

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of  
New York Life Insurance Company)

**FINANCIAL STATEMENTS**  
**(STATUTORY BASIS)**  
**DECEMBER 31, 2017 and 2016**

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## **Report of Independent Auditors**

To the Board of Directors of  
NYLIFE Insurance Company of Arizona:

We have audited the accompanying statutory financial statements of NYLIFE Insurance Company of Arizona (the "Company"), which comprise the statutory statements of financial position as of December 31, 2017 and 2016, and the related statutory statements of operations, changes in capital and surplus, and of cash flows for the years then ended.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the accounting practices prescribed or permitted by the Arizona Department of Insurance. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 financial statements, the financial statements are prepared by the Company on the basis of the 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 the statutory basis of accounting described in Note 2 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

***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 the Company as of December 31, 2017 and 2016, or the results of its operations or its cash flows for the years then ended.

***Opinion on Statutory Basis of Accounting***

In our opinion, the financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities and surplus of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in accordance with the accounting practices prescribed or permitted by the Arizona Department of Insurance described in Note 2.

***Emphasis of Matter***

As disclosed in Note 9 to the financial statements, the Company has significant transactions with New York Life Insurance Company and its affiliates. Because of these relationships, it is possible that the terms of the transactions are not the same as those that would result from transactions among wholly unrelated parties.

PricewaterhouseCoopers LLP

March 30, 2018

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of New York Life Insurance Company)

**STATUTORY STATEMENTS OF FINANCIAL POSITION**

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands)</b>	
<b>Assets</b>		
Bonds	\$ 146,403	\$ 148,583
Cash, cash equivalents and short-term investments	3,189	3,818
Other invested assets	6	—
Total cash and invested assets	149,598	152,401
Deferred and uncollected premiums	22,258	22,915
Investment income due and accrued	1,003	1,020
Reinsurance recoverables	1,426	471
Net deferred tax assets	2,057	5,474
Federal income taxes receivable	781	622
Other assets	55	23
<b>Total assets</b>	<b>\$ 177,178</b>	<b>\$ 182,926</b>
<b>Liabilities, Capital and Surplus</b>		
Liabilities:		
Policy reserves	\$ 59,478	\$ 70,335
Deposit funds	1,713	2,294
Policy claims	849	2,901
Payable to parent and affiliates	2,571	2,635
Other liabilities	1,789	334
Asset valuation reserve	475	494
<b>Total liabilities</b>	66,875	78,993
Capital and surplus:		
Capital stock-par value \$100 (30,000 shares authorized, 25,000 shares issued and outstanding)	2,500	2,500
Gross paid in and contributed surplus	98,500	98,500
Unassigned surplus	9,303	2,933
<b>Total capital and surplus</b>	110,303	103,933
<b>Total liabilities, capital and surplus</b>	<b>\$ 177,178</b>	<b>\$ 182,926</b>

See accompanying notes to financial statements

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of New York Life Insurance Company)

**STATUTORY STATEMENTS OF OPERATIONS**

	<b>Years Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands)</b>	
Income		
Premiums	\$ 14,795	\$ 18,497
Net investment income	4,467	5,231
Commissions and expense allowances on reinsurance ceded	999	1,027
<b>Total income</b>	<b>20,261</b>	<b>24,755</b>
Benefits and expenses		
Death benefits	11,001	12,702
Conversion charges paid to parent and affiliate	2,976	4,420
Other benefit payments	800	377
Total benefit payments	14,777	17,499
Reductions to policy reserves	(10,936)	(17,031)
Commissions	—	37
Operating expenses	4,807	3,755
<b>Total benefits and expenses</b>	<b>8,648</b>	<b>4,260</b>
Gain from operations before federal income taxes	11,613	20,495
Federal and foreign income taxes	1,733	8,127
Net gain from operations	9,880	12,368
Net realized capital gains (losses), after taxes and transfers to interest maintenance reserve	22	(1)
<b>Net income</b>	<b>\$ 9,902</b>	<b>\$ 12,367</b>

See accompanying notes to financial statements

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of New York Life Insurance Company)

**STATUTORY STATEMENTS OF CHANGES IN CAPITAL AND SURPLUS**

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands)</b>	
Capital and surplus, beginning of year	\$ 103,933	\$ 91,176
Net income	9,902	12,367
Change in net deferred income tax	(4,200)	163
Change in nonadmitted assets	644	(217)
Change in asset valuation reserve	19	(11)
Change in net unrealized capital losses	5	—
Prior period correction	—	455
<b>Capital and surplus, end of year</b>	<b>\$ 110,303</b>	<b>\$ 103,933</b>

See accompanying notes to financial statements

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of New York Life Insurance Company)

**STATUTORY STATEMENTS OF CASH FLOWS**

	<b>Years Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands)</b>	
<b>Cash flow from operating activities:</b>		
Premiums received	\$ 17,030	\$ 20,666
Net investment income received	4,663	5,495
Commissions and expense allowances on reinsurance ceded	985	1,036
Total received	22,678	27,197
Benefits and other payments	16,827	16,954
Operating expenses	5,915	4,412
Federal income taxes paid	1,924	13,557
Total paid	24,666	34,923
<b>Net cash used in operating activities</b>	<b>(1,988)</b>	<b>(7,726)</b>
<b>Cash flow from investing activities:</b>		
Proceeds from investments sold, matured or repaid	23,231	43,308
Cost of investments acquired	(20,997)	(44,609)
<b>Net cash from (used in) investing activities</b>	<b>2,234</b>	<b>(1,301)</b>
<b>Cash flow from financing and miscellaneous activities:</b>		
Net outflows from deposit contracts	(583)	(653)
Other miscellaneous (uses) sources	(292)	332
<b>Net cash used in financing and miscellaneous activities</b>	<b>(875)</b>	<b>(321)</b>
Net decrease in cash, cash equivalents and short-term investments	(629)	(9,348)
Cash, cash equivalents and short-term investments, beginning of year	3,818	13,166
<b>Cash, cash equivalents and short-term investments, end of year</b>	<b>\$ 3,189</b>	<b>\$ 3,818</b>
Supplemental disclosures of cash flow information:		
Non-cash activities during the year:		
Capitalized interest on bonds	\$ 163	\$ 209

See accompanying notes to financial statements



**NYLIFE INSURANCE COMPANY OF ARIZONA**  
(A wholly owned subsidiary of New York Life Insurance Company)  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**  
**DECEMBER 31, 2017 AND 2016**

**NOTE 1 - NATURE OF OPERATIONS**

NYLIFE Insurance Company of Arizona (“the Company”), a direct, wholly-owned subsidiary of New York Life Insurance Company (“New York Life”), is domiciled in the State of Arizona, and was established to engage in the life insurance and annuity business. The Company currently services a ten-year guaranteed term life insurance product, which was sold through New York Life’s agency force. The Company stopped sales of this product in 2011.

**NOTE 2 - BASIS OF PRESENTATION**

The accompanying financial statements have been prepared using accounting practices prescribed by the Arizona Department of Insurance (“statutory accounting practices”), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (“U.S. GAAP”).

The Arizona Department of Insurance recognizes only statutory accounting practices prescribed or permitted by the State of Arizona for determining and reporting the financial position and results of operations of an insurance company and for determining its solvency under Arizona Insurance Law. The National Association of Insurance Commissioners’ (“NAIC”) *Accounting Practices and Procedures Manual* (“NAIC SAP”) has been adopted as a component of prescribed or permitted practices by the State of Arizona. Prescribed statutory accounting practices include state laws and regulations. Permitted statutory accounting practices encompass accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future. Arizona has adopted all prescribed accounting practices found in NAIC SAP. The Company has no permitted practices.

**Prior Period Correction**

In 2016, the Company corrected an error related to waiver of premium benefits incurred but not reported (“IBNR”) and in course of settlement (“ICOS”) reserves. The Company calculated the prior year reserves based on claims experience data that incorrectly identified certain claims as IBNR. To correct this error, the Company reduced its reserves and recorded a prior period correction that increased statutory surplus by \$455 thousand on an after-tax basis.

**Statutory vs. U.S. GAAP Basis of Accounting**

Financial statements prepared under NAIC SAP as determined under Arizona Insurance Law vary from those prepared under U.S. GAAP. The primary differences that apply to the financial statements of the Company are as follows:

- the costs related to acquiring business, principally commissions, certain policy issue expenses and sales inducements are charged to income in the year incurred, whereas under U.S. GAAP, these costs are deferred for successful sales and amortized over the periods benefited;

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 2 – BASIS OF PRESENTATION (continued)**

- life insurance reserves are based on different statutory methods and assumptions than they are under U.S. GAAP;
- an asset valuation reserve ("AVR") based on a formula prescribed by the NAIC is established as a liability to offset potential non-interest related investment losses. Changes in the AVR are recorded directly to surplus, whereas under U.S. GAAP, no AVR is recognized;
- investments in bonds are generally carried at amortized cost or values as prescribed by the AZID whereas under U.S. GAAP, investments in bonds that are classified as available for sale or trading are carried at fair value, with changes in fair value of bonds classified as available for sale reflected in equity, and changes in fair value of bonds classified as trading reflected in earnings;
- realized gains and losses resulting from changes in interest rates are deferred in the interest maintenance reserve ("IMR") and amortized into investment income over the remaining life of the investment sold, whereas under U.S. GAAP, the gains and losses are recognized in income at the time of sale;
- deferred income taxes exclude state income taxes and are admitted to the extent they can be realized within three years subject to a 15% limitation of capital and surplus with changes in the net deferred tax reflected as a component of surplus, whereas under U.S. GAAP, deferred income taxes include federal and state income taxes, and changes in deferred taxes are reflected in either earnings or other comprehensive income;
- a tax loss contingency is required to be established if it is more likely than not that a tax position will not be sustained upon examination by taxing authorities. If a loss contingency is greater than 50 percent of the tax benefit associated with a tax position, the loss contingency is increased to 100 percent, whereas under U.S. GAAP the amount of the benefit for any uncertain tax position is the largest amount that is greater than 50 percent likely of being realized upon settlement;
- certain assets, such as deferred taxes that are not realizable within three years and unsecured receivables, are considered nonadmitted and excluded from assets, whereas they are included in assets under U.S. GAAP subject to a valuation allowance, as appropriate;
- corporate securities deemed to be other-than-temporarily impaired are written down to fair value, whereas under U.S. GAAP, if certain conditions are met, credit impairments on corporate securities are recorded based at the net present value of future cash flows expected to be collected, discounted at the current book yield. Also, if certain conditions are met, the non-credit portion of the impairment on a loan-backed or structured security is not accounted for whereas under U.S. GAAP, if certain conditions are met, the non-credit portion of the impairment on a debt security is recorded through other comprehensive income. A non-credit loss exists when the fair value of a security is less than the present value of projected future cash flows expected to be collected.

The effects on the financial statements of the variances between NAIC SAP as determined under Arizona Insurance Law and U.S. GAAP are material to the Company.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 2 – BASIS OF PRESENTATION (continued)**

The following table reconciles the Company's statutory capital and surplus determined in accordance with statutory accounting practices with equity determined on a U.S. GAAP basis at December 31, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Capital and surplus	\$ 110,303	\$ 103,933
AVR	475	494
Capital and surplus and AVR	<u>110,778</u>	<u>104,427</u>
Adjustments to statutory-basis for:		
Inclusion of DAC	2,750	5,226
Mark-to-market on investments, pre-tax and deferred acquisition cost ("DAC")	1,256	1,196
Inclusion of statutory nonadmitted assets	635	468
Revaluation of deferred taxes	1,278	1,415
Re-estimation of future policy benefits	(6,165)	(5,733)
Other	937	945
Total adjustments	<u>691</u>	<u>3,517</u>
Total U.S. GAAP stockholder's equity	<u>\$ 111,469</u>	<u>\$ 107,944</u>

The following table reconciles the Company's statutory net income determined in accordance with statutory accounting practices with net income determined on a U.S. GAAP basis for the years ended December 31, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Net gain from operations	\$ 9,880	\$ 12,368
Realized capital gains (losses)	22	(1)
Statutory net income	<u>9,902</u>	<u>12,367</u>
Adjustments to statutory net income for:		
Removal of IMR capitalization, net of amortization	33	(283)
Inclusion of net amortization of DAC	(2,476)	(3,086)
Re-estimation of future policy benefits	(480)	458
Inclusion of deferred income tax expense	(3,532)	1,884
Other	39	(577)
Total adjustments	<u>(6,416)</u>	<u>(1,604)</u>
Total U.S. GAAP net income	<u>\$ 3,486</u>	<u>\$ 10,763</u>

**NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements. Management is also required to disclose contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the period. Actual results may differ from those estimates.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 3– SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Investments**

Income from investments, including amortization of premium, accrual of discount and similar items, is recorded within net investment income, unless otherwise stated herein.

Bonds other than loan-backed and structured securities are stated at amortized cost using the interest method. Bonds in or near default (rated NAIC 6) are stated at the lower of amortized cost or fair value. Refer to Note 7 – Fair Value Measurements, for a discussion of the valuation approach and methods for bonds.

Loan-backed and structured securities, which are included in bonds, are valued at amortized cost using the interest method including current assumptions of projected cash flows. Loan-backed and structured securities in or near default (rated NAIC 6) are stated at the lower of amortized cost or fair value. Amortization of the premium or accretion of discount from the purchase of these securities considers the estimated timing and amount of cash flows of the underlying loans, including prepayment assumptions based on data obtained from external sources or internal estimates. Projected future cash flows are updated monthly, and the amortized cost and effective yield of the securities are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. For high credit quality loan-backed and structured securities (those rated AA or above at the date of acquisition), the adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For loan-backed and structured securities that are not of high credit quality (those rated below AA at date of acquisition), certain floating rate securities and securities with the potential for a loss of a portion of the original investment due to contractual prepayments (e.g., interest only securities), the effective yield is adjusted prospectively for any changes in estimated cash flows.

The cost basis of bonds is adjusted for impairments in value when it is deemed to be other than temporary. An other-than-temporary loss is recognized in net income when it is anticipated that the amortized cost will not be recovered. Factors considered in evaluating whether a decline in value is other than temporary include: (1) whether the decline is substantial; (2) the duration that the fair value has been less than cost; (3) the financial condition and near-term prospects of the issuer; and (4) the Company's ability and intent to retain the investment for the period of time sufficient to allow for an anticipated recovery in value.

When a bond (other than loan-backed and structured securities) is deemed other-than-temporarily impaired, the difference between the investments' amortized cost and its fair value is recognized as a realized loss and reported in net income if the loss is credit related, or deferred in the IMR if interest related for bonds.

For loan-backed and structured securities, the entire difference between the security's amortized cost and its fair value is recognized in net income only when the Company (a) has the intent to sell the security or (b) it does not have the intent and ability to hold the security to recovery. If neither of these two conditions exists, a realized loss is recognized in net income for the difference between the amortized cost basis of the security and the net present value of projected future cash flows expected to be collected. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the loan-backed or structured security prior to impairment.

The determination of cash flow estimates in the net present value calculation is subjective and methodologies will vary, depending on the type of security. The Company considers all information relevant to the collectability of the security, including past events, current conditions, and reasonably supportable assumptions and forecasts in developing the estimate of cash flows expected to be collected. This information generally includes, but may not be limited to, the remaining payment terms of the security, estimated prepayment speeds, defaults, recoveries upon liquidation of the underlying collateral securing the notes, the

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 3– SIGNIFICANT ACCOUNTING POLICIES (continued)**

financial condition of the issuer(s), credit enhancements and other third-party guarantees. In addition, other information, such as industry analyst reports and forecasts, sector credit ratings, the financial condition of the bond insurer for insured fixed income securities and other market data relevant to the collectability may also be considered, as well as the expected timing of the receipt of insured payments, if any. The estimated fair value of the collateral may be used to estimate recovery value if the Company determines that the security is dependent on the liquidation of the collateral for recovery.

The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired bond security is accounted for as if it had been purchased on the measurement date of the impairment. Accordingly, the discount (or reduced premium) based on the new cost basis may be accreted (or amortized) into net investment income in future periods based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

Short-term investments consist of securities with remaining maturities of one year or less but greater than three months at the time of acquisition and are carried at amortized cost, which approximates fair value. Cash and cash equivalents includes same cash on hand, amounts due from banks and highly liquid debt instruments that have original maturities of three months or less at date of purchase and are stated at amortized cost.

All acquisitions of securities are recorded in the financial statements on a trade date basis except for the acquisitions of private placement bonds, which are recorded on the funding date.

The AVR is used to stabilize surplus from fluctuations in the market value of bonds and other investments. Changes in the AVR are accounted for as direct increases or decreases in surplus. The IMR captures interest related realized gains and losses on sales (net of taxes) of bonds, interest related other-than-temporary impairments (net of taxes) and realized gains or losses (net of taxes) on terminated interest rate related derivatives which are amortized into net income over the expected years to maturity of the investments sold or the item being hedged using the grouped method. An interest related other-than-temporary impairment occurs when the Company has the intent to sell an investment, at the reporting date, before recovery of the cost of the investment. For loan-backed and structured securities, the non-interest related other-than-temporary impairment is booked to the AVR, and the interest related portion to the IMR.

**Premiums and Related Expenses**

Life premiums are recognized as revenue when due. Commissions are charged to operations as incurred. Amounts received or paid under deposit type contracts without mortality or morbidity risk are not reported as income or benefits but are recorded directly as an adjustment to the liability for deposit funds.

**Policy Reserves**

Policy reserves are based on mortality tables and valuation interest rates, which are consistent with statutory requirements and are designed to be sufficient to provide for contractual benefits. The Company holds reserves greater than those developed under the minimum statutory reserving rules when the valuation actuary determines that the minimum statutory reserves are inadequate. Actual results could differ from these estimates and may result in the establishment of additional reserves. The valuation actuary monitors actual experience and where circumstances warrant, revises assumptions and the related estimates for policy reserves. Refer to Note 10 – Insurance Liabilities, for discussion of reserves in excess of minimum NAIC requirements.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 3– SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Federal Income Taxes**

Current federal income taxes are charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year and any adjustments to such estimates from prior years. Deferred federal income tax assets (“DTAs”) and deferred federal income tax liabilities (“DTLs”) are recognized for expected future tax consequences of temporary differences between statutory and taxable income. Temporary differences are identified and measured using a balance sheet approach whereby statutory and tax balance sheets are compared. Changes in DTAs and DTLs are recognized as a separate component of surplus (except for the net deferred tax asset related to unrealized gains, which is included in unrealized gains and losses). Net DTAs are admitted to the extent permissible under NAIC SAP. Gross DTAs are reduced by a statutory valuation allowance, if it is more likely than not that some portion or all of the gross DTA will not be realized. The Company is required to establish a tax loss contingency if it is more likely than not that a tax position will not be sustained. The amount of the contingency reserve is management’s best estimate of the amount of the original tax benefit that could be reversed upon audit, unless the best estimate is greater than 50% of the original tax benefit, in which case the reserve is equal to the entire tax benefit.

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was signed into law, making significant changes to the U.S. Internal Revenue Code that could impact the Company’s effective tax rate and cash tax payments in future periods. Among the key provisions that impact the 2017 financial statements are the following: (1) a reduction in the corporate income tax rate to 21% and (2) the transition to a territorial tax system rather than a worldwide system, including the imposition of a one-time transitional tax on the accumulated earnings of our foreign subsidiaries. Other significant provisions that are not yet effective but may impact income taxes in future years include: (1) modifications to the calculation of the dividends received deduction (“DRD”), (2) changes in how deductions are determined for insurance reserves, (3) increases in the amount of policy acquisition expenses that must be capitalized and amortized for federal income tax purposes, (4) the imposition of a Global Intangible Low-Taxed Income (“GILTI”) provision which applies to a U.S. minimum tax to earnings of foreign subsidiaries in excess of 10% deemed return on tangible assets for foreign subsidiaries, (5) a new tax with respect to payments to non-U.S. affiliates that are at least 25% owned (the Base Erosion Anti-Abuse Tax (the “BEAT Tax”) and (6) limitations on the current deductibility of net interest expense.

On February 8, 2008, the NAIC issued Interpretation (“INT”) 18-01 to address the reporting and updating of estimates that companies are required to reflect as various accounting adjustments in their financial statements as a result of TCJA. This guidance provides that, although some accounting computations may be considered “complete”, other accounting computations or assessments may be considered “incomplete” when the financial statements are filed. As such, for those items which are “incomplete” but for which a reasonable estimate can be made those amounts should be recorded as provisional in the year-end 2017 financial statements. For those items for which a reasonable estimate cannot be made, companies may continue to apply pre-TCJA law. Changes to amounts recognized in the 2017 financial statements as a result of TCJA, shall be recognized as a change in accounting estimate, pursuant to SSAP No. 3, when the information necessary to update the estimate becomes available.

The Company is a member of an affiliated group, which files a consolidated federal income tax return with New York Life. The consolidated income tax provision or benefit is allocated among the members of the group in accordance with a tax allocation agreement. This tax allocation agreement provides that the Company computes its share of the consolidated tax provision or benefit, in general, on a separate company basis, and may, where applicable, include the tax benefits of operating or capital losses utilizable in the New York Life's consolidated returns. Intercompany tax balances are settled quarterly on an estimated basis with a final

**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 3– SIGNIFICANT ACCOUNTING POLICIES (continued)**

settlement occurring within 30 days of the filing of the consolidated tax return. Current federal income taxes are charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year and any adjustments to such estimates from prior years.

**Other Assets and Liabilities**

Other assets primarily consist of guaranty funds receivable and receivables from parent.

Other liabilities consist primarily of amounts payable for undelivered securities, premiums paid in advance and IMR.

**Nonadmitted Assets**

Under statutory accounting practices, certain assets are designated as nonadmitted assets and are not included in the accompanying Statutory Statements of Financial Position since these assets are not permitted by the AZID to be taken into account in determining the Company's financial condition. Nonadmitted assets primarily consists of DTAs not realizable within three years and receivables over ninety days past due. Changes to nonadmitted assets are reported as a direct adjustment to surplus in the accompanying Statutory Statements of Changes in Surplus.

**Fair Value of Financial Instruments and Insurance Liabilities**

Fair value of various assets and liabilities are included throughout the notes to the financial statements. Specifically, fair value disclosure of investments held is reported in Note 6 – Investments. Fair values for insurance liabilities are reported in Note 10 – Insurance Liabilities. The aggregate fair value of all financial instruments summarized by type is included in Note 7 – Fair Value Measurements.

**Contingencies**

Amounts related to contingencies are accrued if it is probable that a liability has been incurred and an amount is reasonably estimable.

**NOTE 4 – BUSINESS RISKS AND UNCERTAINTIES**

The Company is exposed to an array of risks, including, but not limited to, regulatory actions, financial risk, risks associated with its investments and operational risk, including cyber security.

The Company is regulated by the insurance departments of the states and territories where it is licensed to do business. Although the federal government does not directly regulate the business of insurance, federal legislation and administrative policies can significantly and adversely affect the insurance industry and the Company. The Company is unable to predict whether any administrative or legislative proposals, at both the federal or state level, will be adopted in the future, or the effect, if any, such proposals would have on the Company.

The Company's insurance liabilities and assets under management are exposed to market risk, policyholder behavior risk and mortality/longevity risk. Furthermore, the level of sales of the Company's insurance products is influenced by many factors, including general market rates of interest, the strength, weakness and volatility of equity markets, and terms and conditions of competing products.

**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 4 - BUSINESS RISKS AND UNCERTAINTIES (continued)**

The Company is exposed to the risks normally associated with an investment portfolio, which include interest rate, liquidity, credit and counterparty risks. The Company controls its exposure to these risks by, among other things, closely monitoring and managing the duration and cash flows of its assets and liabilities, maintaining a large percentage of its portfolio in highly liquid securities, engaging in a disciplined process of underwriting, reviewing and monitoring credit risk, and by devoting significant resources to develop and periodically update its risk management policies and procedures.

The Company relies on computer systems to conduct business and to retain confidential information. The failure of the Company's computer systems for any reason could disrupt its operations, result in the loss of customer business, damage the Company's reputation, expose the Company to litigation and regulatory action and adversely impact its profitability.

**NOTE 5 – RECENT ACCOUNTING PRONOUNCEMENTS**

Accounting changes adopted to conform to the provisions of NAIC SAP or other state prescribed accounting practices are reported as changes in accounting principles. The cumulative effect of changes in accounting principles is generally reported as an adjustment to unassigned funds (surplus) in the period of the change in accounting principle. Generally, the cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principles had been applied retroactively for all prior periods. There were no significant accounting changes in 2017 or 2016.

**NOTE 6 - INVESTMENTS**

**Bonds**

The carrying value and estimated fair value of bonds as of December 31, 2017 and 2016, by contractual maturity are presented below (in thousands):

	<u>2017</u>		<u>2016</u>	
	<u>Carrying Value</u>	<u>Estimated Fair Value</u>	<u>Carrying Value</u>	<u>Estimated Fair Value</u>
Due in one year or less	\$ 14,580	\$ 14,680	\$ 13,735	\$ 13,820
Due after one year through five years	60,602	61,092	48,010	49,251
Due after five years through ten years	58,676	59,192	71,334	71,249
Due after ten years	12,545	12,695	15,504	15,459
Total	<u>\$ 146,403</u>	<u>\$ 147,659</u>	<u>\$ 148,583</u>	<u>\$ 149,779</u>

Corporate bonds are shown based on contractual maturity. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage and asset-backed securities are not due at a single maturity date and therefore are shown based on the expected cash flows of the underlying loans, which includes estimates of anticipated future prepayments.

In addition to the information disclosed above, cash equivalents with a carrying value of \$4,939 thousand and \$4,009 thousand at December 31, 2017 and 2016, respectively, and short-term investments with a carrying value of \$394 thousand at December 31, 2016, are included in due in one year or less in the table above.



**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 6 – INVESTMENTS (continued)**

The Company did not have any short-term investments at December 31, 2017. Carrying value approximates fair value for these investments.

At December 31, 2017 and 2016, the distribution of gross unrealized gains and losses on bonds were as follows (in thousands):

	<b>2017</b>			
	<b>Carrying Value</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Estimated Fair Value</b>
U.S. Treasury	\$ 3,855	\$ 8	\$ 20	\$ 3,843
U.S. agency mortgage and asset-backed securities	25,613	456	372	25,697
Foreign governments	1,623	19	—	1,642
U.S. corporate	87,574	1,265	496	88,343
Foreign corporate	22,029	381	61	22,349
Non-agency residential mortgage-backed securities	166	10	—	176
Non-agency commercial mortgage-backed securities	4,548	51	2	4,597
Non-agency asset-backed securities	995	17	—	1,012
<b>Total</b>	<b>\$ 146,403</b>	<b>\$ 2,207</b>	<b>\$ 951</b>	<b>\$ 147,659</b>

  

	<b>2016</b>			
	<b>Carrying Value</b>	<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	<b>Estimated Fair Value</b>
U.S. Treasury	\$ 7,977	\$ 52	\$ 1	\$ 8,028
U.S. agency mortgage and asset-backed securities	26,404	446	483	26,367
Foreign governments	2,623	40	—	2,663
U.S. corporate	83,276	1,550	881	83,945
Foreign corporate	21,771	389	87	22,073
Non-agency residential mortgage-backed securities	191	11	1	201
Non-agency commercial mortgage-backed securities	5,359	106	2	5,463
Non-agency asset-backed securities	982	57	—	1,039
<b>Total</b>	<b>\$ 148,583</b>	<b>\$ 2,651</b>	<b>\$ 1,455</b>	<b>\$ 149,779</b>

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 6 – INVESTMENTS (continued)**

**Assets on Deposit**

Assets with a carrying value of \$3,357 thousand and \$3,802 thousand at December 31, 2017 and 2016, respectively, were on deposit with government authorities or trustees as required by certain state insurance laws and are included with bonds in the accompanying Statutory Statements of Financial Position.

At December 31, 2017 and 2016, the Company's restricted assets were as follows (\$ in thousands):

<b>December 31, 2017</b>							
Restricted Asset Category	<b>Gross Restricted</b>			Total Current Year Admitted Restricted	<b>Percentage</b>		
	Total Current Year	Total From Prior Year	Increase / (Decrease)		Gross Restricted to Total Assets	Admitted Restricted to Total Admitted Assets	
On deposit with states	\$ 3,357	\$ 3,802	\$ (445)	\$ 3,357	1.877%	1.894%	

  

<b>December 31, 2016</b>							
Restricted Asset Category	<b>Gross Restricted</b>			Total Current Year Admitted Restricted	<b>Percentage</b>		
	Total Current Year	Total From Prior Year	Increase / (Decrease)		Gross Restricted to Total Assets	Admitted Restricted to Total Admitted Assets	
On deposit with states	\$ 3,802	\$ 3,836	\$ (34)	\$ 3,802	2.053%	2.079%	

**NOTE 7 – FAIR VALUE MEASUREMENTS**

The Company's financial assets and liabilities have been classified, for disclosure purposes, based on a hierarchy defined by SSAP No. 100, "Fair Value Measurements." Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This guidance establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are based on the inputs to the valuation as follows:

- Level 1 Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market. Active markets are defined as a market in which many transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices in active markets for similar assets or liabilities; quoted prices in markets that are not active for identical or similar assets or liabilities, or other model driven inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Valuations are generally obtained from third-party pricing services for identical or comparable assets or liabilities or through the use of valuation methodologies using observable market inputs.
- Level 3 Instruments whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions in pricing the asset or liability. Pricing may also be based upon

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 7 – FAIR VALUE MEASUREMENTS (continued)**

broker quotes that do not represent an offer to transact. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Non-binding broker quotes, which are utilized when pricing service information is not available, are reviewed for reasonableness based on the Company's understanding of the market, and are generally considered Level 3. To the extent the internally developed valuations use significant unobservable inputs, they are classified as Level 3.

The Company had no investments held at fair value as of December 31, 2017 and 2016.

**Determination of Fair Value**

The Company has an established and well-documented process for determining fair value. Security pricing is applied using a hierarchy approach whereby publicly available prices are first sought from nationally recognized third-party pricing services. For most private placement securities, the Company applies a matrix-based pricing methodology, which uses spreads derived from third-party benchmark bond indices. For private placement securities that cannot be priced through these processes, the Company uses internal models and calculations. All other securities are submitted to independent brokers for prices. The Company performs various analyses to ascertain that the prices represent fair value. Examples of procedures performed include, but are not limited to, back testing recent trades, monitoring of trading volumes, and performing variance analysis of monthly price changes using different thresholds based on asset type. The Company also performs an annual review of all third-party pricing services. During this review, the Company obtains an understanding of the process and sources used by the pricing service to ensure that they maximize the use of observable inputs, the pricing service's frequency of updating prices, and the controls that the pricing service uses to ensure that their prices reflect market assumptions. The Company also selects a sample of securities and obtains a more detailed understanding from each pricing service regarding how they derived the price assigned to each security. Where inputs or prices do not reflect market participant assumptions, the Company will challenge these prices and apply different methodologies that will enhance the use of observable inputs and data. The Company may use non-binding broker quotes or internal valuations to support the fair value of securities that go through this formal price challenge process.

In addition, the Company has a pricing committee that provides oversight over the Company's prices and fair value process for securities. The committee is comprised of representatives from the Company's Investment Management group, Controller's, Compliance and Security Operations. The committee meets quarterly and is responsible for the review and approval of the Company's valuation procedures. The committee is also responsible for the review of pricing exception reports as well as the review of significant inputs used in the valuation of assets that are valued internally.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 7 – FAIR VALUE MEASUREMENTS (continued)**

The following table presents the carrying value and estimated fair values of the Company's financial instruments at December 31, 2017 (in thousands):

	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Not Practicable</u>
Assets:						
Bonds	\$ 147,659	\$ 146,403	\$ —	\$ 147,659	\$ —	\$ —
Cash, cash equivalents and short-term investments	3,189	3,189	22	3,167	—	—
Investment income due and accrued	1,003	1,003	—	1,003	—	—
Total assets	<u>\$ 151,851</u>	<u>\$ 150,595</u>	<u>\$ 22</u>	<u>\$ 151,829</u>	<u>\$ —</u>	<u>\$ —</u>
Liabilities:						
Premiums paid in advance	\$ 103	\$ 103	\$ —	\$ 103	\$ —	\$ —
Total liabilities	<u>\$ 103</u>	<u>\$ 103</u>	<u>\$ —</u>	<u>\$ 103</u>	<u>\$ —</u>	<u>\$ —</u>

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2016 (in thousands):

	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Not Practicable</u>
Assets:						
Bonds	\$ 149,779	\$ 148,583	\$ —	\$ 149,779	\$ —	\$ —
Cash, cash equivalents and short-term investments	3,818	3,818	—	3,818	—	—
Investment income due and accrued	1,020	1,020	—	1,020	—	—
Total assets	<u>\$ 154,617</u>	<u>\$ 153,421</u>	<u>\$ —</u>	<u>\$ 154,617</u>	<u>\$ —</u>	<u>\$ —</u>
Liabilities:						
Premiums paid in advance	\$ 97	\$ 97	\$ —	\$ 97	\$ —	\$ —
Total liabilities	<u>\$ 97</u>	<u>\$ 97</u>	<u>\$ —</u>	<u>\$ 97</u>	<u>\$ —</u>	<u>\$ —</u>

**Bonds**

Securities priced using a pricing service are classified as Level 2. The pricing service generally uses an income-based valuation approach by using a discounted cash-flow model or it may use a market approach by looking at recent trades of a specific security to determine fair value on public securities or a combination of the two. Typical inputs used by these pricing services include, but are not limited to: benchmark yields, reported trades, issuer spreads, bids, offers, benchmark securities, estimated cash flows and prepayment speeds.

Private placement securities are primarily priced using a market approach such as a matrix-based pricing methodology, which uses spreads derived from third-party benchmark bond indices. Specifically, the Barclays Investment Grade Corporate Index is used for investment-grade securities and the Citi High Yield Cash Index is used for below investment-grade securities. These indices are two widely recognizable, reliable and well regarded benchmarks by participants in the financial industry which represent the broader U.S.

**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 7 – FAIR VALUE MEASUREMENTS (continued)**

public bond markets. The spreads derived from each matrix are adjusted for liquidity. The liquidity premium is standardized and based on market transactions.

Certain private placement securities that cannot be priced using the matrix pricing described above, are priced by an internally developed discounted cash flow model or are based on internal calculations. The model uses observable inputs with a discount rate based off spreads of comparable public bond issues, adjusted for liquidity, rating and maturity. The Company assigns a credit rating for private placement securities based upon internal analysis. The liquidity premium is usually based on market transactions. These securities are classified as Level 2.

For some of the private placement securities priced through the model, the liquidity adjustments may not be based on market data, but rather, calculated internally. If the impact of the liquidity adjustment, which usually requires the most judgment, is not significant to the overall value of the security, the security is still classified as Level 2. If it is deemed to be significant, the security is classified as Level 3.

The valuation techniques for most Level 3 bonds are generally the same as those described in Level 2. However, if the investments are less liquid or are lightly traded, there is generally less observable market data, and therefore these investments will be classified as Level 3. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. In addition, certain securities are priced based upon internal valuations using significant unobservable inputs. If a security could not be priced by a third-party vendor or through internal pricing models, broker quotes are received and reviewed by each investment analyst. These inputs may not be observable therefore Level 3 classification is determined to be appropriate.

**Cash, Cash Equivalents and Short-term Investments and Investment Income Due and Accrued**

Cash on hand is classified as Level 1. Cash overdrafts (i.e. outstanding checks) are classified as Level 2. Due to the short-term maturities of cash equivalents, short-term investments, and investment income due and accrued, carrying value approximates fair value and is classified as Level 2.

**Premiums Paid in Advance**

For premiums paid in advance, the carrying value of the liability approximates fair value.

**NOTE 8 - INVESTMENT INCOME AND CAPITAL GAINS AND LOSSES**

The components of net investment income for the years ended December 31, 2017 and 2016 were as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Bonds <sup>(1)</sup>	\$ 4,582	\$ 5,399
Cash, cash equivalents and short-term investments	<u>61</u>	<u>23</u>
Gross investment income	4,643	5,422
Investment expenses	<u>(146)</u>	<u>(167)</u>
Net investment income	4,497	5,255
Amortization of IMR	<u>(30)</u>	<u>(24)</u>
Net investment income, including IMR	<u>\$ 4,467</u>	<u>\$ 5,231</u>

<sup>(1)</sup> Prepayment income of \$250 thousand and \$32 thousand for the years ended December 31, 2017 and 2016, respectively, is included in bonds in the net investment income chart above.

**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 8 – INVESTMENT INCOME AND CAPITAL GAINS AND LOSSES (continued)**

The following table shows the Company's securities redeemed or otherwise disposed as a result of a callable feature (including make whole call provisions) and the aggregate amount of investment income generated as a result of a prepayment and/or acceleration fee (in millions):

	<b>General Account</b>
Number of cusips	4
Aggregate amount of investment income	\$ 32

Proceeds from investments in bonds sold were \$11,717 thousand and \$21,510 thousand for the years ended December 31, 2017 and 2016, respectively. Gross gains of \$82 thousand and \$32 thousand in 2017 and 2016, respectively, and gross losses of \$30 thousand and \$499 thousand in 2017 and 2016, respectively, were realized on these sales. The Company computes gains and losses on sales under the specific identification method.

For the years ended December 31, 2017 and 2016, realized capital gains and losses on sales of bonds were as follows (in thousands):

	<b>2017</b>		<b>2016</b>	
	<b>Gains</b>	<b>Losses</b>	<b>Gains</b>	<b>Losses</b>
Bonds	\$ 92	\$ 34	\$ 49	\$ 519
Net realized capital gains (losses) before tax and transfer to the IMR	\$ 58		\$ (470)	
Less:				
Capital gains tax expense (benefit)	33		(162)	
Net realized capital gains (losses) after tax transferred to IMR	3		(307)	
Net realized capital gains (losses) after tax and transfers to the IMR	\$ 22		\$ (1)	

The Company had no other-than-temporary impairments for the year ended December 31, 2017. Included in the realized capital losses for the year ended December 31, 2016 are other-than-temporary impairments on bonds of \$8 thousand.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 8 – INVESTMENT INCOME AND CAPITAL GAINS AND LOSSES (continued)**

The following tables present the Company’s gross unrealized losses and fair values for bonds aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016 (in thousands):

	2017					
	Less than 12 months		Greater than 12 months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Bonds						
U.S. Treasury	\$ 1,229	\$ 19	\$ 200	\$ —	\$ 1,429	\$ 19
U.S. agency mortgage and asset-backed securities	7,946	84	9,669	287	17,615	371
U.S. corporate	26,095	182	14,976	314	41,071	496
Foreign corporate	5,804	40	1,981	22	7,785	62
Non-agency commercial mortgage-backed securities	569	2	—	—	569	2
Total	<u>\$ 41,643</u>	<u>\$ 327</u>	<u>\$ 26,826</u>	<u>\$ 623</u>	<u>\$ 68,469</u>	<u>\$ 950</u>

	2016					
	Less than 12 months		Greater than 12 months		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Bonds						
U.S. Treasury	\$ 199	\$ 1	\$ —	\$ —	\$ 199	\$ 1
U.S. agency mortgage and asset-backed securities	17,703	457	243	27	17,946	484
U.S. corporate	38,000	826	1,504	55	39,504	881
Foreign corporate	11,449	87	—	—	11,449	87
Non-agency residential mortgage-backed securities	—	—	94	1	94	1
Non-agency commercial mortgage-backed securities	479	2	—	—	479	2
Total	<u>\$ 67,830</u>	<u>\$ 1,373</u>	<u>\$ 1,841</u>	<u>\$ 83</u>	<u>\$ 69,671</u>	<u>\$ 1,456</u>

At December 31, 2017, the gross unrealized loss on bonds was comprised of approximately 129 different securities, which are reflected in the table above. Of the total amount of bond unrealized losses, \$948 thousand or 99.8% is related to unrealized losses on investment grade securities. At December 31, 2016, the gross unrealized loss on bonds was comprised of approximately 142 different securities, which are reflected in the table above. Of the total amount of bond unrealized losses, \$1,448 thousand or 99.6% is related to unrealized losses on investment grade securities. Investment grade is defined as a security having a credit rating from the NAIC of 1 or 2; a rating of Aaa, Aa, A or Baa from Moody’s or a rating of AAA, AA, A or BBB from Standard & Poor’s (“S&P”); or a comparable internal rating if an externally provided rating is not available. Unrealized losses on bonds with a rating below investment grade represent \$2 thousand or 0.2% of the total amount of bond unrealized losses.

There were no bonds where fair value had declined by 20% or more of the amortized cost at December 31, 2017 and 2016.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 9 – RELATED PARTY TRANSACTIONS**

New York Life provides the Company with certain services and facilities including, but not limited to, accounting, tax and auditing services; legal services; actuarial services; electronic data processing operations; and communications operations. New York Life charges the Company for the identified costs associated with these services and facilities under the terms of a service agreement between New York Life and the Company. For the years ended December 31, 2017 and 2016, the fees incurred associated with these services and facilities, amounted to \$4,296 thousand and \$3,172 thousand, respectively, and are reflected in operating expenses and net investment income in the accompanying Statutory Statements of Operations.

The Company is a party to an investment advisory agreement with NYL Investors LLC ("NYL Investors"), a wholly-owned subsidiary of New York Life, whereby NYL Investors provides investment advisory and administrative services to the Company. For the years ended December 31, 2017 and 2016, the total cost for these services amounted to \$144 thousand and \$152 thousand, respectively, which is included in the costs of services billed by New York Life to the Company.

The Company reported \$2,549 thousand and \$2,635 thousand as net amounts payable to parent and affiliates at December 31, 2017 and 2016, respectively. The terms of the agreement require that these amounts be settled in cash within 90 days.

The Company compensates New York Life and New York Life Insurance and Annuity Corporation ("NYLIAC"), a wholly-owned subsidiary of New York Life, for policy credits associated with converting the Company's term policies to permanent cash value life insurance policies issued by New York Life and NYLIAC without any additional underwriting.

The Company incurred the following conversion charges during 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
New York Life	\$ 643	\$ 807
NYLIAC	2,333	3,613
Total	<u>\$ 2,976</u>	<u>\$ 4,420</u>



**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 10 – INSURANCE LIABILITIES**

**Policy Reserves and Deposit Fund Liabilities**

At December 31, 2017 and 2016, total direct life reserves were \$77,767 thousand and \$90,773 thousand, respectively, with none of the policies having surrender privileges since the Company wrote only term policies.

Reserves for life insurance policies are maintained principally using the 1980 and 2001 Commissioners' Standard Ordinary ("CSO") Mortality Tables under the net level premium method or the Commissioners' Reserve Valuation Method ("CRVM") with valuation interest rates of 4.5% and 4.0%, respectively.

At December 31, 2017 and 2016, there were no changes to reserve basis.

The Company has established policy reserves (excluding the effects of reinsurance) on contracts issued January 1, 2001 and later that exceed the minimum amounts determined under Appendix A-820, "*Minimum Life and Annuity Reserve Standards*" of NAIC SAP by approximately \$2 thousand in both 2017 and 2016.

The Company waives deductions of deferred fractional premiums upon death of the insured and returns a portion of the final premium beyond the date of death. No surrender values are promised in excess of the total reserves. Certain substandard policies are valued on tables that are multiples of the standard table. Other substandard policies are valued as equivalent to standard lives on the basis of insurance age. Additional reserves are held on account of anticipated extra mortality for policies subject to extra premiums.

At December 31, 2017 and 2016, the Company had \$340 thousand and \$4,030 thousand, respectively, of insurance in force for which the gross premiums were less than the net premiums according to the standard of valuation set by the State of Arizona.

Tabular interest credited to policy reserves and the tabular less actual reserve released have been determined by formula as described in the NAIC instructions. The tabular cost has been determined by formula as described in the NAIC instructions adjusted for the difference in valuation mortality in different years between the tabular cost of mortality floor and the rest of the Regulation XXX calculation.

The following table reflects the withdrawal characteristics of deposit fund liabilities as of December 31, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
At book value without adjustment	\$ 1,713	\$ 2,294

At December 31, 2017 and 2016, deposit fund liabilities of \$1,713 thousand and \$2,294 thousand, respectively, were all eligible for surrender and payable in cash to depositors.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 11 – REINSURANCE**

The Company enters into reinsurance agreements in the normal course of its insurance business to reduce overall risk. The Company remains liable for reinsurance ceded if the reinsurer fails to meet its obligation on the business it has assumed. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Life insurance reinsured was 61% and 50% of total life insurance in force at December 31, 2017 and 2016, respectively. The reserve reductions taken for life insurance reinsured at December 31, 2017 and 2016 were \$18,288 thousand and \$20,439 thousand, respectively.

The effects of reinsurance for the years ended December 31, 2017 and 2016 were as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Premiums:		
Direct	\$ 31,657	\$ 36,876
Assumed	227	227
Ceded	<u>(17,089)</u>	<u>(18,606)</u>
Net premiums	<u>\$ 14,795</u>	<u>\$ 18,497</u>
Policyholders' benefits ceded	\$ 11,280	\$ 10,757
Reinsurance recoverable	\$ 1,426	\$ 471

The Company has reinsurance agreements with New York Life Agents Reinsurance Company (“NYLARC”). NYLARC is a life insurance company wholly owned by NYLARC Holding Company, Inc., whose shareholders consist of New York Life’s top agents who meet certain criteria and who may also be agents of the Company or NYLIAC. NYLARC reinsures a portion of certain life insurance products sold by its shareholders. NYLARC’s purpose is to retain high production agents, and increase the volume and quality of the business that they submit to New York Life, NYLIAC and the Company.

A stop loss agreement between New York Life and NYLAZ is in effect. Under the stop loss agreement, New York Life reinsures the portion of any claim incurred by NYLAZ in any calendar quarter that exceeds 10% of NYLAZ’s surplus, after taking external reinsurance into account. In addition, under the stop loss agreement, NYLIC reinsures the portion of aggregate annual claims paid by NYLAZ that exceeds \$30 million, less any amount paid in a prior calendar quarter by New York Life to reimburse NYLAZ for the portion of claims exceeding 10% of NYLAZ’s surplus. The premiums for this coverage were \$360 thousand and \$210 thousand for December 31, 2017 and 2016, respectively.

**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 12 – BENEFIT PLANS**

The Company participates in the cost of the following plans sponsored by New York Life: (1) certain postretirement life and health benefits for retired employees and agents including their eligible dependents, (2) certain defined benefit pension plans for eligible employees and agents, (3) certain defined contribution plans for substantially all employees and agents and (4) postemployment benefits. The expense for these plans is allocated to the Company in accordance with an intercompany cost sharing agreement. The liabilities for these plans are included with the liabilities for the corresponding plan of New York Life. The Company's share of the cost of these plans was as follows for the years ended December 31, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Postretirement life and health	\$ 40	\$ 28
Defined benefit pension	136	115
Defined contribution	47	41
Post employment	—	1
Total	<u>\$ 223</u>	<u>\$ 185</u>

**NOTE 13 – COMMITMENTS AND CONTINGENCIES**

**Support and Credit Agreements**

The Company has a credit agreement with New York Life dated August 11, 2004, and restated November 16, 2015, under which the Company may borrow from New York Life in an amount of up to \$10,000 thousand. During 2017 and 2016, the credit facility was not used, no interest was paid, and there was no outstanding balance due.

**Litigation**

The Company, along with New York Life and NYLIAC, is a defendant in one consolidated purported class action suit arising from its agency sales force. The lawsuit seeks, among other things, extra contractual damages. Notwithstanding the uncertain nature of litigation, the outcome of which cannot be predicted, the Company believes that, after provisions made in the financial statements, the ultimate liability that could result from this litigation would not have a material adverse effect on the Company's financial position; however, it is possible that a settlement or adverse determination in this action or other proceedings in the future could have a material adverse effect on the Company's operating results for a given year.

**Liens**

Several commercial banks have customary security interests in certain assets of the Company to secure potential overdrafts and other liabilities of the Company that may arise under custody and other banking agreements with such banks.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 14 - INCOME TAXES**

The components of the net DTAs and DTLs for the years ended December 31, 2017 and 2016 were as follows (in thousands):

	2017			2016			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross DTAs	\$ 9,102	\$ 8	\$ 9,110	\$ 17,926	\$ 3	\$ 17,929	\$ (8,824)	\$ 5	\$ (8,819)
Statutory valuation allowance	—	—	—	—	—	—	—	—	—
Adjusted gross DTAs	9,102	8	9,110	17,926	3	17,929	(8,824)	5	(8,819)
Nonadmitted DTAs	786	8	794	1,573	—	1,573	(787)	8	(779)
Subtotal net admitted DTAs	8,316	—	8,316	16,353	3	16,356	(8,037)	(3)	(8,040)
Gross DTLs	6,259	—	6,259	10,880	3	10,883	(4,621)	(3)	(4,624)
Net admitted DTAs/(DTLs)	<u>\$ 2,057</u>	<u>\$ —</u>	<u>\$ 2,057</u>	<u>\$ 5,473</u>	<u>\$ —</u>	<u>\$ 5,473</u>	<u>\$ (3,416)</u>	<u>\$ —</u>	<u>\$ (3,416)</u>

Net DTAs are non-admitted primarily because they are not expected to be realized within three years of the balance sheet date. The admitted portion of the net DTAs is included in net deferred tax assets in the accompanying Statutory Statements of Financial Position.

The admission calculation components for the years ended December 31, 2017 and 2016 are as follows (paragraph references throughout Note 14 are to paragraphs of SSAP No. 101) (in thousands):

	2017			2016			Change		
	Ordinary	Capital	Total	Ordinary	Capital	Total	Ordinary	Capital	Total
Federal income taxes paid in prior years recoverable through loss carry backs (Paragraph 11.a)	\$ —	\$ —	\$ —	\$ 5,474	\$ —	\$ 5,474	\$ (5,474)	\$ —	\$ (5,474)
Adjusted gross DTAs expected to be realized (excluding the amount of DTAs from paragraph 11.a above) after application of the threshold limitation (the lesser of paragraph 11.b.i and 11.b.ii below):	2,057	—	2,057	—	—	—	2,057	—	2,057
Adjusted gross DTAs expected to be realized following the balance sheet date (Paragraph 11.b.i)	2,057	—	2,057	—	—	—	2,057	—	2,057
Adjusted gross DTAs allowed per limitation threshold (Paragraph 11.b.ii)	N/A	N/A	16,237	N/A	N/A	14,769	N/A	N/A	1,468
Adjusted gross DTAs (excluding the amount of DTAs from paragraphs 11.a and 11.b above) offset by gross DTLs (Paragraph 11.c)	6,259	—	6,259	10,880	3	10,883	(4,621)	(3)	(4,624)
DTAs admitted as the result of application of SSAP 101 (Totals of paragraphs 11.a, 11.b, 11.c)	<u>\$ 8,316</u>	<u>\$ —</u>	<u>\$ 8,316</u>	<u>\$ 16,354</u>	<u>\$ 3</u>	<u>\$ 16,357</u>	<u>\$ (8,038)</u>	<u>\$ (3)</u>	<u>\$ (8,041)</u>

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 14 - INCOME TAXES (continued)**

The ratio used to determine the applicable period used in paragraph 11.b.i above and the amount of adjusted capital and surplus used to determine the percentage threshold limitation in paragraph 11.b.ii above are as follows (\$ in thousands):

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Ratio percentage used to determine recovery period and threshold limitation amount.	3,695%	2,824%
Amount of adjusted capital and surplus used to determine recovery period and threshold limitation in paragraph 11.b.ii above.	\$ 108,246	\$ 98,459

There was no impact on the Company's adjusted gross and net admitted DTAs due to tax planning strategies at December 31, 2017 and 2016. The Company did not use reinsurance in its tax planning strategies.

The Company had no unrecognized DTL's at December 31, 2017 and 2016. At December 31, 2016, the Company had no adjustments of DTAs or DTLs for enacted changes in tax laws or rates, or a change in the tax status.

Additionally, the Company had no adjustments to gross DTAs because of a change in circumstances that causes a change in judgment about the realizability of the related DTAs.

Significant components of the current federal income tax expense incurred for the years ended December 31, 2017 and 2016 were as follows (in thousands):

	<b>2017</b>	<b>2016</b>	<b>Change</b>
Federal current income tax <sup>1</sup>	\$ 1,733	\$ 8,127	\$ (6,394)
Federal income tax on net capital gains	32	(162)	194
Other - prior period correction	—	245	(245)
Total federal income tax expense incurred	\$ 1,765	\$ 8,210	\$ (6,445)

<sup>1</sup> The Company had no investment tax credits for the years ended December 31, 2017 and 2016.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 14 - INCOME TAXES (continued)**

The tax effects of temporary differences that give rise to DTAs and DTLs for the years ended December 31, 2017 and 2016 were as follows (in thousands):

	<u>2017</u>	<u>2016</u>	<u>Change</u>
<b>DTAs</b>			
Ordinary			
Policyholder reserves	\$ 5,373	\$ 10,965	\$ (5,592)
Deferred acquisition costs	3,627	6,801	(3,174)
Fixed assets	45	79	(34)
Other	57	82	(25)
Subtotal	<u>9,102</u>	<u>17,927</u>	<u>(8,825)</u>
Nonadmitted	786	1,572	(786)
Admitted ordinary DTAs	<u>8,316</u>	<u>16,355</u>	<u>(8,039)</u>
Capital			
Investments	8	3	5
Nonadmitted	(8)	—	(8)
Admitted capital DTAs	<u>—</u>	<u>3</u>	<u>(3)</u>
Total admitted DTAs	<u>8,316</u>	<u>16,358</u>	<u>(8,042)</u>
<b>DTLs</b>			
Ordinary			
Deferred and uncollected premium	5,537	9,241	(3,704)
Investments	88	158	(70)
Policyholder reserves	634	1,482	(848)
Subtotal	<u>6,259</u>	<u>10,881</u>	<u>(4,622)</u>
Capital			
Investments	—	3	(3)
Total DTLs	<u>6,259</u>	<u>10,884</u>	<u>(4,625)</u>
Net admitted DTAs	<u>\$ 2,057</u>	<u>\$ 5,474</u>	<u>\$ (3,417)</u>
Deferred income tax benefit on change in net unrealized capital gains and losses			\$ 5
Decrease in net deferred tax related to other items			(4,200)
Decrease in DTAs nonadmitted			778
Total change in net admitted DTAs			<u>\$ (3,417)</u>

The TCJA was enacted on December 22, 2017. The TCJA significantly changes U.S. tax law primarily by lowering the corporate income tax rate from 35% to 21% beginning in 2018. Deferred taxes were revalued to reflect the 21% corporate income tax rate with the following result:

	<u>2017</u>
Deferred income tax benefit on change in net unrealized capital gains and losses	\$ —
Decrease in net deferred tax related to other items	(1,901)
Decrease in net deferred taxes	(1,901)
Decrease in nonadmitted DTAs	203
Total change in net admitted DTAs	<u>\$ (1,698)</u>

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 14 - INCOME TAXES (continued)**

All income tax effects have been identified and appropriately accounted for as a result of TCJA in accordance with INT 18-01. The tax accounting for the revaluation of deferred tax liabilities is complete. The following income tax effects have been recorded as provisional as the analysis is incomplete but a reasonable estimate can be determined: (1) restatement as of year-end 2017 of life insurance reserves for tax purposes pursuant to the TCJA.

For tax years beginning January 1, 2018, the TCJA limits life insurance reserves for tax purposes to the greater of the net surrender value or 92.81% of NAIC required reserves. In general the TCJA will result in lower life insurance reserves for tax purposes than under pre-TCJA law. Tax accounting for these changes requires the restatement of year end 2017 tax insurance reserves calculated using pre-TCJA rules to the amounts required to be held under the TCJA. This revaluation requires establishing a “gross up” in which an additional DTA for the revised statutory to tax differences is recorded. The TCJA also requires the recapture of prior years’ tax benefits from the higher life insurance reserves. This recapture is paid ratably over eight years beginning in 2018 and is recorded in the December 31, 2017 financial statements as a deferred tax liability in an equal amount to the additional deferred tax asset. The Company has recorded as a provisional amount offsetting DTAs and DTLs in the amount of \$60 thousand. The tax accounting will be completed within the measurement period, as defined in INT 18-01, and any adjustments will be recorded in the period in which the estimate is complete, in accordance with INT 18-01. The determination of the impact of the income tax effects of these items and the items reflected as provisional amounts will require additional analysis of historical records and further interpretation of the TCJA from yet to be issued U.S. Treasury regulations which will require more time, information and resources than currently available to the Company.

The Company’s income tax expense for the years ended December 31, 2017 and 2016 differs from the amount obtained by applying the statutory rate to net gain from operations before federal income taxes for the following reasons (in thousands):

	<b>2017</b>	<b>2016</b>	<b>Change</b>
Net gain from operations before federal income taxes at 35%	\$ 4,065	\$ 7,173	\$ (3,108)
Net realized capital gains at 35%	20	(162)	182
Amortization of IMR	10	8	2
Prior year audit liability and settlement	—	211	(211)
Nonadmitted assets	(35)	144	(179)
Impact of TCJA	1,901	—	1,901
Accruals in surplus	—	427	(427)
Prior period correction	—	245	(245)
Other	4	1	3
Income tax incurred and change in net DTAs during period	<u>\$ 5,965</u>	<u>\$ 8,047</u>	<u>\$ (2,082)</u>
Federal income taxes reported in the Statutory Statements of Operations	\$ 1,733	\$ 8,127	\$ (6,394)
Capital gains tax benefit/(expense) incurred	32	(162)	194
Change in net deferred income taxes	4,200	(163)	4,363
Prior period correction	—	245	(245)
Total statutory income tax expense	<u>\$ 5,965</u>	<u>\$ 8,047</u>	<u>\$ (2,082)</u>

The Company’s federal income tax returns are routinely audited by the Internal Revenue Service (“IRS”) and provisions are made in the financial statements in anticipation of the results of these audits. The IRS has

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 14 - INCOME TAXES (continued)**

completed audits through 2010 and tax years 2011 through 2013 are currently under examination. There were no material effects on the Company's Statutory Statements of Operations as a result of these audits. The Company believes that its recorded income tax liabilities are adequate for all open years.

The Company did not have any operating loss and tax credit carry forwards available for tax purposes. There are no taxes incurred in current and prior periods that are available for recoupment.

The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next 12 months.

As discussed in Note 3 – Significant Accounting Policies - Federal Income Taxes, the Company's federal income tax return is consolidated with New York Life, NYLIFE Insurance Company of Arizona, NYLIFE LLC, New York Life Enterprises LLC, NYL Investments, and NYL Investors.

At December 31, 2017, and 2016, the Company recorded a current income tax receivable of \$781 thousand and \$622 thousand, respectively, which is included in the federal income taxes receivable in the Statutory Statements of Financial Position.

At December 31, 2017, the Company had no protective tax deposits on deposit with the Internal Revenue Service under Section 6603 of the Internal Revenue Service Code.



**NYLIFE INSURANCE COMPANY OF ARIZONA  
NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 15 – CAPITAL AND SURPLUS**

**Capitalization**

The Company has 30,000 shares authorized, with a par value of \$100 per share with 25,000 shares issued and outstanding. All shares are common stock and are all owned by New York Life. The Company has no preferred stock.

**Nonadmitted Assets**

Under statutory accounting rules, a nonadmitted asset is defined as an asset having economic value other than that which can be used to fulfill policyholder obligations, or those assets that are unavailable due to encumbrances or other third-party interests. These assets are not recognized in the accompanying Statutory Statements of Financial Position, and are, therefore, considered nonadmitted. The changes between years in nonadmitted assets are charged or credited directly to surplus.

The following table shows the major categories of assets that are nonadmitted at December 31, 2017 and 2016, respectively (in thousands):

	<b>2017</b>	<b>2016</b>	<b>Change</b>
Net deferred tax asset	\$ 794	\$ 1,573	\$ (779)
Deferred and uncollected life insurance premiums	364	329	35
Other	469	369	100
Total	\$ 1,627	\$ 2,271	\$ (644)

**NOTE 16 - DIVIDENDS TO STOCKHOLDER**

The Company is subject to restrictions on the payment of dividends to New York Life. Under Arizona Insurance Law, cash dividends to stockholders may only be paid out of an insurer's available surplus funds which are derived from realized net profits on its business. The Company had available surplus funds of \$9,303 thousand and \$2,933 thousand at December 31, 2017 and 2016, respectively, from which to pay dividends. Stock dividends may be paid out of any available surplus funds that exceed the aggregate amount of surplus loaned to the insurer. No surplus funds have been loaned to the Company. In addition, generally, no extraordinary dividend (as described under Arizona Revised Statute (“A.R.S.”) Section 20-481.19) may be paid or distributed to stockholders without the prior approval of the Director of Insurance of Arizona. Dividends may be declared by the Board of Directors of the Company from available surplus, as it deems appropriate, on a non-cumulative basis. No dividends were paid or declared for the years ended December 31, 2017 and 2016.

**NYLIFE INSURANCE COMPANY OF ARIZONA**  
**NOTES TO STATUTORY FINANCIAL STATEMENTS**

**NOTE 17 – WRITTEN PREMIUMS**

Deferred and uncollected life insurance premiums at December 31, 2017 and 2016, were as follows (in thousands):

	2017		2016	
	Gross	Net of Loading	Gross	Net of Loading
Ordinary renewal	\$ 15,743	\$ 22,622	\$ 16,445	\$ 23,245

Based upon Company experience, the amount of premiums that may become uncollectible and result in a potential loss is not material to the Company's financial position. At December 31, 2017 and 2016, respectively, the Company nonadmitted \$364 thousand and \$329 thousand of premiums that were over 90 days past due.

**NOTE 18 – SUBSEQUENT EVENTS**

At March 30, 2018, the date the financial statements were available to be issued, there have been no events occurring subsequent to the close of the Company's books or accounts for the accompanying annual statement that would have a material effect on the financial condition of the Company.