326, respectively, were realized on those sales.

Bonds and other invested assets with a statement value of \$1,800,488 and \$1,790,751 were on deposit at December 31, 2012 and 2011, respectively, with various banks, as required by the respective states or by reinsurance contracts.

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 4. Investments in Subsidiary**

The Company owns 100% of Capital Reserve. Summarized financial statement information of Capital Reserve as of and for the years ended December 31, 2012 and 2011 is as follows.

Statutory Statement of Admitted Assets, Liabilities  
and Capital and Surplus

|                           | <b>2012</b>         | <b>2011</b>         |
|---------------------------|---------------------|---------------------|
| Total Admitted Assets     | <b>\$ 1,412,291</b> | <b>\$ 1,424,015</b> |
| Total Liabilities         | <b>\$ 16,144</b>    | <b>\$ 17,847</b>    |
| Total Capital and Surplus | <b>1,396,147</b>    | <b>1,406,168</b>    |
|                           | <b>\$ 1,412,291</b> | <b>\$ 1,424,015</b> |

Statutory Statements of Operations

|                               |                    |                     |
|-------------------------------|--------------------|---------------------|
| Total Revenues                | <b>\$ 53,463</b>   | <b>\$ 80,577</b>    |
| Total Underwriting Deductions | <b>120,278</b>     | <b>189,189</b>      |
| Total Federal Income Taxes    | <b>-</b>           | <b>-</b>            |
| Net Loss                      | <b>\$ (66,815)</b> | <b>\$ (108,612)</b> |

The change in the carrying value of the Company's wholly owned subsidiaries, which includes goodwill, for years ended December 31, 2012 and 2011 follows:

|                                     | <b>December 31, 2012</b>       |                   |                     |
|-------------------------------------|--------------------------------|-------------------|---------------------|
|                                     | <b>Capital<br/>and Surplus</b> | <b>Goodwill</b>   | <b>Total</b>        |
| <b>Beginning of year</b>            | <b>\$ 1,406,168</b>            | <b>\$ 673,797</b> | <b>\$ 2,079,965</b> |
| <b>Net loss</b>                     | <b>(66,815)</b>                | <b>-</b>          | <b>(66,815)</b>     |
| <b>Correction of an error</b>       | <b>(125,305)</b>               | <b>-</b>          | <b>(125,305)</b>    |
| <b>Change in deferred tax asset</b> | <b>(451,915)</b>               | <b>-</b>          | <b>(451,915)</b>    |
| <b>Change in nonadmitted assets</b> | <b>633,637</b>                 | <b>(453,650)</b>  | <b>179,987</b>      |
| <b>Amortization of goodwill</b>     | <b>-</b>                       | <b>(27,519)</b>   | <b>(27,519)</b>     |
| <b>Change in AVR</b>                | <b>377</b>                     | <b>-</b>          | <b>377</b>          |
|                                     | <b>(10,021)</b>                | <b>(481,169)</b>  | <b>(491,190)</b>    |
| <b>End of year</b>                  | <b>\$ 1,396,147</b>            | <b>\$ 192,628</b> | <b>\$ 1,588,775</b> |

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 4. Investments in Subsidiary (Continued)**

|                              | December 31, 2011      |                   |                     |
|------------------------------|------------------------|-------------------|---------------------|
|                              | Capital<br>and Surplus | Goodwill          | Total               |
| Beginning of year            | \$ 1,772,625           | \$ 277,468        | \$ 2,050,093        |
| Net loss                     | (108,612)              | -                 | (108,612)           |
| Change in nonadmitted assets | (71,427)               | -                 | (71,427)            |
| Acquisition of Old Reliance  | -                      | 473,374           | 473,374             |
| Amortization of goodwill     | -                      | (47,243)          | (47,243)            |
| Sale of Fidelity Standard    | (187,845)              | (29,802)          | (217,647)           |
| Change in AVR                | 1,427                  | -                 | 1,427               |
|                              | <u>(366,457)</u>       | <u>396,329</u>    | <u>29,872</u>       |
| End of year                  | <u>\$ 1,406,168</u>    | <u>\$ 673,797</u> | <u>\$ 2,079,965</u> |

**Note 5. Fair Value of Financial Instruments**

The fair values of investment securities, including short-term investments and cash, are estimated based on prices received from SVO and Reference Data. Cash and short-term investment fair values approximate their carrying values. The amortized cost and the estimated fair value of investment securities as of December 31, 2012 and 2011 were as follows:

|                                      | 2012                |                         | 2011               |                         |
|--------------------------------------|---------------------|-------------------------|--------------------|-------------------------|
|                                      | Statement<br>Value  | Estimated<br>Fair Value | Statement<br>Value | Estimated<br>Fair Value |
| Financial assets:                    |                     |                         |                    |                         |
| Bonds                                | <b>\$ 8,400,541</b> | <b>\$ 8,423,724</b>     | \$ 8,273,111       | \$ 8,184,337            |
| Common stocks – affiliates           | <b>1,588,775</b>    | <b>1,588,775</b>        | 2,079,965          | 2,079,965               |
| Common stocks – nonaffiliates        | <b>103,652</b>      | <b>103,652</b>          | 113,000            | 113,000                 |
| Preferred stocks                     | <b>75,000</b>       | <b>75,000</b>           | 137,680            | 127,840                 |
| Mortgage loans                       | <b>647,139</b>      | <b>706,434</b>          | 683,441            | 726,953                 |
| Policy loans                         | <b>274,664</b>      | <b>274,664</b>          | 325,138            | 325,138                 |
| Cash                                 | <b>914,345</b>      | <b>914,345</b>          | 649,506            | 649,506                 |
| Financial liabilities:               |                     |                         |                    |                         |
| Liability for deposit-type contracts | <b>455,236</b>      | <b>455,236</b>          | 394,043            | 394,043                 |

The Company has no other assets or liabilities meeting the definition of a financial instrument. In addition, the Company has no off-balance-sheet financial instruments.



## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 5. Fair Value of Financial Instruments (Continued)

The Company's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The hierarchy gives the highest priority to fair values determined using unadjusted quote prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to fair values determined using unobservable inputs (Level 3). An asset's or liability's classification is determined based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

*Level 1* – Unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

*Level 2* – Valuations derived from inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as:

- a) Quoted prices for similar assets or liabilities in active markets.
- b) Quoted prices for identical or similar assets or liabilities in markets that are not active.
- c) Inputs other than quoted prices that are observable for the asset or liability.
- d) Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

*Level 3* – Valuations are derived from techniques that require significant unobservable inputs. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

The following summarizes financial instruments measured at fair value as of December 31, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

| <b>December 31, 2012</b>          | <b>Level 1</b>    | <b>Level 2</b> | <b>Level 3</b> | <b>Total Estimated<br/>Fair Value</b> |
|-----------------------------------|-------------------|----------------|----------------|---------------------------------------|
| <b>Assets at fair value</b>       |                   |                |                |                                       |
| <b>Common stock</b>               | \$ 103,652        | \$ -           | \$ -           | \$ 103,652                            |
| <b>Total assets at fair value</b> | <b>\$ 103,652</b> | <b>\$ -</b>    | <b>\$ -</b>    | <b>\$ 103,652</b>                     |

| <b>December 31, 2011</b>          | <b>Level 1</b>    | <b>Level 2</b> | <b>Level 3</b> | <b>Total Estimated<br/>Fair Value</b> |
|-----------------------------------|-------------------|----------------|----------------|---------------------------------------|
| <b>Assets at fair value</b>       |                   |                |                |                                       |
| <b>Common stock</b>               | \$ 113,000        | \$ -           | \$ -           | \$ 113,000                            |
| <b>Total assets at fair value</b> | <b>\$ 113,000</b> | <b>\$ -</b>    | <b>\$ -</b>    | <b>\$ 113,000</b>                     |

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 6. Reinsurance**

The Company utilizes reinsurance contracts to reduce its exposure to losses in all aspects of its insurance business. Such reinsurance permits recovery of a portion of losses from reinsurers, although it does not relieve the Company from its primary liability to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial strength of potential reinsurers and continually monitors the financial condition of reinsurers.

Amounts recoverable from reinsurers are estimated based upon assumptions consistent with those used in establishing the liabilities related to the underlying reinsured contracts. Management believes the recoverables are appropriately established. The Company generally strives to diversify its credit risks related to reinsurance ceded.

A summary of reinsurance amounts affecting the accompanying statutory financial statements follows:

|         | 2012                |                     | 2011                |                     |
|---------|---------------------|---------------------|---------------------|---------------------|
|         | Written             | Earned              | Written             | Earned              |
| Direct  | \$ 4,829,659        | \$ 4,829,659        | \$ 5,422,763        | \$ 5,422,763        |
| Assumed | 33,644              | 33,644              | 35,876              | 35,876              |
| Ceded   | (98,798)            | (98,798)            | (721,746)           | (721,746)           |
| Net     | <u>\$ 4,764,505</u> | <u>\$ 4,764,505</u> | <u>\$ 4,736,893</u> | <u>\$ 4,736,893</u> |

The effect of reinsurance on benefits to policyholders for 2012 and 2011 are as follows:

|         | 2012                | 2011                |
|---------|---------------------|---------------------|
| Direct  | \$ 20,860,750       | \$ 19,440,746       |
| Assumed | 3,001,718           | 3,264,013           |
| Ceded   | (14,103,242)        | (14,359,455)        |
| Net     | <u>\$ 9,759,226</u> | <u>\$ 8,345,304</u> |

The following table provides a summary of the significant reinsurance balances recoverable on paid and unpaid losses by reinsurers, along with the A.M. Best credit rating:

| Reinsurer                      | Credit Rating | Recoverable on Paid Losses | Recoverable on Unpaid Losses |
|--------------------------------|---------------|----------------------------|------------------------------|
| Optimum Re Insurance Company   | A-            | -                          | 11,000                       |
| Sagicor Life Insurance Company | A-            | -                          | 332,254                      |
|                                |               | <u>\$ -</u>                | <u>\$ 343,254</u>            |

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 7. Deposit Liabilities**

Withdrawal characteristics of deposit-type contracts and other contracts with life contingencies are as follows at December 31, 2012 and 2011:

|   | 2012              | 2011              |
|---|-------------------|-------------------|
| Subject to discretionary withdrawal without surrender charge or market value adjustment | \$ 455,236        | \$ 394,043        |
| Not subject to withdrawal   | -                 | -                 |
| Total   | <u>\$ 455,236</u> | <u>\$ 394,043</u> |

The Company holds a reserve for the nondeduction of deferred fractional premiums or return of premium at the death of the insured. Reserves are computed to be never less than the surrender value defined in the policy.

Extra premiums are charged for substandard lives for certain types of policies, plus the gross premium for the true age. Mean reserves are determined by computing the regular mean reserve for the plan and holding, in addition, one-half of the extra premium charged. For the other groups of policies, substandard lives are issued policies with initially reduced death benefit schedules that increase with duration to the ultimate amount. Mean reserves are determined by computing the regular mean reserve for the ultimate face amount.

At December 31, 2012 and 2011, the amount of \$455,236 and \$394,043, respectively, reported as deposit-type funds, relates to supplemental contracts, dividends, and premiums on deposit and are reported as policyholder funds left on deposit in the statutory statements of admitted assets, liabilities, and surplus.

**Note 8. Premiums and Annuity Considerations Deferred and Uncollected**

Deferred and uncollected life insurance premiums and annuity considerations as of December 31, 2012 and 2011 were as follows:

|  | 2012              |                   | 2011              |                   |
|--|-------------------|-------------------|-------------------|-------------------|
|  | Gross             | Net of Loading    | Gross             | Net of Loading    |
| Ordinary - first year due and deferred | \$ 80,073         | \$ 30,115         | \$ 217,778        | \$ 76,862         |
| Ordinary - renewal due and deferred    | 353,372           | 196,549           | 169,422           | 91,163            |
| Total                                  | <u>\$ 433,445</u> | <u>\$ 226,664</u> | <u>\$ 387,200</u> | <u>\$ 168,025</u> |

## American Life & Security Corp.

### Notes to Statutory Financial Statements

#### Note 9. Transactions with Parent Company

The Company has a cost sharing agreement with its parent company Midwest Holding Inc. Under the terms of this cost sharing agreement, the Company paid Midwest Holding Inc. the amount of \$1,240,539 and \$1,196,422 for the years ended December 31, 2012 and 2011, respectively, and had a receivable of \$33,761 and owed \$159,916 as of December 31, 2012 and 2011, respectively, which was included in other assets.

#### Note 10. Income Taxes

At December 31, the components of the net adjusted admitted deferred income tax asset were as follows:

|                                    | 12/31/2012   |           |              | 12/31/2011   |           |              | Change     |             |            |
|------------------------------------|--------------|-----------|--------------|--------------|-----------|--------------|------------|-------------|------------|
|                                    | Ordinary     | Capital   | Total        | Ordinary     | Capital   | Total        | Ordinary   | Capital     | Total      |
| Gross deferred tax assets          | \$ 2,372,305 | \$ 10,930 | \$ 2,383,235 | \$ 2,004,956 | \$ 26,025 | \$ 2,030,981 | \$ 367,349 | \$ (15,095) | \$ 352,254 |
| Statutory valuation allowance      | 2,295,239    | 10,930    | 2,306,169    | 1,945,258    | 26,025    | 1,971,283    | 349,981    | (15,095)    | 334,886    |
| Adjusted gross deferred tax assets | 77,066       | -         | 77,066       | 59,698       | -         | 59,698       | 17,368     | -           | 17,368     |
| Deferred tax assets nonadmitted    | -            | -         | -            | -            | -         | -            | -          | -           | -          |
| Net admitted deferred tax asset    | 77,066       | -         | 77,066       | 59,698       | -         | 59,698       | 17,368     | -           | 17,368     |
| Deferred tax liabilities           | 77,066       | -         | 77,066       | 59,698       | -         | 59,698       | 17,368     | -           | 17,368     |
| Net adjusted deferred tax asset    | \$ -         | \$ -      | \$ -         | \$ -         | \$ -      | \$ -         | \$ -       | \$ -        | \$ -       |

At December 31, 2012 and 2011, the Company recorded a valuation allowance on the deferred tax assets to reduce the total to an amount that management believes will ultimately be realized. Realization of deferred tax assets is dependent upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income.

The significant components, by character, of deferred tax assets and liabilities as of December 31, 2012 and 2011, were as follows:

|  | December 31, 2012 |              |              |                  |
|--|-------------------|--------------|--------------|------------------|
|  | Statutory         | Tax          | Difference   | Tax Effect       |
| <b>Deferred tax assets - ordinary</b>            |                   |              |              |                  |
| Net operating loss carry forward                 | \$ -              | \$ 6,182,462 | \$ 6,182,462 | \$ 2,102,037     |
| Deferred acquisition costs                       | -                 | 672,325      | 672,325      | 228,591          |
| Other  | -                 | 122,578      | 122,578      | 41,677           |
| <b>Total deferred tax assets - ordinary</b>      |                   |              |              | <b>2,372,305</b> |
| <b>Deferred tax assets - capital</b>             |                   |              |              |                  |
| Unrealized loss on common stock of nonaffiliates | 103,652           | 135,800      | 32,148       | 10,930           |
| <b>Total deferred tax assets - capital</b>       |                   |              |              | <b>10,930</b>    |
| <b>Total gross deferred tax assets</b>           |                   |              |              | <b>2,383,235</b> |
| Statutory valuation allowance                    |                   |              |              | (2,306,169)      |
| <b>Total adjusted deferred tax assets</b>        |                   |              |              | <b>77,066</b>    |
| <b>Deferred tax liabilities - ordinary</b>       |                   |              |              |                  |
| Due and deferred premiums                        | 226,664           | -            | 226,664      | 77,066           |
| <b>Total gross deferred tax liabilities</b>      |                   |              |              | <b>77,066</b>    |
| <b>Total net deferred tax asset</b>              |                   |              |              | <b>-</b>         |
| <b>Nonadmitted deferred tax asset</b>            |                   |              |              | <b>-</b>         |
| <b>Total net admitted deferred tax asset</b>     |                   |              |              | <b>\$ -</b>      |

**American Life & Security Corp.**

**Notes to Statutory Financial Statements**

**Note 10. Income Taxes (Continued)**

|  | December 31, 2011 |              |              |                    |
|--|-------------------|--------------|--------------|--------------------|
|  | Statutory         | Tax          | Difference   | Tax Effect         |
| Deferred tax assets - ordinary                   |                   |              |              |                    |
| Net operating loss carry forward                 | \$ -              | \$ 5,211,732 | \$ 5,211,732 | \$ 1,771,989       |
| Deferred acquisition costs                       | -                 | 685,197      | 685,197      | 232,967            |
| Total deferred tax assets - ordinary             |                   |              |              | <u>2,004,956</u>   |
| Deferred tax assets - capital                    |                   |              |              |                    |
| Unrealized loss on common stock of nonaffiliates | 113,000           | 189,543      | 76,543       | 26,025             |
| Total deferred tax assets - capital              |                   |              |              | <u>26,025</u>      |
| Total gross deferred tax assets                  |                   |              |              | 2,030,981          |
| Statutory valuation allowance                    |                   |              |              | <u>(1,971,283)</u> |
| Total adjusted deferred tax assets               |                   |              |              | <u>59,698</u>      |
| Deferred tax liabilities - ordinary              |                   |              |              |                    |
| Due and deferred premiums                        | 168,026           | -            | 168,026      | 57,129             |
| Other  | 7,556             | -            | 7,556        | 2,569              |
| Total gross deferred tax liabilities             |                   |              |              | <u>59,698</u>      |
| Total net deferred tax asset                     |                   |              |              | <u>-</u>           |
| Nonadmitted deferred tax asset                   |                   |              |              | <u>-</u>           |
| Total net admitted deferred tax asset            |                   |              |              | <u>\$ -</u>        |

The change in deferred income taxes reported in surplus comprises the following components:

|  | 2012               | 2011         | Change     |
|--|--------------------|--------------|------------|
| Deferred tax assets - ordinary:                  |                    |              |            |
| Net operating loss carry forward                 | \$ 2,102,037       | \$ 1,771,989 | \$ 330,048 |
| Deferred acquisition costs                       | 228,591            | 232,967      | (4,376)    |
| Other  | 41,677             | -            | 41,677     |
| Total deferred tax assets - ordinary             | <u>2,372,305</u>   | 2,004,956    | 367,349    |
| Deferred tax assets - capital:                   |                    |              |            |
| Unrealized loss on common stock of nonaffiliates | 10,930             | 26,025       | (15,095)   |
| Total deferred tax assets                        | <u>2,383,235</u>   | 2,030,981    | 352,254    |
| Statutory valuation allowance                    | <u>(2,306,169)</u> | (1,971,283)  | (334,886)  |
| Total adjusted deferred tax assets               | <u>77,066</u>      | 59,698       | 17,368     |
| Deferred tax liabilities - ordinary:             |                    |              |            |
| Due and deferred premiums                        | 77,066             | 57,129       | 19,937     |
| Other  | -                  | 2,569        | (2,569)    |
| Total deferred tax liabilities                   | <u>77,066</u>      | 59,698       | 17,368     |
| Total net deferred tax asset                     | <u>\$ -</u>        | \$ -         | \$ -       |
| Nonadmitted deferred tax asset                   | -                  | -            | -          |
| Total net admitted deferred tax asset            | <u>\$ -</u>        | \$ -         | \$ -       |

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 10. Income Taxes (Continued)

Current income taxes incurred consist of the following major components:

| Current year tax expense (benefit)      | 2012         | 2011         |
|---|--------------|--------------|
| Federal income tax (benefit)            | \$ (334,886) | \$ (696,554) |
| Change in statutory valuation allowance | 334,886      | 696,554      |
| Current income tax (benefit)            | <u>\$ -</u>  | <u>\$ -</u>  |

| Deferred tax expense            | 2012        | 2011             |
|---------------------------------|-------------|------------------|
| Change in deferred income taxes | \$ -        | \$ 10,516        |
| Deferred tax expense            | <u>\$ -</u> | <u>\$ 10,516</u> |

The Company's income tax incurred and change in deferred income tax differ from the amount obtained by applying the federal statutory rate of 34% to income before income taxes, as follows:

|  | 2012         | 2011             |
|--|--------------|------------------|
| Current income tax (benefit) incurred                      | \$ -         | \$ -             |
| Deferred tax expense                                       | -            | 10,516           |
| Total income tax reported                                  | <u>\$ -</u>  | <u>\$ 10,516</u> |
| (Loss) before taxes  | \$ (911,049) | \$ (1,719,904)   |
|  | 34%          | 34%              |
| Expected income tax (benefit) at 34% statutory rate        | (309,757)    | (584,767)        |
| Increase (decrease) in actual tax reported resulting from: |              |                  |
| Increase in valuation allowance                            | 334,886      | 696,554          |
| Other  | (25,129)     | (101,271)        |
| Current income tax expense reported                        | <u>\$ -</u>  | <u>\$ 10,516</u> |

As of December 31, 2012, the Company has operating loss carryforwards of \$2,102,037 that will expire from 2024 through 2027.

As of December 31, 2012 and 2011, there were no federal income taxes incurred that are available for recoupment of future net losses, there were no deferred tax liabilities that were not recognized in determining the net admitted deferred tax asset, the Company did not employ any tax planning strategies, and the Company does not have any tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date.

#### Note 11. Commitments and Contingencies

The Company is a party to certain claims and legal actions arising during the ordinary course of business. It is management's opinion, after consulting with legal counsel, that these matters will not have a material adverse effect on the financial position and results of operations of the Company.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

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#### Note 12. Surplus Notes

The following table provides a summary of the Company's surplus notes along with issue dates, maturity dates, face amounts, and interest rates as of December 31, 2012:

|   | 2012       | 2011       |
|---|------------|------------|
| 7% surplus note executed to First American Capital Corporation on September 12, 2006 in the amount of \$100,000 which matures September 12, 2016. | \$ 100,000 | \$ 100,000 |
| 7% surplus note executed to First American Capital Corporation on September 30, 2006 in the amount of \$150,000 which matures September 20, 2016. | 150,000    | 150,000    |
| 7% surplus note executed to David G. Elmore on December 31, 2008 in the amount of \$200,000 which matures December 31, 2011.                      | -          | 200,000    |
| 5% surplus note executed to David G. Elmore on August 3, 2011 in the amount of \$500,000 which matures August 3, 2016.                            | 300,000    | 500,000    |

Any payments and/or repayments must be approved by the Arizona Department of Insurance. On April 2, 2012, the Company paid down \$300,000 of principal and approximately \$50,000 of accrued interest. During the first quarter of 2013, the repayment of the interest and principal on a portion of the surplus notes was approved by the Arizona Department of Insurance. On January 4, 2013, the Company paid down \$100,000 of principal and approximately \$7,000 of accrued interest, which both are included in accrued expenses on the statutory statements of admitted assets, liabilities, and capital stock and surplus as of December 31, 2012.

#### Note 13. Subsequent Events

All of the effects of subsequent events that provide additional evidence about conditions that existed at the statements of admitted assets, liabilities, capital and surplus date, including the estimates inherent in the process of preparing the statutory financial statements, are recognized in the statutory financial statements. The Company does not recognize subsequent events that provide evidence about conditions that did not exist at the Statements of Admitted Assets, Liabilities, Capital and Surplus date but arose after, but before the statutory financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the statutory financial statements from being misleading.

Subsequent events have been evaluated through May 31, 2013, the date that the statutory financial statements were issued.

## American Life & Security Corp.

### Notes to Statutory Financial Statements

#### Note 14. Reconciliation to Annual Statement

For 2011, the Company recorded various adjustments in the 2011 audited financial statements which were not recorded in the 2011 annual statement. There were no differences in the annual statement filed with the Insurance Department of the State of Arizona and the audited statutory statements of admitted assets, liabilities and capital stock and surplus and the statutory statements of operations for the year ended December 31, 2012.

The following tables show the difference in the annual statement filed with the Insurance Department of the State of Arizona and the audited statutory statements of admitted assets, liabilities and capital and surplus and the statutory statements of operations for the year ended December 31, 2011.

| December 31, 2011  | Annual<br>Statement | Difference  | Statutory<br>Financial<br>Statement |
|--|---------------------|-------------|-------------------------------------|
| <b>Statutory Statements of Admitted Assets,<br/>Liabilities, and Capital Stock and Surplus</b> |                     |             |                                     |
| Common stock of affiliate, at admitted value   | \$ 1,735,601        | \$ 344,364  | \$ 2,079,965                        |
| Common stock of nonaffiliates, at admitted value   | -                   | 113,000     | 113,000                             |
| Aggregate write-ins (Goodwill)   | 1,120,714           | (1,120,714) | -                                   |
| Other assets   | 31,635              | (1)         | 31,634                              |
| Interest maintenance reserve   | 20,963              | 41,327      | 62,290                              |
| Unassigned deficit   | (7,499,562)         | (704,678)   | (8,204,240)                         |
| <b>Statutory Statements of Operations</b>  |                     |             |                                     |
| Investment income earned, and amortization<br>of IMR, net of investment expenses               | \$ 259,045          | \$ 13,623   | \$ 272,668                          |
| Increase in aggregate reserves for life contracts  | 1,589,200           | (3)         | 1,589,197                           |
| General expenses   | 2,386,325           | (137,030)   | 2,249,295                           |
| Realized gains (losses) on investments   | 47,633              | (28,634)    | 18,999                              |
| Net loss   | (1,841,926)         | 122,022     | (1,719,904)                         |
| <b>Statutory Statements of Cash Flows</b>  |                     |             |                                     |
| Premiums collected, net  | \$ 4,499,070        | \$ 87,997   | \$ 4,587,067                        |
| Net investment income  | 176,161             | 141,130     | 317,291                             |
| Benefit and loss related payments  | (1,008,097)         | (75,803)    | (1,083,900)                         |
| Miscellaneous income   | -                   | -           | -                                   |
| Underwriting expenses paid   | (4,154,342)         | 144,850     | (4,009,492)                         |
| Federal income taxes paid  | (589,028)           | 589,028     | -                                   |
| Total impact on net cash used in operations  | (1,076,236)         | 887,202     | (189,034)                           |
| Proceeds from sale of stocks   | 364,485             | (135,684)   | 228,801                             |
| Proceeds from sale of preferred stocks   | -                   | 135,684     | 135,684                             |
| Proceeds from mortgage loans repaid  | 7,997               | (1)         | 7,996                               |
| Cost of bonds acquired   | (5,337,648)         | 1           | (5,337,647)                         |
| Net change in contract loans   | 31,541              | (34,418)    | (2,877)                             |
| Miscellaneous proceeds from investments  | 24,000              | (24,000)    | -                                   |
| Total impact on net cash used in investing   | (4,909,625)         | (58,418)    | (4,968,043)                         |
| Net deposits on deposit type contracts   | 91,819              | 6,289       | 98,108                              |
| Cash applied to capital and paid in surplus  | (1,500,000)         | 1,500,000   | -                                   |
| Purchase of Old Reliance   | -                   | (2,315,512) | (2,315,512)                         |
| Other cash applied   | 65,642              | (19,561)    | 46,081                              |
| Total impact on net cash used in financing   | (1,342,539)         | (828,784)   | (2,171,323)                         |
| Total impact on Statutory Statement of Cash Flows  | \$ (7,328,400)      | \$ -        | \$ (7,328,400)                      |



**AMERICAN LIFE & SECURITY CORP.****Schedule 1**

Selected Financial Data

Year Ended December 31, 2012

Admitted Assets per Annual Statement

|   |                     |
|---|---------------------|
| Investment income earned:   |                     |
| Government bonds  | \$ 71,693           |
| Other bonds (unaffiliated)  | 245,643             |
| Bonds of affiliates   | -                   |
| Preferred stocks (unaffiliated)   | 2,071               |
| Common stocks (unaffiliated)  | 1,109               |
| Common stocks of affiliates   | -                   |
| Mortgage loans  | 49,747              |
| Real estate   | 52,500              |
| Premium notes, policy loans, and liens                                  | 27,719              |
| Cash on hand and on deposit   | 550                 |
| Short-term investments  | -                   |
| Other invested assets   | -                   |
| Derivative instruments  | -                   |
| Aggregate write-ins for investment                                      | -                   |
| Gross investment income   | <u>\$ 451,032</u>   |
| Real estate owned - book value less encumbrances                        | \$ -                |
| Mortgage loans - book value:  |                     |
| Farm mortgages  | \$ -                |
| Residential mortgages   | 647,139             |
| Commercial mortgages  | -                   |
| Total mortgage loans  | <u>\$ 647,139</u>   |
| Mortgage loans, by standing - book value                                |                     |
| Good standing   | \$ -                |
| Good standing with restructured terms                                   | -                   |
| Interest overdue more than three months, not in foreclosure             | -                   |
| Foreclosure in process  | -                   |
| Other long-term assets - statement value                                | -                   |
| Collateral loans  | -                   |
| Bonds and stocks of parents, subsidiaries, and affiliates - book value: |                     |
| Bonds   | -                   |
| Preferred stocks  | -                   |
| Common stocks   | 1,588,775           |
| Bonds and short-term investments, by maturity and class:                |                     |
| By maturity - statement value:  |                     |
| Due within 1 year or less   | 212,249             |
| Over 1 year through 5 years   | 1,302,226           |
| Over 5 years through 10 years   | 4,156,186           |
| Over 10 years through 20 years  | 2,729,880           |
| Over 20 years   | -                   |
| Total bonds and short-term investments by maturity                      | <u>\$ 8,400,541</u> |

(Continued)

**AMERICAN LIFE & SECURITY CORP.****Schedule 1**

Selected Financial Data (Continued)

Year Ended December 31, 2012

Admitted Assets per Annual Statement

|  |              |
|--|--------------|
| By class - statement value:  |              |
| Class 1  | \$ 4,646,684 |
| Class 2  | 3,753,857    |
| Class 3  | -            |
| Class 4  | -            |
| Class 5  | -            |
| Class 6  | -            |
| Total bonds and short-term investments by class                                      | \$ 8,400,541 |
| Total bonds publicly traded  | \$ 8,400,541 |
| Total bonds privately placed   | \$ -         |
| Preferred stocks - statement value   | \$ 75,000    |
| Common stocks - market value   | 103,652      |
| Short-term investments - book value  | -            |
| Options, caps, and floors owned - statement value                                    | -            |
| Options, caps, and floors written and in force - statement value                     | -            |
| Collars, swap, and forward agreements open - statement value                         | -            |
| Futures contracts open - current value   | -            |
| Cash on deposit  | 914,345      |
| Life insurance in force (in thousands):  |              |
| Industrial   | \$ 5,646     |
| Ordinary   | 193,082      |
| Credit life  | -            |
| Group life   | -            |
| Amount of accidental death insurance in force under ordinary policies (in thousands) | \$ -         |
| Life insurance policies with disability provisions in force (in thousands):          |              |
| Industrial   | \$ -         |
| Ordinary   | -            |
| Credit life  | -            |
| Group life   | -            |
| Supplementary contracts in force:  |              |
| Ordinary - not involving life contingencies:   |              |
| Amount of deposit  | \$ -         |
| Income payable   | -            |
| Ordinary - involving life contingencies:   |              |
| Amount of deposit  | -            |
| Income payable   | -            |
| Group - not involving life contingencies:  |              |
| Amount of deposit  | -            |
| Income payable   | -            |
| Group - involving life contingencies:  |              |
| Income payable   | -            |

(Continued)

**AMERICAN LIFE & SECURITY CORP.****Schedule 1**

Selected Financial Data (Continued)

Year Ended December 31, 2012

Admitted Assets per Annual Statement

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|   |            |
|---|------------|
| Annuities:  |            |
| Ordinary:   |            |
| Immediate - amount of income payable  | \$ -       |
| Deferred - fully paid account balance                                       | 384,712    |
| Deferred - not fully paid account balance                                   | 2,111,594  |
| Group:  |            |
| Amount of income payable  | -          |
| Fully paid account balance  | -          |
| Not fully paid account balance  | -          |
| Accident and health insurance - premiums in force:                          |            |
| Ordinary  | \$ -       |
| Group   | -          |
| Credit  | -          |
| Deposit funds and dividend accumulations:                                   |            |
| Deposit funds - account balance   | \$ 455,236 |
| Dividend accumulations - account balance                                    | -          |
| Claim payments - years ended December 31 (in thousands):                    |            |
| Group accident and health:  |            |
| 2012  | \$ -       |
| 2011  | -          |
| 2010  | -          |
| 2009  | -          |
| 2008  | -          |
| Prior   | -          |
| Other accident and health:  |            |
| 2012  | \$ 7,146   |
| 2011  | 10,083     |
| 2010  | 21,140     |
| 2009  | 24,296     |
| 2008  | 18,095     |
| Prior   | 20,486     |
| Other coverages that use developmental methods to calculate claim reserves: |            |
| 2012  | \$ -       |
| 2011  | -          |
| 2010  | -          |
| 2009  | -          |
| 2008  | -          |
| Prior   | -          |

See accompanying Independent Auditor's Report.

1. Admitted assets per Annual Statement \$ 13,077,012

2. The 10 largest exposures to single issuer/borrower/investment, by investment category, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt, (ii) property occupied by the Company, and (iii) policy loans, at December 31, 2012 are as follows:

| Issuer                                 | Category  | Amount       | Percentage of total admitted assets |
|--|---|--------------|-------------------------------------|
| Capital Reserve Life Insurance Company | Wholly owned insurance subsidiary                         | \$ 1,588,775 | 12.15%                              |
| Nationsbank Corp.                      | Corporate   | 561,648      | 4.29%                               |
| Sunamerica Inc.                        | Corporate   | 459,570      | 3.51%                               |
| Morgan Stanley                         | Corporate   | 441,465      | 3.38%                               |
| Maricopa County, Arizona               | States and Political Subdivisions –<br>General Obligation | 343,822      | 2.63%                               |
| Republic NY Corp.                      | Corporate   | 339,994      | 2.60%                               |
| Bank of America Corp.                  | Corporate   | 293,520      | 2.24%                               |
| Merrill Lynch Co.                      | Corporate   | 274,939      | 2.10%                               |
| Barclays Bank PLC                      | Corporate   | 269,468      | 2.06%                               |
| Wayne County, Michigan                 | States and Political Subdivisions –<br>General Obligation | 234,656      | 1.79%                               |

3. As of December 31, 2012, the amounts and percentages of total admitted assets held in bonds, including those classified as short-term investments, and preferred stocks by NAIC rating are as follows:

| Investment category | Amount       | Percentage of total admitted assets |
|---------------------|--------------|-------------------------------------|
| NAIC—1              | \$ 4,646,684 | 35.53%                              |
| NAIC—2              | 3,753,857    | 28.71                               |
| NAIC—3              | —            | —                                   |
| NAIC—4              | —            | —                                   |
| NAIC—5              | —            | —                                   |
| NAIC—6              | —            | —                                   |

4. As of December 31, 2012, the Company does not hold foreign investments that exceed 2.5% of admitted assets. Therefore, interrogatories 5-10 are not applicable.

11. As of December 31, 2012, the Company does not hold Canadian investments and unhedged Canadian currency exposures, including Canadian-currency-denominated investments that exceed 2.5% of total admitted assets.

12. As of December 31, 2012, the Company does not hold investments with contractual sales restrictions (defined as investments having restrictions that prevent investments from being sold within 90 days at December 31, 2011).

(Continued)

**AMERICAN LIFE & SECURITY CORP.****Schedule 2**

Supplemental Investment Risks Interrogatories (Continued)

Year Ended December 31, 2012

13. The largest exposures to equity interest as of December 31, 2012 are as follows:

| Issuer                                 | Amount       | Percentage of<br>total admitted<br>assets |
|--|--------------|---|
| Capital Reserve Life Insurance Company | \$ 1,588,775 | 12.15%                                    |
| Goldman Sachs Group                    | 89,292       | 0.68%                                     |
| AGIC Convertible & Income Fund II      | 25,000       | 0.19%                                     |
| AGIC Convertible I                     | 25,000       | 0.19%                                     |
| Pimco Corp Income Fund                 | 25,000       | 0.19%                                     |
| Charles Schwab                         | 14,360       | 0.11%                                     |

14. As of December 31, 2012, the Company held no investments in nonaffiliated, privately placed equities (included in other equity securities), excluding securities eligible for sale under (i) Securities and Exchange Commission ("SEC") Rule 144a or (ii) SEC Rule 144 without volume restrictions.

15. As of December 31, 2012, the Company held no investments in general partnership interests (included in other equity securities).

16. The type of mortgage loans held as of December 31, 2012 are as follows:

| Type   | Amount     | Percentage of<br>total admitted<br>assets |
|--|------------|---|
| Residential mortgages                        | \$ 647,139 | 4.95%                                     |
| Construction loans                           | \$ -       | 0.00%                                     |
| Mortgage loans over 90 days past due         | -          | 0.00%                                     |
| Mortgage loans in the process of foreclosure | -          | 0.00%                                     |
| Mortgage loans foreclosed                    | -          | 0.00%                                     |
| Restructured mortgage loans                  | -          | 0.00%                                     |

17. The aggregate loan-to-value ratios as determined from the most current appraisal as of December 31, 2012 are as follows:

| Loan-to-Value | Amount  | Percentage of<br>total admitted<br>assets |
|---------------|---------|---|
| Above 95%     | \$ -    | 0.00%                                     |
| 91% to 95%    | -       | 0.00%                                     |
| 81 to 90%     | 362,400 | 2.77%                                     |
| 71 to 80%     | 150,519 | 1.15%                                     |
| below 70%     | 134,220 | 1.03%                                     |

18. The largest five investments in any one parcel or group of contiguous parcels of real estate as of December 31, 2012 are as follows:

| Description                                      | Amount     | Percentage of<br>total admitted<br>assets |
|--|------------|---|
| 1946 Ala Moana Blvd, Honolulu, Hawaii (10 Units) | \$ 565,889 | 4.33%                                     |

19. As of December 31, 2012, the Company does not hold investment in mezzanine real estate loans that exceed 2.5% total admitted assets.

See accompanying Independent Auditor's Report.

**AMERICAN LIFE & SECURITY CORP.**

Summary Investment Schedule

December 31, 2012

**Schedule 3**

| Investment categories  | Gross investment holdings |            | Admitted assets as reported in the Annual Statement |            |
|--|---------------------------|------------|---|------------|
|  | Amount                    | Percentage | Amount  | Percentage |
| <b>Bonds:</b>  |                           |            |   |            |
| U.S. Treasury securities   | \$ 1,338,720              | 10.6%      | \$ 1,338,720  | 10.7%      |
| U.S. government and corporate obligations (excluding mortgage-backed securities):                            |                           |            |   |            |
| Issued by U.S. government agencies   | —                         | —          | —   | —          |
| Issued by U.S. government-sponsored agencies   | —                         | —          | —   | —          |
| Foreign government (including Canada; excluding mortgage-backed securities)                                  | —                         | —          | —   | —          |
| Securities issued by states, territories and possessions, and political subdivisions in the U.S.:            |                           |            |   |            |
| States, territories, and possessions general obligations   | 945,083                   | 7.5        | 945,083   | 7.5        |
| Political subdivision of states, territories and possessions, and political subdivisions general obligations | —                         | —          | —   | —          |
| Revenue and assessment obligations   | 1,176,182                 | 9.3        | 1,176,182   | 9.4        |
| Industrial development and similar obligations   | 4,940,556                 | 39.2       | 4,940,556   | 39.3       |
| Mortgage-backed securities (including residential and commercial MBS):                                       |                           |            |   |            |
| Pass-through securities:   |                           |            |   |            |
| Guaranteed by GNMA   | —                         | —          | —   | —          |
| Issued by FNMA and FHLMC   | —                         | —          | —   | —          |
| Privately issued   | —                         | —          | —   | —          |
| CMOs and REMICs:   |                           |            |   |            |
| Issued by FNMA and FHLMC   | —                         | —          | —   | —          |
| Privately issued and collateralized by MBS; issued or guaranteed by GNMA, FNMA, or FHLMC                     | —                         | —          | —   | —          |
| All other privately issued   | —                         | —          | —   | —          |
| Other debt and other fixed income securities (excluding short-term):   |                           |            |   |            |
| Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)                             | —                         | —          | —   | —          |
| Unaffiliated foreign securities  | —                         | —          | —   | —          |
| Affiliated securities  | —                         | —          | —   | —          |
| Equity interests:  |                           |            |   |            |
| Investments in mutual funds  | —                         | —          | —   | —          |
| Preferred stocks:  |                           |            |   |            |
| Affiliated   | —                         | —          | —   | —          |
| Unaffiliated   | 75,000                    | 0.6        | 75,000  | 0.6        |
| Publicly traded equity securities (excluding preferred stocks):  |                           |            |   |            |
| Affiliated   | —                         | —          | —   | —          |
| Unaffiliated   | —                         | —          | —   | —          |
| Other equity securities:   |                           |            |   |            |
| Affiliated   | 1,588,775                 | 12.6       | 1,588,775   | 12.6       |
| Unaffiliated   | 103,652                   | 0.8        | 103,652   | 0.8        |
| Other equity interests, including tangible personal property under lease:                                    |                           |            |   |            |
| Affiliated   | —                         | —          | —   | —          |
| Unaffiliated   | —                         | —          | —   | —          |

(Continued)

| Investment categories  | Gross investment holdings |               | in the Annual Statement |               |
|--|---------------------------|---------------|-------------------------|---------------|
|  | Amount                    | Percentage    | Amount                  | Percentage    |
| Mortgage loans:  |                           |               |                         |               |
| Construction and land development  | —                         | —             | —                       | —             |
| Agricultural   | —                         | —             | —                       | —             |
| Single family residential properties   | 677,011                   | 5.4           | 647,139                 | 5.1           |
| Multifamily residential properties   | —                         | —             | —                       | —             |
| Commercial loans   | —                         | —             | —                       | —             |
| Real estate investments:   |                           |               |                         |               |
| Property occupied by Company   | —                         | —             | —                       | —             |
| Property held for production of income (includes \$0 of property acquired in satisfaction of debt) | 565,889                   | 4.5           | 565,889                 | 4.5           |
| Property held for sale (\$0 including property acquired in satisfaction of debt)                   | —                         | —             | —                       | —             |
| Policy loans   | 274,664                   | 2.2           | 274,664                 | 2.2           |
| Receivables for securities   | —                         | —             | —                       | —             |
| Cash and short-term investments  | 914,345                   | 7.3           | 914,345                 | 7.3           |
| Other invested assets  | —                         | —             | —                       | —             |
| Total invested assets  | <u>\$ 12,599,877</u>      | <u>100.0%</u> | <u>\$ 12,570,005</u>    | <u>100.0%</u> |

See accompanying Independent Auditors' Report.