
MANAGEMENT'S DISCUSSION AND ANALYSIS



THE PENN MUTUAL LIFE INSURANCE COMPANY

Management's Discussion and Analysis of Financial Condition and Results of Operations For the Year Ended December 31, 2015 (\$ in Millions)

Introduction

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") addresses the financial condition of The Penn Mutual Life Insurance Company ("the Company") at December 31, 2015, compared with December 31, 2014, and its results of operations for the years ended December 31, 2015 and 2014. This discussion should be read in conjunction with the Company's 2015 Statutory Annual Statement.

Forward-Looking Information

This MD&A contains forward-looking statements that are intended to enhance the reader's ability to assess the Company's future financial and business performance. Forward-looking statements include, but are not limited to, statements that represent the Company's beliefs concerning future operations, strategies, financial results or other developments, and contains words and phrases such as "may," "expects," "should," or similar expressions. Because these forward looking statements are based on estimates and assumptions that are subject to significant business, economic, and competitive uncertainties, many of which are beyond the Company's control or subject to change, actual results could be materially different. The following risks and uncertainties, among others, may have such an impact:

- Changes in economic conditions, including changes in interest rates and the performance of financial markets, which may have an impact on credit spreads, increase defaults on and impairments of our bond portfolio, reduce sales of our variable and investment management products and the fees we receive on assets under management, increase the level of our reserves for guaranteed minimum death and living benefits and increase our pension funding costs;
- Changes in domestic and foreign laws, rules and regulations, taxes, and accounting rules;
- Competitive pressures on product pricing and services, including competition by other insurance companies and financial services companies;
- A change in the Company's ratings by nationally recognized ratings organizations;
- Industry consolidation
- International tensions, the continued threat of terrorism, and ongoing military and other actions and heightened security measures in response to these threats;
- The relative success and timing of our business strategies;
- Adverse capital and credit market conditions and downturns and volatility in the global capital markets and economy
- Litigation and the possibility of regulatory investigations
- Inability of the Company to access credit facilities or other capital;
- Inability to attract and retain key personnel;
- Significant fluctuations in the market value of our investments that are relatively illiquid;
- Subjectivity in valuation of fixed maturity and equity securities;
- Sensitivity of the statutory risk-based capital that we are required to hold to factors outside the Company's control
- Deviations from assumptions regarding persistency, mortality, and interest rates used in calculation reserve amounts and in pricing the Company's products;
- Requirements to post collateral or make payments related to declines in the market value of specified assets;
- Losses due to defaults by others, including issuers of investment securities or reinsurance and derivative instrument counterparties;
- The rehabilitation, liquidation, conservation, or dissolution of the Company;
- Exposure to unidentified or unanticipated risks; and
- Computer system failures or security breaches.

Consequently, such forward-looking statements should be regarded solely as the Company's current plans, estimates, and beliefs. The Company does not intend, and does not undertake, any obligation to update any forward-looking statements to reflect future events or circumstances after the date of such statements.

Certain reclassifications have been made to prior year financial information to conform to the current year presentation.

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I. Overview

Founded in 1847, the Company is the second oldest mutual life insurance company in the United States. As a mutual life insurance company, the Company has no shareholders. Headquartered in Horsham, Pennsylvania, a suburban location about 25 miles outside of Philadelphia, the Company is licensed to do business in all 50 states and the District of Columbia, and is the largest life insurance company domiciled in Pennsylvania.

The Company provides individual life insurance and annuity products principally to affluent individuals, professionals and owners of small-to-medium size businesses. Products include whole life, term life, universal life, and variable universal life policies, as well as a full range of deferred and immediate annuity products. The Company markets its products through a network of career agents, independent agents, and independent broker dealers. These operations are conducted through the Company along with the following subsidiaries.

- Penn Insurance and Annuity Company (PIA), a wholly owned subsidiary of the Company, was organized in 1980 as a stock life insurance company domiciled in the state of Delaware to develop and sell nonparticipating products. PIA is licensed in 48 states and the District of Columbia and markets its business through the Company's distribution systems and has its in-force business serviced by the Company.
- Hornor Townsend & Kent, a registered broker/dealer; is a wholly owned subsidiary of the Company. It licenses the Company's producers and serves as the Company's marketing agent for registered products that are regulated as securities under federal and state securities laws.
- Janney Montgomery Scott LLC (Janney), acquired by the Company in 1982, is a wholly owned subsidiary of Independence Square Properties, LLC (ISP), which is an intermediate holding company for Janney. Janney is one of the largest full-service regional securities broker/dealers in the United States. Operating in predominantly retail markets, Janney serves customers throughout the country through a comprehensive network of branch offices located principally in the Mid-Atlantic and New England regions. It offers clients a comprehensive range of investment vehicles, from individual securities to mutual funds, insurance, and money management. It also provides investment-banking services to corporations, municipalities, and institutional clients.
- Penn Mutual Asset Management, Inc. (PMAM), a wholly owned subsidiary of the Company, was organized in 1989 to conduct business as a registered investment advisor.
- Leap Systems, LLC, acquired by the Company in 2012, is a wholly owned subsidiary of ISP. It is a leading provider of innovative financial systems for financial professionals throughout the United States and Canada.

The Company's subsidiaries are not consolidated for statutory reporting purposes.

Recent Activity

The Company has entered into a contract to cede reserves pursuant to transactions subject to the requirements of Section 7 of the NAIC XXX and AXXX Reinsurance Model Regulation. The contract is a 70% coinsurance with funds withheld agreement with PIA effective December 31, 2014, to reinsure all risks related to an in-force block of single life no-lapse guaranteed universal life policies, net of inuring reinsurance, issued between October 2007 and June 2013 and inforce as of December 31, 2014. The policies are within the scope of the NAIC Valuation of Life Insurance Policies Model Regulation ("Regulation AXXX"). PIA contemporaneously reinsured the policies to PIA Reinsurance Company of Delaware I ("PIA RE I"), an authorized, affiliated reinsurer. The total reserve credit transferred at December 31, 2015 and 2014 was \$943 and \$849 respectively. The reserve credit is supported by primary assets in the form of a funds withheld account held at the Company of \$646 and \$582 respectively, and other assets held by the ultimate assuming Company of \$296 and \$266 for 2015 and 2014.

Effective January 1, 2015, the Company ceded to PIA an inforce block of single life index universal life policies issued by the Company between 2012 and 2014. The Company ceded 100% of the risk, net of inuring reinsurance. The Company transferred \$113 of reserves and \$81 in securities, and received \$32 in ceding commission. The after-tax gain of \$21 was a direct increase to surplus and will be amortized into income over the emerging earnings of the business.

Effective January 1, 2015 the Company entered into a coinsurance/modified coinsurance reinsurance arrangement to cede certain whole life products. A quota share of 85% of each policy is ceded net of inuring reinsurance. The subject policies issued by the Company between January 2015 and December 2016 will be covered under the agreement, which is indefinite with no stated expiration.

Income, Benefits and Expenses

The Company derives its income principally from 1) insurance premiums, 2) mortality, asset management and administrative fees from insurance and investment products; and 3) net investment income from general account assets and other funds. The Company earns premiums primarily from the sale of new and retention of existing individual life and annuity policies. The Company's benefits and expenses consist principally of insurance benefits provided to policyholders and beneficiaries; changes to reserves; and operating expenses, including marketing, administrative, commissions, and other distribution costs. In addition, the Company expects to continue to sell, participating life insurance products, which typically pay annual policyholder dividends. As a result, a significant deduction from income is represented, and likely will continue to be represented, by policyholder dividends.

The Company's profitability depends primarily on the adequacy of its product pricing, which is a function of its ability to select underwriting risk, its mortality and persistency experience, its ability to generate earnings and control credit risk on the investments supporting its products and its ability to control expenses in accordance with its pricing assumptions.

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II. Critical Accounting 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.

The Company has identified the following estimates as critical in that they involve a higher degree of judgment and are subject to a significant degree of variability: carrying value of certain invested assets and derivatives, liabilities for reserves and funds for payment of insurance and annuity benefits, pension and other postretirement benefits, accounting for income taxes and valuation of deferred income tax assets and liabilities and unrecognized deferred tax benefits, and litigation and other contingencies. In developing these estimates, management makes subjective and complex judgments that are inherently uncertain and subject to material change as facts and circumstances develop. Although variability is inherent in these estimates, management believes the amounts provided are appropriate based upon the facts available as of the date of the financial statements.

Carrying Value of Certain Invested Assets and Derivatives

The carrying values of bonds, mortgage-backed and asset-backed securities are written down when a decline is considered to be other-than-temporary. The Company considers an impairment to be other than temporary ("OTTI") if: (a) the Company's intent is to sell, (b) the Company will more likely than not be required to sell, (c) the Company does not have the intent and ability to hold the security for a period of time sufficient to recover the amortized cost basis, or (d) the Company does not expect to recover the entire amortized cost basis. The Company conducts a periodic management review of all bonds including those in default, not-in-good standing, or otherwise designated by management. The Company also considers other qualitative and quantitative factors in determining the existence of other-than-temporary impairments including, but not limited to, unrealized loss trend analysis and significant short-term changes in value. If the impairment is other-than-temporary, the non-interest loss portion of the impairment is recorded through realized losses and the interest related portion of the loss would be disclosed in the notes to the financial statements.

The non-interest portion is determined based on the Company's "best estimate" of future cash flows discounted to a present value using the appropriate yield. The difference between the present value of the best estimate of cash flows and the amortized cost is the non-interest loss. The remaining difference between the amortized cost and the fair value is the interest loss.

The level of other-than-temporary impairments generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired 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 is accreted into net investment income, and included in adjusted operating income in future periods based upon the amount and timing of expected future cash flows of the security, if the recoverable value of the investment, based upon cash flows we can reasonably estimate, is greater than the carrying value of the investment after the impairment.

The Company utilizes derivatives to achieve its risk management goals. Exposure to risk is monitored and analyzed as part of the Company's asset/liability management process, which focuses on risks that impact liquidity, capital, and income. The Company may enter into derivative transactions to hedge exposure to interest rate, credit, liability, currency, and cash flow risks. The Company may use forward contracts, swaps, futures, options, swaptions, caps, floors, collars and options on futures to hedge these risks.

When entering into a derivative transaction, there are several risks, including but not limited to basis risk, credit risk, and market risk. Basis risk is the exposure to loss from imperfectly matched positions, and is monitored and minimized by modifying or terminating the transaction. Credit risk is the exposure to loss as a result of default or a decline in credit rating of counterparty. Credit risk is addressed by establishing and monitoring guidelines on the amount of exposure to any particular counterparty. Market risk is the adverse effect that a change in interest rates, currency rates, implied volatility rates, or a change in certain equity indexes or instruments has on the value of a financial instrument. The Company manages the market risk by establishing and monitoring limits as to the types and degree of risk that may be undertaken. Also, the Company requires that an International Swaps and Derivatives Association Master agreement govern all Over-the-Counter ("OTC") derivative contracts.

Liabilities for Reserves and Funds for Payment of Insurance and Annuity Benefits

Policyholders' reserves provide amounts adequate to discharge estimated future obligations in excess of estimated future premium on policies in-force. Any adjustments that are made to the reserve balances are reflected in the Statements of Income in the year in which such adjustments are made, with the exception of changes in valuation bases which is accounted for as charges or credits to surplus.

Reserves for life insurance and annuity contracts are based on mortality tables and valuation interest rates, which are consistent with statutory requirements. These reserves are expected to be sufficient to meet the Company's various policy and contract obligations as they become due. Changes in or deviations from the assumptions used for mortality, expected future premiums and interest can significantly affect the Company's reserve levels and related future operations.

In some situations, the Company may need to hold statutory reserves greater than those developed under the minimum statutory reserving rules. Annually, the Appointed Actuary is required by the regulators to test the adequacy of the statutory reserves using asset adequacy analysis. The dominant asset adequacy analysis technique is cash flow testing, which utilizes prescribed interest rate scenarios using detailed actuarial models. If the Appointed Actuary determines that the statutory reserves being tested are inadequate, additional statutory reserves are established. At the end of the process, the Appointed Actuary must opine that the statutory reserves are adequate to support the anticipated liabilities at maturity when considered in light of the assets held by the Company.

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Pension and Other Postretirement Benefits

Pursuant to accounting principles related to the Company's pension and other postretirement benefit obligations to employees and agents under its various benefit plans, the Company is required to make assumptions in order to estimate the liabilities and related expense each period. Assumptions that have an impact on pension and other postretirement benefit expense include the discount rate, the expected long-term rate of return of plan assets and health care cost trends.

The expected long-term rate of return on plan assets was 7.00% in 2015 and 2014. The expected rate of return on plan assets was estimated utilizing a variety of factors including the historical investment returns achieved over a long-term period, the targeted allocation of plan assets and expectations concerning future returns in the marketplace for both equity and debt securities. Lower returns on plan assets result in higher pension expense. The discount rate is determined at the annual measurement date of the plans and is therefore subject to change each year. The rate reflects prevailing market rates for high quality fixed-income debt instruments with maturities corresponding to expected duration of the benefit obligations on the measurement date. The rate is used to discount the future cashflows of benefits obligations back to the measurement date.

Accounting for Income Taxes and Valuation of Deferred Income Tax Assets and Liabilities and Unrecognized Deferred Tax Benefits

The Company files a consolidated federal income tax return with its insurance and non-insurance subsidiaries. Each subsidiary's tax liability or refund is accrued on a separate company basis. The Company reimburses subsidiaries for losses utilized in the consolidated return based on inter-company tax allocation agreements. The provision for federal income taxes is computed in accordance with the section of the Internal Revenue Code applicable to life insurance companies and is based on income that is currently taxable.

Uncertain tax positions ("UTP") are established when the merits of a tax position are evaluated against certain measurement and recognition tests. UTP changes are reflected as a component of income taxes.

Deferred income tax assets and liabilities are established to reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred tax assets or liabilities are measured by using the enacted tax rates expected to apply to taxable income in the period in which the deferred tax liabilities or assets are expected to be settled or realized. Changes in the deferred tax balances are reported as adjustments to surplus. Deferred tax assets in excess of statutory limits are treated as non-admitted assets and charged to surplus.

The company is required to evaluate the recoverability of deferred tax assets and to establish a valuation allowance if necessary to reduce the deferred tax asset to an amount which is more likely than not to be realized. Considerable judgment is required in determining whether a valuation allowance is necessary, and if so, the amount of such valuation allowance. In evaluating the need for a valuation allowance, the Company considers many factors, including: (1) the nature of the deferred tax assets and liabilities; (2) whether they are ordinary or capital; (3) the timing of their reversal; (4) taxable income in prior carry back years as well as projected taxable income exclusive of reversing temporary differences and carry forwards; (5) the length of time that carryovers can be utilized; (6) unique tax rules that would impact the utilization of the deferred tax assets; and (7) any tax planning strategies that the Company would employ to avoid a tax benefit from expiring unused; although the realization is not assured, management believes it is more likely than not that the deferred tax assets, net valuation allowances, will be realized. The Company has not recorded a valuation allowance as of December 31, 2015 and 2014.

The Internal Revenue Service ("IRS") has completed their examination of the Company's income tax returns through the year 2010. A limited scope audit for the years 2006-2010 was completed in 2015. Management believes they have adequately presented all adjustments. Tax years 2012 and subsequent are still subject to audit by the IRS.

Litigation and Other Contingencies

Management establishes reserves for contingencies at its "best estimate". The majority of commitments and contingencies currently being evaluated by the Company relate to the following:

In 2012, a putative class action complaint was filed against the Company in federal court alleging that the Company breached its contracts by allegedly failing to distribute surplus in excess of an alleged statutorily prescribed limit. After the complaint was filed, the Company moved to dismiss the complaint and plaintiffs opposed the Company's motion. The court decided the motion by abstaining from adjudicating the matter, ruling that the matter was one that should be decided by the Commonwealth of Pennsylvania Insurance Department. The action has been joined in the Insurance Department and the parties are presently conducting discovery. The Company believes that it has substantial defenses and will vigorously defend itself. No reasonable estimate can be made at this time regarding the potential liability, if any, or the amount or range of any loss that may result from this claim.

The Company reached an agreement with the New York State Department of Financial Services ("NY DFS") which will result in the Company holding additional statutory reserves on a New York only basis, beginning in 2015. The Company is not domiciled in New York, and these changes do not impact statutory reserves reported in our state of domicile, Pennsylvania, or any states other than New York, and therefore do not impact RBC ratios.

The Company is subject to insurance guaranty fund laws in the states in which it does business. These laws assess insurance companies' amounts to be used to pay benefits to policyholders and policy claimants of insolvent insurance companies. Many states allow these assessments to be credited against future premium taxes. The liability for estimated guaranty fund assessments net of applicable premium tax credits as of December 31, 2015 and 2014 was \$0.4 and \$0.8, respectively. The Company monitors sales materials and compliance procedures and makes extensive efforts to minimize any potential liabilities in this area. The Company believes such assessments in excess of amounts accrued will not materially impact its financial statement position, results of operation, or liquidity.

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III. Results of Operations

The following table illustrates the Company's results of operations for the years ended December 31,

	2015	2014	\$ Change	% Change
Income:				
Premiums and Annuity Considerations	\$ 1,192	\$ 657	\$ 535	81%
Net Investment Income	532	480	52	11%
Commissions and Expense Allowance on Reinsurance Ceded	100	101	(1)	(1%)
Reserve Adjustments on Reinsurance Ceded	166	-	166	NM
Other Income	208	200	8	4%
Total Income	2,198	1,438	760	53%
Benefits and Expenses:				
Benefit Payments	1,068	1,050	18	2%
Changes in Reserves	375	(311)	686	NM
Net Transfers to/(from) Separate Accounts	111	151	(40)	(26%)
Operating and Other Expenses	401	357	44	12%
Commissions	138	120	18	15%
Total Benefits and Expenses	2,093	1,367	726	53%
Gain (loss) from operations before dividends and federal income taxes	105	71	34	48%
Dividends to Policyholders	50	43	7	16%
Gain (loss) from operations before federal income taxes	55	28	27	96%
Federal Income Tax Benefit	(35)	36	(71)	NM
Net Gain/(Loss) from Operations	90	(8)	98	NM
Net realized capital losses, after tax and transfers to the interest maintenance reserve ("IMR")	11	17	(6)	(35%)
Net Income (Loss)	\$ 101	\$ 9	\$ 92	NM

NM = Ratio Not Meaningful

Net Income (Loss)

The net income for the year ended December 31, 2015 was \$101, an increase of \$92 compared to prior year. This change to net income was primarily due to the following:

- o Higher premium and annuity considerations due to higher sales, higher renewal premium, and a decrease in ceded business due to the 2014 no-lapse guaranteed universal life reinsurance agreement.
- o Higher net investment income resulting from an increase in volume of investments.

These were offset by:

- o Increases to change in reserves due to the impacts of the 2014 reinsurance agreement.
- o Higher expenses related to operating, commissions, and benefit payments due to less favorable mortality.

Premium Income

Premiums are generated from first year sales of life insurance and annuities, as well as subsequent renewals. The composition of Premium and Annuity Considerations are as follows:

	12/31/2015	12/31/2014	\$ Change	% Change
New Premium - Life	\$ 240	\$ 348	\$ (108)	(31%)
Renewal Premium - Life	270	(429)	699	NM
Annuity Considerations	681	737	(56)	(8%)
Other	1	1	-	0%
Total Premium and Annuity Considerations	\$ 1,192	\$ 657	\$ 535	81%

Life new premiums decreased 31% primarily due to the reinsurance of the inforce block of single life index universal life policies to PIA. Both the 2015 whole life reinsurance agreement and the 2015 reinsurance agreement with PIA combined to increase the percentage of direct premium being reinsured.

The renewal premium increased year over year; however, the impacts of reinsurance agreements in both years affected the results. In 2014, the initial impact of the 2014 no lapse guaranteed universal life reinsurance agreement, which occurred on December 31, 2014, reduced 2014 premium by \$849. In 2015, the combined 2014 reinsurance agreement and the 2015 reinsurance of an inforce block of indexed universal life reduced premium by \$227. The net impact of these variances is an increase in net renewal premium in 2015.

Annuity Considerations declined 8%, as the Company continues to manage its product mix.

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The following tables set forth individual life insurance and annuities for the periods indicated. In managing our individual life insurance business, we analyze annualized weighted new premium, which does not correspond to Premiums and Annuity Considerations (as reflected in the income statement above), because weighted premium measures the current sales performance of the business based on internal formulas for specific products, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years, as well as current sales.

	For the Years Ended		
	12/31/2015	12/31/2014	Change
Weighted New Business Premium			
Variable Universal Life	\$ 4	\$ 3	\$ 1
Other Universal Life	71	61	10
Permanent Life	57	44	13
Term Life	8	8	-
	<u>\$ 140</u>	<u>\$ 116</u>	<u>\$ 24</u>

	For the Years Ended		
	12/31/2015	12/31/2014	Change
New Annuity Deposits			
Variable Annuity	\$ 468	\$ 486	\$ (18)
SPIA	62	128	(66)
Fixed Deferred Annuity	21	3	18
	<u>\$ 551</u>	<u>\$ 617</u>	<u>\$ (66)</u>

Sales of new life insurance, measured as described above, increased \$24 from prior year, primarily due to higher fixed universal and permanent life sales. Annuity deposits have decreased as the Company continues to manage the product mix.

Net Investment Income

	For the Years Ended		
	12/31/2015	12/31/2014	Change
Bonds and Preferred Stocks	\$ 436	\$ 423	\$ 13
Common Stocks and Affiliates	47	11	36
Policy Loans	15	15	-
Alternative Assets	44	35	9
Other Invested Assets	18	31	(13)
Derivatives	9	11	(2)
Other	12	3	9
Gross investment Income	<u>581</u>	<u>529</u>	<u>52</u>
Investment Expenses	<u>(49)</u>	<u>(49)</u>	<u>-</u>
Net Investment Income	<u>\$ 532</u>	<u>\$ 480</u>	<u>\$ 52</u>

Cash from FHLB-PGH, and premium inflows resulted in additional opportunities to invest in 2015. These higher balances are the primary reason for the increase to net investment income.

During 2015 and 2014, the Company's net investment yield on general account assets was 6.05% and 5.96%, respectively. Management believes that the net yield rate of 6.05% for 2015 is sufficient to cover the Company's aggregate average yield requirement on its interest bearing product and non-product liabilities.

Commissions and Expense Allowance on Reinsurance Ceded

At December 31, 2015, total commissions and expense allowance on reinsurance ceded was \$100, a decrease of \$1, from the prior year, due to a decrease in commission and expense allowance related to the 2014 no-lapse guaranteed universal life reinsurance agreement, which was partially offset by commission and expense allowance related to the 2015 single life indexed universal life reinsurance agreement.

Reserve Adjustment on Reinsurance Ceded

At December 31, 2015, the reserve adjustment on reinsurance ceded was \$166, which is due to the 2015 whole life reinsurance agreement.

Benefit Payments

Benefit payments of \$1,068 for the year ended December 31, 2015 were \$18, or 2%, higher than prior year. This increase was due to higher annuity benefits primarily due to the growth in the block of business as well as higher death benefits resulting from less favorable mortality, partially offset by lower surrender benefits. Surrender benefits decreased due to policyholder behavior.

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Changes in Reserves

At December 31, 2015, total changes in reserves were \$375, an increase of \$686, from prior year. The increase was primarily attributable to the change from the prior year reserves ceded to PIA as part of the 2014 no-lapse guaranteed universal life reinsurance agreement.

Net Transfers to Separate Accounts

Net transfers to Separate Accounts for the year ended December 31, 2015 were \$111 which was \$40 lower than prior year. The decrease in separate account transfers is primarily due to a decrease in premiums, death, and surrender benefits compared to prior year.

Operating and Other Expenses

The Company's operating and other expenses primarily include general insurance expenses, taxes, licenses, and fees. For the year ended December 31, 2015, total operating and other expenses of \$401 reflected a \$44 increase from prior year. Operating expenses increased primarily due to higher premium taxes and field variable expenses, both correlating with the increase in sales. Other expenses increased primarily due to the net investment income ceded to PIA as part of the 2014 no-lapse guaranteed universal life reinsurance agreement.

Commissions

Commissions for the year ended December 31, 2015 were \$138 which was \$18 higher than prior year. The increase is primarily related to an increase in overall sales and renewal and trailer commissions.

Federal Income Taxes

The Company's federal income tax benefit for the year ended December 31, 2015 of (\$35) was \$71 lower than prior year due to realized hedging losses against ordinary income and the 2014 tax impact of the commission and expense allowance related to the reinsurance agreement.

Net Realized Capital Gains/ (Losses)

Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for other-than-temporary impairments. All after-tax realized capital gains and losses which result from changes in the overall level of interest rates for all types of fixed-income investments and interest-related derivative activities for derivatives backing assets are deferred into the IMR and amortized into revenue. These interest-related gains and losses are amortized into net investment income using the grouped method over the remaining life of the investment sold or, in the case of derivative financial instruments, over the remaining life of the underlying asset.

Net realized capital gains/ (losses), net of federal income taxes were as follows, for the years ended:

	<u>12/31/2015</u>	<u>12/31/2014</u>	<u>Change</u>
Realized Capital (Losses)	\$ 47	\$ 67	\$ (20)
Less: Gains Transferred to IMR, net of taxes	9	19	(10)
Subtotal	38	48	(10)
Less: Taxes	27	31	(4)
Net Realized Capital (Losses) After-Tax	\$ 11	\$ 17	\$ (6)

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IV. Financial Position

Assets

	12/31/2015	12/31/2014	\$ Change	% Change
Invested Assets:				
Bonds	\$ 8,135	\$ 7,528	\$ 607	8%
Common and Preferred Stocks	541	569	(28)	(5%)
Real Estate	29	28	1	4%
Cash and Short-Term Investments	245	129	116	90%
Policy Loans	305	299	6	2%
Derivatives	60	63	(3)	(5%)
Limited Partnerships and Other Investments	872	793	79	10%
Other Invested Assets	0	1	(1)	(100%)
Total Invested Assets	10,187	9,410	777	8%
Investment Income Due and Accrued	107	99	8	8%
Deferred and Uncollected Premiums	70	64	6	9%
Current Federal Income Tax Recoverable	1	-	1	NM
Net Deferred Tax Asset	231	230	1	0%
Other Assets	421	289	132	46%
Total General Account Assets	11,017	10,092	925	9%
Total Separate Account Assets	7,218	7,179	39	1%
Total Assets	\$ 18,235	\$ 17,271	\$ 964	6%

Total assets increased to \$18,235 in 2015, a \$964 increase, or 6%, from prior year. This increase was primarily due to the following:

- o \$607 increase in bonds primarily due to net additional purchases.
- o \$116 increase in cash and short term investments due to holding funds for an investment purchase scheduled for January 2016.
- o \$132 increase in other assets due primarily to an increase in derivative and collateral receivables due to market fluctuations.

Investment Portfolio

During 2015, the Company continued to maintain a strong balance sheet while maintaining a high quality bond portfolio.

The Company maintains a high quality, highly liquid investment portfolio.

Invested Assets

	12/31/2015	% of Total	12/31/2014	% of Total	\$ Change
Bonds	\$ 8,135	79.9	\$ 7,528	80.0	\$ 607
Preferred Stocks	72	0.7	73	0.8	(1)
Common Stocks	469	4.6	496	5.3	(27)
Real Estate	29	0.3	28	0.3	1
Cash	245	2.4	129	1.4	116
Policy Loans	305	3.0	299	3.2	6
Derivatives	60	0.6	63	0.7	(3)
Alternative Assets *	684	6.7	618	6.6	66
Investment in ISP	188	1.8	175	1.9	13
Other Invested Assets	0	0.0	1	0.0	(1)
Total Invested Assets	\$ 10,187	100.0	\$ 9,410	100.0	\$ 777

*Alternative Assets include Limited Partnerships, JMS Revolving Note, LIHTC, and Other Investments.

Bonds

The overall quality of the Company's bond portfolio remained high at 1.36, as measured by the weighted average NAIC bond category. The Company continues to maintain a conservative investment portfolio. As of December 31, 2015, 77% of total invested assets were comprised of investment grade bonds and 3% were below investment grade. Investment grade is defined as a security having a credit rating from the National Association of Insurance Commissioners ("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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of Bonds

The Company's investment philosophy is to maintain relatively strong investment portfolio returns on both yield and total return bases, both of which are critical to the achievement of high profitability for The Company. The general goal is to maximize return while operating within strict guidelines for risk taking. The Company's opportunistic approach allows us to take prudent risk opportunities to achieve higher risk-adjusted returns.

The goal is to enhance net interest margin over the long term for the Company given the constraints of general market yields, quality and maturity limits. Over the long term, yield and capital will be enhanced with portfolio activities designed to take advantage of cyclical as well as relative value opportunities. Thus by giving up yield and net interest margin for a period of time is a way to reduce risk. Conversely, there may be a time when increasing risk and yield are appropriate when we believe we are adequately compensated for the risk.

Unrealized losses on debt securities that were in an unrealized loss position less than twelve months at December 31, 2015, totaled 83% of the Company's total fixed maturities unrealized loss, and unrealized losses on securities in an unrealized loss position greater than twelve months totaled 17% of the Company's total fixed maturities unrealized loss. Of the total amount of debt securities unrealized losses, \$173 or 89% is related to unrealized losses on investment grade securities. Investment grade is defined as a security having a credit rating in accordance with the NAIC methodology of 1 or 2. Unrealized losses on fixed maturity securities with a rating below investment grade represent \$21 or 11% of the Company's total fixed maturities unrealized losses. The net increase in the number of securities with fair values below amortized cost and in the amount of unrealized capital losses is primarily related to the increasing interest rate environment; the 10yr and 30yr treasury rates rose 10 basis points and 27 basis points, respectively. Additionally, credit spreads widened across all major asset classes.

Common and Preferred Stocks

Common stock is comprised principally of investments in insurance and non-insurance affiliates. Investments in insurance affiliates decreased \$54 primarily due to decrease in PIA's surplus due to the dividend paid to the Company as well as their net loss. This was partially offset by an increase in investments in unaffiliated common stocks of \$27.

Cash and Short-Term Investments

Cash includes cash on hand while short-term investments consist of securities that have original maturities of greater than three months and less than twelve months at date of purchase and are carried at amortized cost, which approximates fair value. At December 31, 2015, cash and short-term investments totaled \$245 an increase of \$116, or 90% from 2014. This was primarily in anticipation of an investment purchase scheduled for January 2016.

Derivatives

Derivatives decreased \$3 over prior year due principally to the decrease in call spreads required for protection against market appreciation related to indexed universal life products.

Limited Partnerships and Other Investments

The composition of Limited Partnerships and Other Investments are as follows:

	<u>12/31/2015</u>	<u>12/31/2014</u>	<u>\$ Change</u>	<u>% Change</u>
Invested Assets:				
Alternative Assets	\$ 450	\$ 398	\$ 52	13%
Investment in ISP	188	175	13	7%
JMS Revolving Note	165	165	-	-%
Investment in LIHTC	67	53	14	26%
Other	2	2	-	-
Total Limited Partnerships and Other Investments	<u>\$ 872</u>	<u>\$ 793</u>	<u>\$ 79</u>	<u>10%</u>

Alternative Assets

The alternate asset investment values are provided per the partnerships' capital statements. The Company has reviewed events that have occurred since the date the values were calculated and has determined that no adjustments to the calculated values are necessary. With the exception of four open-ended investments within the portfolio, the Company's interest cannot be redeemed. Instead, distributions from each fund result from the liquidation of the underlying assets. The period over which unredeemable investments are expected to be liquidated range from 5 years to 10 years.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table presents the Company's Alternative assets portfolio as of December 31, 2015:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
Venture Capital	\$ 170	\$ 133		
MBO	54	74		
Distressed	48	25		
Real Asset	57	60		
Mezzanine	19	15		
Infrastructure *	19	-	Semi-annually	30 days
Hedge Funds	41	-	Monthly	5 - 90 days
Secondaries	7	12		
Fund of Funds	15	4		
Senior Mezzanine	10	9		
Direct Lending	9	2		
Total Alternative Assets	\$ 450	\$ 335		

* Redemption option only applies to one infrastructure fund (FV = \$8; Unfunded Commitment = \$0)

Investment in Independence Square Properties, LLC

At December 31, 2015 and 2014, the Company's investment in its non-insurance affiliate, ISP, LLC, was \$188 and \$175, respectively. The increase in the investment in ISP is related to a \$15 capital contribution partially offset by a decrease in the investment in LEAP of \$2.

Janney Montgomery Scott, LLC Revolving Note

The Company entered into revolving loan agreements with an affiliate, Janney Montgomery Scott ("JMS") on March 13, 2009 and January 15, 2010, to provide funding in an amount not to exceed \$65 and \$50, respectively. Terms of the loans specify that semi-annual interest be paid on the outstanding balances based on market rates determined at the dates of the loans. The principal balances are due to mature in January 2029 and March 2029, respectively.

The Company entered into revolving loan agreement with an affiliate, Janney Montgomery Scott ("JMS") on January 25, 2013, to provide funding in an amount not to exceed \$80. Terms of the loan specify the interest rate will be published 3-Month Libor +250bps as of the draw date and will subsequently reset on the 1st business day of every fiscal quarter. The principal balance is due to mature in January 2033.

The Company recorded \$11 and \$11 in interest income on these notes for the years ended December 31, 2015 and 2014, respectively. At December 31, 2015 and 2014, the Company had outstanding principle receivables from JMS of \$165 and \$165 and interest receivables of \$3 and \$3, respectively, relating to these agreements.

Low Income Housing Tax Credits

Investments in LIHTC increased \$14 over prior year due to additional investments. The Company has no LIHTC properties under regulatory review at December 31, 2015 and 2014. There were no write-downs due to forfeiture of eligibility and there were no impairments during the years ended December 31, 2015 or 2014.

Other Invested Assets

Other invested assets decreased \$1 over prior year, which represents the change in the amounts receivable for securities due to securities sold but not settled as of December 31, 2015.

Separate Account Assets

The Company has established non-guaranteed separate accounts with varying investment objectives that are segregated from the Company's general account and are maintained for the benefit of separate account contract holders.

Separate Account assets as of December 31, 2015 were \$7,218 which was \$39 higher than prior year. Separate Account assets increased due to higher premium inflows and 3.9% market appreciation, partially offset by an increase in benefit payments.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Liabilities

	12/31/2015	12/31/2014	\$ Change	% Change
Liabilities				
Policy Reserves	\$ 7,925	\$ 7,106	\$ 819	12%
Policy Claims	45	44	1	2%
Dividends Payable to Policyholders	48	41	7	17%
Interest Maintenance Reserve	132	121	11	9%
Asset Valuation Reserve	82	77	5	6%
Derivatives	96	70	26	37%
Funds Withheld Liability	647	583	64	11%
Other Liabilities	255	250	5	2%
Total General Account Liabilities	9,230	8,929	938	11%
Separate Account Liabilities	7,217	7,179	38	1%
Total Liabilities	\$ 16,447	\$ 15,471	\$ 976	6%

NM = Ratio Not Meaningful

Total liabilities increased to \$16,447 in 2015, a \$976 increase, or 6%, from prior year. This increase was primarily due to the following items as summarized directly below:

- o \$819 increase in policy reserves due to growth in sales and FHLB-PGH borrowings in the form of funding agreements.
- o \$64 increase in funds withheld liability.
- o \$26 increase in derivatives due to market valuations.

Policy Reserves – General Account

The majority of the Company's general account liabilities consist of policy reserves and deposits for individual life and individual annuity contracts as follows:

General Account Policy Reserves

	12/31/2015	12/31/2014	Change
Individual Life	\$ 4,774	\$ 4,371	\$ 403
Individual Annuities	2,436	2,452	(16)
Group Annuities	715	283	432
Total Policy Reserves and Deposits	\$ 7,925	\$ 7,106	\$ 819

Reserves for individual life increased due to sales growth and maturity of the business. Reserves for individual annuities decreased consistent with sales as we continue to manage the product mix. Reserves for group annuities increased due to our participation in FHLB.

Interest Maintenance Reserve

The IMR increase of \$11 over prior year is due to realized gains on bonds and derivatives partially offset by amortization.

Asset Valuation Reserve

The AVR increase of \$5 from prior year is primarily due to formulaic contributions and adjustments based on the quality of assets and realized gains on derivatives, partially offset by realized losses on bonds and alternative assets, and unrealized losses on bonds, common stock, and derivatives, alternative assets, and affiliates.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Derivatives

The following table presents the notional and fair values of derivative financial instruments not designated and not qualifying as hedging instruments. Fair values showing a loss are reported as a liability.

	December 31,			
	2015		2014	
	Notional Value	Fair Value (Loss)	Notional Value	Fair Value (Loss)
Interest rate futures	\$ 262	\$ (2)	\$ 1,256	(2)
Credit default swaps	5	(1)	5	\$ (1)
Interest rate caps	-	-	-	-
Equity future	106	(2)	151	(6)
Foreign Currency	-	-	19	-
Interest rate swaps	3,466	(44)	1,139	(26)
Inflation Swaps	125	(11)	125	(10)
Equity Options	814	(3)	628	(2)
Total Return Swaps	569	(32)	270	(23)
Swaptions	170	-	695	(1)
Treasury forwards	20	(1)	-	-
	<u>\$ 5,537</u>	<u>\$ (96)</u>	<u>\$ 4,288</u>	<u>\$ (70)</u>

Other Liabilities

Other Liabilities increased \$5 from the prior year due to increases in other amounts payable on reinsurance, premiums in advance, derivatives, and low income housing tax credits, partially offset by decreases to collateral management payable and securities payable.

Separate Account Liabilities

At December 31, 2015, the Company's separate account liabilities totaled \$7,217, an increase of \$38 from prior year. Separate Account liabilities increased due to 3.9% market appreciation, partially offset by outflows of benefit payments.

Policy Reserves – Separate Account

The majority of the Company's separate account liabilities consist of policy reserves and deposits for life and annuity contracts (net of accrued transfers in the General Account) as follows:

Separate Account Policy Reserves

	12/31/2015	12/31/2014	Change
Gross Policy Reserves:			
Individual Life	\$ 870	\$ 927	\$ (57)
Individual Annuities	6,025	5,928	97
Group Annuities	323	324	(1)
Total Gross Separate Account Policy Reserves	<u>7,218</u>	<u>7,179</u>	<u>39</u>
Accrued Transfers	(179)	(192)	13
Total Net Separate Account Policy Reserves	<u>\$ 7,039</u>	<u>\$ 6,987</u>	<u>\$ 52</u>

Reserves for living and death benefits are based on the methodology specified in Actuarial Guideline XLIII (VACARVM), which specifies the final reserve as the greater of standard and stochastic scenarios floored at the basic adjusted reserve and cash value. The standard scenario is based on a single path, deterministic projection with stipulated assumptions. The stochastic scenario is based on the Conditional Tail Expectation ("CTE") 70% of 1000 stochastically generated interest rate scenarios. Prudent estimate assumptions including margins for uncertainty are used to calculate the stochastic amount. Key assumptions needed in valuing the liability include full withdrawals, partial withdrawals, mortality, the Consumer Price Index, investment management fees and revenue sharing, expenses, fund allocations and other policyholder behavior. In addition, a method for projecting interest rates and equity returns is required. The stochastic process also requires the projection of in-force general account assets, assets from reinvested cash flows and in-force hedge assets that support the liabilities. The key assumptions needed in valuing the assets include reinvestment asset mix, reinvestment credit spreads, default rates, implied volatility and swap interest rates. At December 31, 2015 and 2014, the standard scenario was the greater of the two measures and was used as the final reserve. The final reserve balance for policies that fall within the scope of Actuarial Guideline XLIII, which covers both Living and Death Benefit guarantees, is \$6 and \$6, as of December 31, 2015 and 2014, respectively. In 2015 and 2014, as a result of the annual assumption review, there was a release of reserves of \$0.1 and \$0, respectively.

These liabilities have been computed in accordance with commonly accepted actuarial standards and are deemed adequate by the Company's Valuation Actuary (refer to actuarial opinion included with the statutory annual statement).

MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital and Surplus Account

The Company's surplus management policy is to hold surplus at a level appropriate for the risk inherent in its business and investments. The appropriateness of the level of surplus is determined by quantifying the Company's risk profile by utilizing the NAIC risk based capital formula. At the end of 2015, the Company's total surplus (including AVR) decreased by \$8 to \$1,869 at December 31, 2015 or 17% of general account assets. The Company's ratio of total adjusted capital of \$1,915 (which includes capital and surplus of \$1,787, AVR of \$81, dividend of \$24 (50% of the December 31, 2015 dividend liability) and \$21 for PIA's AVR), to the National Association of Insurance Commissioners (NAIC) calculation of risk based capital decreased to 6.12 at December 31, 2015 from 6.52 at December 31, 2014. The ratio of adjusted capital to the authorized control level, which is one half of the risk based surplus, was 12.24 as of December 31, 2015. Management believes that this surplus position is more than adequate to sustain the Company's operations under reasonably severe adverse experience. The Company's overall surplus position is extremely strong when viewed on a risk-adjusted basis.

The Company's total capital of \$1.9 as of December 31, 2015 decreased \$8 from prior year. The chart below shows the capital roll-forward as of:

	<u>12/31/2015</u>	<u>12/31/2014</u>
Beginning of Year Capital	\$ 1,877	\$ 1,541
Net Income/(Loss)	101	9
Change in Unrealized Capital Gains/(Losses)	(97)	113
Change in Capital Due to Reinsurance	21	173
Other Changes to Capital	(33)	41
Total Change in Capital	<u>(8)</u>	<u>336</u>
End of Year Capital	<u>\$ 1,869</u>	<u>\$ 1,877</u>

Change in Unrealized Capital Gains/(Losses)

Change in unrealized capital gains/(losses) include change in unrealized for affiliates, non-affiliates and tax.

Other Changes in Capital

Other changes in surplus primarily include the change in non-admitted, change in minimum pension liability, and deferred tax assets.

Since the Company is a mutual company, growth in surplus must come primarily from net operating income. In the long term, the Company must generate a return on surplus at least equal to its rate of growth. For this reason, the Company's financial strategy is to focus on the fundamentals of the business that contribute to net operating income. These fundamentals include growing the business through new sales and retaining the current business in force, improving operating unit costs, achieving competitive investment returns, and continued underwriting toward favorable mortality experience. It is expected that this financial strategy will enable the Company to maintain its solid surplus to general account asset ratio for the near future.

V. Liquidity Sources and Requirements

Liquidity and capital resources demonstrate the overall financial strength of the Company and its ability to generate strong cash flows from its operations. Consideration of liquidity risk is an integral part of the company's annual investment plan. The Company has a conservative stance to liquidity risk. Liquidity is one of four key risks the Company considers when setting its annual investment plan as well as when considering product offerings. As a company whose strategy focuses on providing value-added advice and products to the upscale retail market, the Company's liabilities include little institutional money or other liabilities which are likely to be liquidated en masse in a crisis situation. In addition, the Company maintains a very liquid investment portfolio. The Company tracks and reports its liquidity position relative to its formal liquidity plan to its Asset/Liability Management Committee on a quarterly basis. One of this committee's major responsibilities is to review the Company's potential product liability outflows and ensure that the investment portfolio has sufficient liquidity. The Company's Asset/Liability Committee has examined the impact of stress conditions on our cash flow and determined that we are well suited to meet material cash demands. Cash flow testing, which is performed annually, measures our ability to meet withdrawal demands under numerous conditions.

Liquidity Sources

The Company's principal cash inflows from its insurance activities are derived from life insurance premiums, annuity considerations, and deposit funds. Cash inflows from investment activities include principal repayments, maturities and investment income. The following table sets forth the total available liquidity of the Company from liquid assets and other funding sources at the end of the specified periods. The table is reported at market value as of December 31, 2015 and 2014. In the event these securities had to be liquidated in disorderly markets, the Company potentially may not realize full value of these assets due to market impacts and other potential costs.

Invested Assets

	<u>12/31/2015</u>	<u>12/31/2014</u>
Cash and Short Term Securities	\$ 245	\$ 129
Investment Grade Public Bonds	4,720	4,581
Mortgage and Asset Backed Securities	2,828	2,240
Preferred Stock (unaffiliated - Public)	73	73
Other Liquid Assets	60	64
Total Liquid Securities	<u>7,926</u>	<u>7,087</u>
Other, including \$305 in policy loans	<u>2,261</u>	<u>2,323</u>
Total Invested Assets	<u>\$10,187</u>	<u>\$9,410</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

In August 2014, the Company became a member of the Federal Home Loan Bank of Pittsburgh ("FHLB-PGH"), which provides access to collateralized advances, collateralized funding agreements, and other FHLB-PGH products. Collateralized advances from the FHLB-PGH are classified in "Borrowed money." Collateralized funding agreements issued to the FHLB-PGH are classified as liabilities for deposit-type funds and are recorded within "Reserves and funds for payment of insurance and annuity benefits." FHLB-PGH is a first-priority secured creditor.

The Company's membership in FHLB-PGH requires the ownership of member stock, and borrowings from FHLB-PGH require the purchase of FHLB-PGH activity based stock in an amount equal to 4% of the outstanding borrowings. All FHLB-PGH stock purchased by the Company is classified as restricted general account investments within "Common stock - unaffiliated." The Company's borrowing capacity is determined by the lesser of the assets available to be pledged as collateral to FHLB-PGH or 10% of the Company's prior period admitted general account assets. The fair value of the qualifying assets pledged as collateral by the Company must be maintained at certain specified levels of the borrowed amount, which can vary, depending on the nature of the assets pledged. The Company's agreement allows for the substitution of assets and the advances are pre-payable. Current borrowings are subject to prepayment penalties. As of December 31, 2015 and 2014, borrowings from the FHLB-PGH were \$450 and \$0 respectively.

Liquidity Uses

The Company's principal cash outflows primarily relate to the payment of liabilities associated with its various life insurance and individual and group annuity products, operating expenses and income taxes. Liabilities arising from its insurance activities primarily relate to benefit payments, policy surrenders, and dividends to policyholders.

A primary liquidity concern with respect to life insurance and annuity products is the risk of early policyholder and contractholder withdrawals. The Company closely monitors its liquidity requirements in order to match cash inflows with expected cash outflows, and employs an asset/liability management approach tailored to the specific requirements of each product line, based upon the return objectives, risk tolerance, liquidity, tax and regulatory requirements of the underlying products. It also regularly conducts liquidity stress tests and monitors early warning indicators of potential liquidity issues.

The following summarizes the withdrawal characteristics of the Company's reserves and deposit funds as of December 31:

Policy Reserves

	<u>2015</u>	<u>2014</u>
Reserves not subject to Surrender	\$ 1,613	\$ 1,160
Reserves Subject to a Market Value Adjustment	-	-
Reserves Subject to a Surrender Charge	1,920	2,077
Reserves Subject to Surrender at Book Value without surrender charge	4,393	3,869
Total policy reserves	<u>\$ 7,925</u>	<u>\$ 7,106</u>

The characteristics of the Company's product liabilities are such that there is built-in protection or disincentives against an extraordinary surrender situation. The \$4,393 subject to surrender at book value without any surrender charge, net of policy loans is \$4,137. The result is that, for 48% of reserves, there is built in protection or disincentives against extraordinary surrender situations. Against the \$6,008 of withdrawal reserves, net of policy loans, the Company has \$7,926 in liquid assets, which represents 132% of these liabilities. This high ratio of liquid assets to withdrawable funds indicates that the Company has an adequate amount of liquid assets, since it is unlikely that all funds would be withdrawn at the same time.

The Company does not have a significant amount of institutional business, and no funding notes, so it is unlikely that a ratings downgrade would trigger a "run on the company" scenario given the surrender characteristics of our liabilities. In conjunction with its ongoing asset/liability analysis, the Company reviews shock lapse scenarios and determined that this level of demand would not place significant pressure on the company and could be met by normal operating cash flows, including maturities or by liquidating a portion of the US Government securities held on 12/31.

However, in the event that there was an immediate and material cash demand, the Company expects to meet this demand with operating cash flow. If the demand exceeded operating cash flow, the Company would sell a portion of its liquid assets. As of 12/31/2015, the Company held \$4.7 billion of US Government and investment grade public bonds and an additional \$2.8 billion of liquid commercial & residential mortgage asset backed as well as asset-backed securities. In total, 93% of the portfolio is held in liquid investments. Given the nature of its liabilities, the company has provisions in most products that would allow enough time for an orderly disposition of these securities without significant deterioration in their market value.

The Company is committed to maintaining surplus levels for its insurance and non-insurance subsidiaries to fund growth opportunities, support new products, reduce surplus strain or maintain targeted risk-based capital ("RBC") levels. The Company believes it is unlikely that any required contributions to subsidiaries would have a material effect on either short-term or long-term liquidity.

Cash Flows

The Company has a rigorous asset liability management process whereby the cash flow and duration of investments are tightly managed to correspond with the cash flows of fixed liabilities. These cash flows are included in proceeds from investments.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Cash flows were as follows:

	<u>12/31/2015</u>	<u>12/31/2014</u>	<u>Change</u>
Cash sources/(uses):			
Operations	\$ 1,045	\$ 454	\$ 591
Investments	(866)	(325)	(541)
Financing	(63)	(69)	6
Change in Cash and Short Term	116	60	56
Beginning of Year cash and Short Term	129	69	60
End of Year Cash and Short Term	<u>\$ 245</u>	<u>\$ 129</u>	<u>\$ 116</u>

Net cash flow from operations was \$1,045 in 2015, an increase of \$591 from prior year. This increase is primarily related to an increase in premiums and net investment income.

Net cash flow from investments decreased \$541 due to net trading activity for debt and equity securities.

The increase in financing cash flows is primarily due remittances not allocated and drafts outstanding.

VI. Commitments

There are no known demands, commitments, events, or uncertainties that would favorably or unfavorably affect the Company's liquidity at the current time. However a material claim would not be known, or anticipated, until it actually occurs.

The Company has entered into repurchase agreements with financial institutions; however there were no open positions as of December 31, 2015 and 2014.

In the normal course of business, the Company extends commitments relating to its investment activities. As of December 31, 2015, the Company had outstanding commitments totaling \$346 relating to these investment activities. The fair value of these commitments approximates the face amount.

Although not a firm commitment, the Company has undertaken on behalf of its wholly-owned subsidiary, PIA, to provide sufficient financial support so that PIA will have adequate capital and surplus as required by applicable laws to meet its obligations to its policyholders under the terms of PIA's policies and contracts.

Guarantees

The Company has no guarantees associated with market valued separate accounts of the company as of December 31, 2015. Guarantees related to death and living benefits are excluded.

VII. Business Risks and Uncertainties

Economic Environment

In 2015, economies around the world have experienced mixed performance. The U.S. economy has been relatively strong during the year and continues to trend positively. Employment in the U.S. continues to improve with the unemployment rate dropping and standing at a post-financial crisis low. U.S. economic growth has been good relative to other economies, but there is still mixed economic signals creating uncertainty for investors. Interest rates rose at the end of the year when the Federal Reserve issued a rate increase almost seven years to the day since the federal funds rates was lowered to zero.

2015 witnessed the return of financial market volatility. Periodic episodes of extreme volatility emerged across almost every asset class. Financial engineering in the form of share buybacks, higher dividends, and mergers and acquisition activity reached post-financial crisis heights during 2015. However, this period of historically low interest rates continues and could persist for some time, which will continue to create a number of challenges for insurers including lower investment yields.

A period of sustained low interest rates could negatively impact the Company's profitability as the interest margin could decline. Declines in our interest margin or instances where the returns on our general account investments are not enough to support the interest rate guarantees could have a material adverse effect on our businesses or results of operations. The Company recognizes this risk and has been proactive in our investment strategies, product designs, crediting rate strategies and overall asset-liability practices to mitigate the risk of unfavorable consequences in this type of environment.

In periods when interest rates are declining or remain at low levels, we may have to reinvest the cash we receive as interest or return of principal on our investments in lower yielding instruments reducing our interest margin. Moreover, borrowers may prepay fixed-income securities and mortgage-backed securities in our general account in order to borrow at lower market rates, which exacerbates this risk. Lowering interest crediting rates helps to mitigate the effect of margin compression on some of our products. However, because many of our contracts have guaranteed minimum interest or crediting rates, our margin could still decrease and potentially become negative.

During period of low interest rates, policy reserves may not be sufficient to meet future obligations and may need to be strengthened, which would reduce net income in that reporting period. No additional policyholder reserves were established in 2015 or 2014 as a result of the low interest rate environment.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Regulatory Environment

Our business is subject to comprehensive regulation and supervision. The financial market dislocations we have experienced have produced, and are expected to continue to produce, extensive changes in existing laws and regulations, and regulatory frameworks applicable to our businesses.

The Company is currently undergoing an examination of its compliance with 14 states' respective abandoned and unclaimed property acts. While the Company is not currently able to estimate additional possible costs, the Company does not believe they will have a material impact to its financial position or liquidity.

We continue to respond to a changing regulatory landscape. Penn Mutual filed our first Own Risk and Solvency Assessment (ORSA) report in 2015 with the Pennsylvania Insurance Department. The ORSA requires insurers to demonstrate their risk management framework, process for identifying of risk exposures, and provide a prospective view of the insurer's (group) solvency.

Rating Agencies

Rating agencies assign the Company financial strength/claims paying ability ratings based on their evaluations of the Company's ability to meet its financial obligations. These ratings indicate a rating agency's view of an insurance company's ability to meet its obligations to its insured.

The Company and PIA, its insurance subsidiary are reviewed annually by nationally recognized rating agencies. The ratings issued on our companies by these agencies are announced publicly and are available directly from the agencies. Our Internet site, [//www.pennmutual.com](http://www.pennmutual.com), also contains some information about our ratings. Financial strength ratings reflect the rating agencies' opinions of a company's claims paying ability. Independent ratings are one of the important factors that establish our competitive position in the insurance markets. The rating agencies consider many factors in determining the financial strength rating of an insurance company, including the relative level of statutory surplus necessary to support the business operations of the company. These ratings are based upon factors relevant to policyholders and agents and are not directed toward the protection of investors. The Company continues to receive strong ratings from these agencies.

Competition

The Company faces strong competition in its life and annuity businesses. The Company's ability to compete is based on a number of factors, including product features, investment performance, service, price, distribution capabilities, scale, commission structure, name recognition, and financial strength ratings. The nature of the Company's business means that actual and potential competitors include a large number of insurance companies, mutual fund companies, banks and investment management firms, many of which have advantages of the Company in one or more of the above competitive factors. Continued industry consolidation, including acquisitions of insurance and other financial services companies in the U.S. by international companies, has resulted in larger competitors with strong financial resources, marketing and distribution capabilities, and brand identities.

Market conditions determine the availability and cost of the reinsurance protection the Company purchases. Accordingly, the Company may be forced to incur additional expenses for reinsurance or may not be able to obtain sufficient reinsurance on acceptable terms which could adversely affect the profitability of future business or the Company's willingness to write future business.

In addition, the Company is subject to significant competition relating to the distribution of its products and services as well as price competition, which has occurred, and may occur, as a result of challenging market conditions and which may in turn strain the Company's business through a reduction in demand for its products.

VIII. Outlook

The Company strives to provide products of value to a growing base of policyholders and to operate business for their benefit. Management strives for prudent financial management, employs a conservative investment philosophy, and is committed to maintaining good asset quality, strong capitalization, and ample liquidity. The strategic and operating focus of the Company is to excel at supporting face-to-face, needs-based distribution of individual life insurance and annuity products that address complex financial needs in affluent markets. The Company has a well-established affluent market presence, developed through its focus on relationship-oriented producers and a well-balanced emphasis on three complementary distribution channels, the Career Agency System, the Independence Financial Network, and the Independent Broker/Dealer channel. These three distribution channels provide the Company with diversification and an opportunity to reach large numbers of producers that target affluent markets.

The Company concentrates on strengthening and expanding relationships with producers who have the ability and desire to serve our target markets - small-business owners, professionals, and other affluent individuals - by providing protection, wealth accumulation, retirement planning, estate planning and business planning solutions. For producers who focus on these markets, The Company is the insurance and annuity product provider that will help them to be more successful.

MANAGEMENT'S DISCUSSION AND ANALYSIS

To support our producer's success, we furnish them with leading-edge products designed to help meet the needs of clients. We also provide industry-leading advanced sales and marketing solutions that can help producers break into new markets. Our complete package of support is called our Advisor Value Commitment, which consists of nine components, each representing exceptional service and support in the areas of:

- Competitive Products
- Underwriting Service
- Competitive Compensation & Recognition
- Marketing/Lead Generation
- Field Leadership
- Broker/Dealer Relationship
- Advanced Sales Support
- Practice Management
- Home Office Responsiveness

The Company believes that its investment management operations are an important part of the overall strategy and pursues leveraging its customer base and asset management skills to grow this business.

The Company intends to maintain its strong balance sheet and capital position and remains fully committed to mutuality and financial strength. As a mutual insurer, the Company is able to manage for the long-term to meet policyholder obligations while maintaining top ratings from the various agencies.