



**NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES**

2016 Consolidated Financial Statements

# NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

FOR THE YEAR ENDED DECEMBER 31, 2016

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KPMG LLP  
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Columbus, OH 43215-2568

## Independent Auditors' Report

The Board of Directors and Shareholder  
Nationwide Financial Services, Inc.:

We have audited the accompanying consolidated financial statements of Nationwide Financial Services, Inc. and subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

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

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Nationwide Financial Services, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

**KPMG LLP**

Columbus, Ohio  
February 28, 2017

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Consolidated Balance Sheets

	December 31,	
<i>(in millions, except for share and per share amounts)</i>	2016	2015
<b>Assets</b>		
Investments:		
Fixed maturity securities, available-for-sale	\$ 45,511	\$ 39,613
Mortgage loans, net of allowance	12,436	10,163
Policy loans	989	993
Short-term investments	2,005	785
Other investments	3,266	3,411
Total investments	\$ 64,207	\$ 54,965
Cash and cash equivalents	304	181
Accrued investment income	531	496
Deferred policy acquisition costs	5,432	5,200
Goodwill	274	284
Other assets	3,029	2,535
Separate account assets	89,071	87,238
<b>Total assets</b>	<b>\$ 162,848</b>	<b>\$ 150,899</b>
<b>Liabilities and equity</b>		
<b>Liabilities</b>		
Future policy benefits and claims	\$ 52,911	\$ 45,397
Short-term debt	980	786
Long-term debt	2,271	2,098
Customer bank deposits	4,791	4,774
Other liabilities	3,274	2,218
Separate account liabilities	89,071	87,238
<b>Total liabilities</b>	<b>\$ 153,298</b>	<b>\$ 142,511</b>
<b>Shareholder's equity</b>		
Common stock (\$0.01 par value; authorized, issued & outstanding - 100 shares)	\$ -	\$ -
Additional paid-in capital	1,825	1,825
Retained earnings	6,437	5,544
Accumulated other comprehensive income	621	375
<b>Total shareholder's equity</b>	<b>\$ 8,883</b>	<b>\$ 7,744</b>
Noncontrolling interests	667	644
<b>Total equity</b>	<b>\$ 9,550</b>	<b>\$ 8,388</b>
<b>Total liabilities and equity</b>	<b>\$ 162,848</b>	<b>\$ 150,899</b>

See accompanying notes to consolidated financial statements.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Consolidated Statements of Operations

<i>(in millions)</i>	Year ended December 31,	
	2016	2015
<b>Revenues</b>		
Policy charges	\$ 2,361	\$ 2,216
Premiums	642	786
Net investment income	2,339	2,186
Net realized investment (losses) gains, including other-than-temporary impairment losses	(122)	84
Other revenues	652	673
<b>Total revenues</b>	<b>\$ 5,872</b>	<b>\$ 5,945</b>
<b>Benefits and expenses</b>		
Interest credited to policyholder account values	\$ 1,455	\$ 1,128
Benefits and claims	1,298	1,662
Amortization of deferred policy acquisition costs	433	68
Other expenses, net of deferrals	1,723	1,802
<b>Total benefits and expenses</b>	<b>\$ 4,909</b>	<b>\$ 4,660</b>
<b>Income before federal income taxes and noncontrolling interests</b>	<b>\$ 963</b>	<b>\$ 1,285</b>
Federal income tax expense	146	313
<b>Net income</b>	<b>\$ 817</b>	<b>\$ 972</b>
Loss attributable to noncontrolling interests, net of tax	(91)	(96)
<b>Net income attributable to Nationwide Financial Services, Inc.</b>	<b>\$ 908</b>	<b>\$ 1,068</b>

*See accompanying notes to consolidated financial statements.*

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Consolidated Statements of Comprehensive Income

<i>(in millions)</i>	Year ended December 31,	
	2016	2015
<b>Net income</b>	\$ 817	\$ 972
<b>Other comprehensive income (loss), net of tax</b>		
Changes in:		
Net unrealized gains (losses) on available-for-sale securities	\$ 225	\$ (739)
Other	21	43
<b>Total other comprehensive income (loss) income, net of tax</b>	\$ 246	\$ (696)
<b>Total comprehensive income</b>	\$ 1,063	\$ 276
Comprehensive loss attributable to noncontrolling interests, net of tax	(91)	(96)
<b>Total comprehensive income attributable to Nationwide Financial Services, Inc.</b>	\$ 1,154	\$ 372

See accompanying notes to consolidated financial statements.

### Consolidated Statements of Equity

<i>(in millions)</i>	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total shareholder's equity	Non- controlling interest	Total equity
<b>Balance as of December 31,</b>	\$ -	\$ 1,825	\$ 4,476	\$ 1,071	\$ 7,372	\$ 640	\$ 8,012
Comprehensive income (loss):							
Net income (loss)	\$ -	\$ -	\$ 1,068	\$ -	\$ 1,068	\$ (96)	\$ 972
Other comprehensive (loss)	-	-	-	(696)	(696)	-	(696)
Total comprehensive income	\$ -	\$ -	\$ 1,068	\$ (696)	\$ 372	\$ (96)	\$ 276
Change in noncontrolling interests	-	-	-	-	-	100	100
<b>Balance as of December 31, 2015</b>	\$ -	\$ 1,825	\$ 5,544	\$ 375	\$ 7,744	\$ 644	\$ 8,388
Comprehensive income (loss):							
Net income (loss)	\$ -	\$ -	\$ 908	\$ -	\$ 908	\$ (91)	\$ 817
Other comprehensive income	-	-	-	246	246	-	246
Total comprehensive income	\$ -	\$ -	\$ 908	\$ 246	\$ 1,154	\$ (91)	\$ 1,063
Dividends paid	-	-	(15)	-	(15)	-	(15)
Change in noncontrolling interests	-	-	-	-	-	114	114
<b>Balance as of December 31, 2016</b>	\$ -	\$ 1,825	\$ 6,437	\$ 621	\$ 8,883	\$ 667	\$ 9,550

See accompanying notes to consolidated financial statements.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Consolidated Statements of Cash Flows

<i>(in millions)</i>	Year ended December 31,	
	2016	2015
<b>Cash flows from operating activities</b>		
Net income	\$ 817	\$ 972
Adjustments to net income:		
Net realized investment losses (gains), including other-than-temporary impairment losses	122	(84)
Interest credited to policyholder account values	1,455	1,128
Capitalization of deferred policy acquisition costs	(823)	(870)
Amortization of deferred policy acquisition costs	433	68
Amortization and depreciation	117	138
Deferred tax expense	67	230
Changes in:		
Policy liabilities	(680)	(249)
Derivatives, net	(247)	(141)
Other, net	(211)	(396)
<b>Net cash provided by operating activities</b>	<b>\$ 1,050</b>	<b>\$ 796</b>
<b>Cash flows from investing activities</b>		
Proceeds from maturities of available-for-sale securities	\$ 3,441	\$ 3,274
Proceeds from sales of available-for-sale securities	1,686	540
Purchases of available-for-sale securities	(10,017)	(7,622)
Proceeds from repayments and sales of mortgage loans	1,604	1,491
Issuances and purchases of mortgage loans	(3,889)	(2,898)
Net (purchases) sales of short-term investments	(1,216)	187
Collateral received, net	221	47
Net change in other loans receivable	337	152
Other, net	(249)	(145)
<b>Net cash used in investing activities</b>	<b>\$ (8,082)</b>	<b>\$ (4,974)</b>
<b>Cash flows from financing activities</b>		
Net change in short-term debt	\$ 194	\$ 477
Proceeds from issuance of long-term debt	400	-
Repayments of long-term debt	(227)	(532)
Cash dividend paid to Nationwide Corporation	(15)	-
Investment and universal life insurance product deposits	10,894	8,224
Investment and universal life insurance product withdrawals	(4,132)	(3,884)
Net change in customer bank deposits	17	(77)
Other, net	24	(18)
<b>Net cash provided by financing activities</b>	<b>\$ 7,155</b>	<b>\$ 4,190</b>
<b>Net increase in cash and cash equivalents</b>	<b>\$ 123</b>	<b>\$ 12</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>181</b>	<b>169</b>
<b>Cash and cash equivalents at end of year</b>	<b>\$ 304</b>	<b>\$ 181</b>

See accompanying notes to consolidated financial statements.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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#### (1) Nature of Operations

Nationwide Financial Services, Inc. (“NFS,” or collectively with its subsidiaries, “the Company”) is the holding company for Nationwide Life Insurance Company (“NLIC”) and other companies that comprise the life insurance, retirement savings and other financial operations of the Nationwide group of companies. NFS is incorporated in Delaware and maintains its principal executive offices in Columbus, Ohio.

The Company is a leading provider of long-term savings and retirement products in the United States (“U.S.”). The Company develops and sells a diverse range of products and services including individual annuities, private and public sector group retirement plans, investment products sold to institutions, life insurance and advisory services. The Company also provides a wide range of banking products and services through Nationwide Bank, a wholly-owned subsidiary of the Company, and mutual funds through Nationwide Funds Group.

The Company sells its products through a diverse distribution network. Unaffiliated entities that sell the Company’s products to their own customer bases include independent broker-dealers, financial institutions, wirehouse and regional firms, pension plan administrators and life insurance specialists. Representatives of the Company that market products directly to a customer base include Nationwide Retirement Solutions, Inc., an indirect wholly-owned subsidiary, and Nationwide Financial Network producers, which includes the agency distribution force of the Company’s ultimate majority parent company, Nationwide Mutual Insurance Company (“NMIC”). The Company believes its broad range of competitive products, strong distributor relationships and diverse distribution network position it to compete effectively under various economic conditions.

As of December 31, 2016 and 2015, the Company did not have a significant concentration of financial instruments in a single investee, industry or geographic region. Also, the Company did not have a concentration of business transactions with a particular customer, lender, distribution source, market or geographic region in which a single event could cause a severe impact on the Company’s financial position after considering insurance risk that has been transferred to external reinsurers.

#### (2) Summary of Significant Accounting Policies

##### *Basis of Presentation*

The consolidated financial statements include the accounts of NFS and companies in which NFS directly or indirectly has a controlling financial interest. The consolidated financial statements include majority-owned subsidiaries and consolidated variable interest entities (“VIEs”). All intercompany accounts and transactions have been eliminated.

##### *Use of Estimates*

The Company’s consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The preparation of the consolidated financial statements in accordance with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Significant estimates include the balance and amortization of deferred policy acquisition costs (“DAC”), future policy benefits and claims, legal and regulatory reserves, certain investment and derivative valuations, goodwill, provision for income taxes and valuation of deferred tax assets. Actual results could differ significantly from those estimates.

##### *Revenues and Benefits*

*Investment and universal life insurance products.* Investment products are long-duration contracts that do not subject the Company to significant risk arising from mortality (the incidence of death) or morbidity (the incidence of disability resulting from disease or physical impairment). These include variable and fixed deferred annuity contracts in the accumulation phase with individuals and groups, as well as certain annuities without life contingencies. Universal life insurance products include long-duration insurance contracts that do not have fixed or guaranteed terms. These include universal life insurance, variable universal life insurance, corporate-owned life insurance (“COLI”), bank-owned life insurance (“BOLI”) and other interest-sensitive life insurance policies. Revenues for investment products and universal life insurance products consist of net investment income, surrender charges and other policy charges earned and assessed against policy account balances during the period. Policy charges are assessed on a daily or monthly basis and are recognized as revenue when assessed and earned. Assessments for services provided in future periods are recorded as unearned revenue and recognized as revenue over the periods benefited. Surrender charges are recognized as revenue upon surrender of a contract in accordance with contractual terms.



## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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*Traditional life insurance products.* Traditional life insurance products include those products with fixed and guaranteed terms, primarily consisting of whole life insurance, term life insurance and certain annuities with life contingencies. Premiums for traditional life insurance products are generally recognized as revenue when due. For certain annuities with life contingencies, any excess of gross premium over the net premium is deferred and recognized with the amount of expected future benefits. Benefits and expenses are associated with earned premiums so that profits are recognized over the life of the contract. This association is accomplished through the provision for future policy benefits and the deferral and amortization of policy acquisition costs.

#### **Future Policy Benefits and Claims**

*Investment and universal life insurance products.* The Company calculates its liability for future policy benefits and claims for investment products in the accumulation phase and for universal life insurance policies at the policy accrued account balance, which represents participants' net deposits adjusted for investment performance, interest credited and applicable contract charges. Policy benefits and claims that are charged to expense include interest credited to policyholder accounts and benefits and claims incurred in the period in excess of related policyholder accounts.

The Company offers guarantees on variable and fixed indexed annuity products, which can include a return of no less than the total deposits made on the contract less any customer withdrawals, total deposits made on the contract less any customer withdrawals plus a minimum return, or the highest contract value on a specified anniversary date minus any customer withdrawals following the contract anniversary. These guarantees can also include benefits payable in the event of death, upon annuitization, upon periodic withdrawal or at specified dates during the accumulation period.

As part of its valuation procedures, the Company makes an assumption of the expected utilization of guarantee benefits by participants. Guarantees that include a benefit that is wholly life contingent or is expected to be exercised upon annuitization are accounted for as insurance liabilities that accumulate over time. Guarantees that are expected to be exercised using a net settlement option are accounted for as embedded derivatives, which are required to be separated, and valued apart from the host variable annuity contracts.

Guaranteed minimum death benefits ("GMDB") and certain guaranteed living withdrawal benefits ("GLWB") on variable annuity and fixed annuity products, as well as no-lapse guarantees on universal life and variable universal life insurance products are accounted for as insurance liabilities. Liabilities for these guarantees are calculated by multiplying the current benefit ratio by the cumulative assessments recorded from contract inception through the balance sheet date, less the cumulative guaranteed benefit payments plus interest. The Company evaluates its experience and assumptions and adjusts the benefit ratio as appropriate. If experience or assumption changes result in a new benefit ratio, the reserves are adjusted to reflect the changes, with a related charge or credit to benefits and claims in the period of evaluation. Determination of the expected benefit payments and assessments are based on a range of scenarios and assumptions, including those related to market rates of return and volatility, contract surrenders and mortality experience. The accounting for these guarantees impacts estimated gross profits used to calculate the balance and amortization of DAC and other expenses.

Certain GLWB that are expected to net settle on variable annuity products represent embedded derivatives which are held at fair value and include the present value of attributed fees. Subsequent changes in the fair value of the embedded derivatives are recognized in earnings as a component of net realized investment gains and losses. The fair value of the embedded derivatives is calculated based on a combination of capital market and actuarial assumptions. Projections of cash flows inherent in the valuation of the embedded derivatives incorporate numerous, unobservable assumptions including, but not limited to, mortality, lapse rates, index volatility, benefit utilization and discounting. Benefit utilization includes a wait period (the number of years the policyholder is assumed to wait prior to beginning withdrawals once eligible) and efficiency of benefit utilization (the percent of the maximum permitted withdrawal that a policyholder takes). Discounting includes liquidity and non-performance risk (the risk that the liability will not be fulfilled) and affects the value at which the liability is transferred. The Company derives these inputs, which vary widely by product, attained age, policy duration, benefits in the money and the existence of surrender charges, from experience and industry data.

The Company offers certain indexed life insurance and annuity products for which the policyholders' interest credits are based on market performance with caps and floors. The interest credits represent embedded derivatives within the insurance contract and therefore are required to be separated, and valued apart from, the host contracts. The embedded derivatives are held at fair value. Subsequent changes in the fair value of the embedded derivatives are recognized in earnings as a component of interest credited. The fair value of the embedded derivatives is calculated based on a combination of capital market and actuarial assumptions. Projections of cash flows inherent in the valuation of the embedded derivatives incorporate numerous assumptions including, but not limited to, mortality, lapse rates and index volatility.

The assumptions used to calculate the fair value of embedded derivatives are reviewed as part of an annual comprehensive study of assumptions. Quarterly, consideration is given as to whether adjustments to these assumptions are necessary.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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*Traditional life and other insurance products.* The process of calculating reserve amounts for traditional life insurance products involves the use of a number of assumptions, including those related to persistency (the percentage of insurance policies remaining in-force from year to year), mortality, morbidity, interest rates and certain other expenses.

The liability for future policy benefits and claims for traditional life insurance policies was determined using the net level premium method, with weighted average interest rates of 6.6% and estimates of mortality, morbidity, investment yields and persistency that were used or being experienced at the time the policies were issued, with a provision for adverse deviation.

The liability for future policy benefits for certain annuities with life contingencies was calculated using the present value of future benefits and certain expenses, discounted using weighted average interest rates of 4.6% with a provision for adverse deviation.

The Company issues fixed and floating rate funding agreements to the Federal Home Loan Bank of Cincinnati ("FHLB"). The liability for such funding agreements is recorded in future policy benefits and claims. The amount of collateralized funding agreements outstanding with the FHLB as of December 31, 2016 and 2015 was \$2.3 billion. In connection with an FHLB requirement for funding agreements, the Company held \$47 million and \$46 million of FHLB stock as of December 31, 2016 and 2015, respectively.

#### **Reinsurance Ceded**

The Company cedes insurance to other companies in order to limit potential losses and to diversify its exposures. Such agreements do not relieve the original insurer from its primary obligation to the policyholder in the event the reinsurer is unable to meet the obligations it has assumed. Reinsurance premiums ceded and reinsurance recoveries on benefits and claims incurred are deducted from the respective income and expense accounts. Assets and liabilities related to reinsurance ceded are reported in the consolidated balance sheets on a gross basis, separately from the related future policy benefits and claims of the Company.

#### **Deferred Policy Acquisition Costs**

The Company has deferred certain acquisition costs that are directly related to the successful acquisition of new and renewal insurance and investment contracts. The methods and assumptions used to amortize and assess recoverability of the DAC balance depend on the type of product.

*Investment and universal life insurance products.* For certain investment and universal life insurance products, DAC is amortized with interest over the lives of the policies in relation to the present value of estimated gross profits, which is determined primarily from projected interest margins, policy charges and net realized investment gains and losses, less policy benefits and other expenses. The DAC asset related to investment and universal life insurance products is adjusted to reflect the impact of unrealized gains and losses on available-for-sale securities, with the corresponding adjustment recorded in accumulated other comprehensive income. This adjustment to DAC represents the change in amortization that would have been required as a charge or credit to earnings had such unrealized amounts been realized. DAC for investment and universal life insurance products is subject to recoverability testing in the year of policy issuance, and DAC for universal life insurance products is also subject to loss recognition testing at the end of each reporting period.

The assumptions used in the estimation of gross profits are based on the Company's current best estimates of future events and are reviewed as part of an annual comprehensive study of assumptions. The most significant assumptions that are involved in the estimation of future gross profits include future net general and separate account investment performance, surrender/lapse rates, interest margins, renewal premiums and mortality. Quarterly, consideration is given as to whether adjustments to these assumptions are necessary. The Company uses a reversion to the mean process to determine the assumption for the future net separate account investment performance. This process assumes different performance levels over the next three years, such that the separate account mean return, measured from the anchor date to the end of the life of the product, equals the long-term assumption. The Company's long-term assumptions for net separate account investment performance consist of assumed gross returns of 10.5% for equity funds and 5.0% for fixed funds.

Changes in assumptions can have a significant impact on the amount of DAC reported for investment and universal life insurance products and on their related amortization patterns. In the event actual experience differs from assumptions or future assumptions are revised, the Company will record an increase or decrease in DAC amortization expense, which could be significant.

*Traditional life insurance products.* DAC is amortized with interest over the premium-paying period of the related policies in proportion to premium revenue recognized. These assumptions are consistent with those used in the calculation of liabilities for future policy benefits at issuance. DAC is evaluated for recoverability in the year of policy issuance, and loss recognition testing is conducted each reporting period.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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Refer to Note 5 for discussion regarding DAC amortization and related balances.

#### *Investments*

*Available-for-sale securities.* Available-for-sale securities are reported at fair value, with unrealized gains and losses reported as a separate component of other comprehensive income, net of adjustments for DAC, future policy benefits and claims, policyholder dividend obligations and deferred federal income taxes. Realized gains and losses on sales of available-for-sale securities are recognized in income based on the specific identification method. Interest and dividend income is recognized when earned.

As of December 31, 2016 and 2015, 99% of fixed maturity securities were priced using externally sourced data. Independent pricing services are most often utilized (86% as of December 31, 2016 and 2015) to determine the fair value of securities for which market quotations or quotations on comparable securities are available. For these securities, the Company obtains the pricing services' methodologies, pricing from additional sources, and classifies the investments accordingly in the fair value hierarchy.

A corporate pricing matrix is used in valuing certain corporate debt securities. The corporate pricing matrix was developed using publicly and privately available spreads for privately placed corporate securities with varying weighted average lives and credit quality ratings. The weighted average life and credit quality rating of a particular fixed maturity security to be priced using the corporate pricing matrix are important inputs into the model and are used to determine a corresponding spread that is added to the appropriate U.S. Treasury yield to create an estimated market yield for that security. The estimated market yield and other relevant factors are then used to estimate the fair value of the particular security.

Non-binding broker quotes are also utilized to determine the fair value of certain fixed maturity securities when deemed appropriate or when quotes are not available from independent pricing services or a corporate pricing matrix. These securities are classified with the lowest priority in the fair value hierarchy as only one broker quote is ordinarily obtained, the investment is not traded on an exchange, the pricing is not available to other entities and/or the transaction volume in the same or similar investments has decreased. Inputs used in the development of prices are not provided to the Company by the brokers, as the brokers often do not provide the necessary transparency into their quotes and methodologies. At least annually, the Company performs reviews and tests to ensure that quotes are a reasonable estimate of the investments' fair value. Price movements of broker quotes are subject to validation and require approval from the Company's management. Management uses its knowledge of the investment and current market conditions to determine if the price is indicative of the investment's fair value.

When the collectability of contractual interest payments on fixed maturity securities is considered doubtful, such securities are placed in non-accrual status and any accrued interest is excluded from investment income. These securities are not restored to accrual status until the Company determines that future payment of principal and interest is probable.

The Company has entered into securities lending agreements with a custodial bank whereby eligible securities are loaned to third parties, primarily major brokerage firms. These transactions are used to generate additional income in the securities portfolio. The Company is entitled to receive from the borrower any payments of interest and dividends received on loaned securities during the loan term. The agreements require a minimum of 102% of the fair value of the loaned securities to be held as collateral. Cash collateral is invested by the custodial bank in investment-grade securities, which are included in the total investments of the Company. Additionally, the Company may receive non-cash collateral, which would be recorded off-balance sheet. As of December 31, 2016 and December 31, 2015, the fair value of the securities received as collateral and recorded off balance sheet is \$331 million and \$167 million, respectively. The Company recognizes loaned securities in available-for-sale investments. A securities lending payable is recorded in other liabilities for the amount of cash collateral received. Net income received from securities lending activities is included in net investment income. As of December 31, 2016 and 2015, the fair value of loaned securities was \$541 million and \$389 million, respectively.

For investments in certain residential and commercial mortgage-backed securities, the Company recognizes income and amortizes discounts and premiums using the effective-yield method, based on prepayment assumptions and the estimated economic life of the securities. When actual prepayments differ significantly from estimated prepayments, the effective-yield is recalculated to reflect actual payments to date and anticipated future payments. Any resulting adjustment is included in net investment income in the period the estimates are revised. All other investment income is recorded using the effective-yield method without anticipating the impact of prepayments.

The Company periodically reviews its available-for-sale securities to determine if any decline in fair value to below amortized cost is other-than-temporary. Factors considered in determining whether a decline is other-than-temporary include the length of time a security has been in an unrealized loss position, the severity of the unrealized loss, reasons for the decline in value and expectations for the amount and timing of a recovery in fair value.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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In assessing corporate debt securities for other-than-temporary impairment (“OTTI”), the Company evaluates the ability of the issuer to meet its debt obligations, the value of the company or specific collateral securing the debt, the Company’s intent to sell the security and whether it is more likely than not the Company will be required to sell the security before the recovery of its amortized cost basis. The Company evaluates U.S. government and agencies and obligations of states and political subdivisions securities for OTTI by examining similar characteristics.

Mortgage-backed securities are assessed for impairment using default estimates based on loan level data, where available. Where loan level data is not available, a proxy based on collateral characteristics is used. The impairment assessment considers loss severity as a function of multiple factors, including unpaid balance, interest rate, mortgage insurance ratios, assessed property value at origination, change in property value, loan-to-value (“LTV”) ratio at origination and prepayment speeds. Cash flows generated by the collateral are then utilized, along with consideration of the instrument’s position in the overall structure, to determine cash flows associated with the security.

Certain asset-backed securities are assessed for impairment using expected cash flows based on various inputs, including default estimates based on the underlying corporate securities, historical and forecasted loss severities or other market inputs when recovery estimates are not feasible. When the collateral is regional bank and insurance company trust preferred securities, default estimates used to estimate cash flows are based on U.S. Bank Rating service data and broker research.

The Company evaluates its intent to sell on an individual security basis. OTTI losses on securities when the Company does not intend to sell the security and it is not more likely than not it will be required to sell the security prior to recovery of the security’s amortized cost basis are bifurcated, with the credit related portion of the impairment loss being recognized in earnings and the non-credit related portion of the impairment loss and any subsequent changes in the fair value of those debt securities being recognized in other comprehensive income, net of applicable taxes and other offsets. To estimate the credit related portion of an impairment loss recognized in earnings, the Company considers the present value of the cash flows. To the extent that the present value of cash flows generated by a debt security is less than the amortized cost, an OTTI is recognized through earnings.

It is possible that further declines in fair values of such investments, or changes in assumptions or estimates of anticipated recoveries and/or cash flows, may cause further OTTI, which could be significant.

The Company invests in fixed maturity securities that could qualify as VIEs, including corporate securities, mortgage-backed securities and asset-backed securities. The Company is not the primary beneficiary of these securities as the Company does not have the power to direct the activities that most significantly impact the entities’ performance. The Company’s potential loss is limited to the carrying values of these securities. There are no liquidity arrangements, guarantees or other commitments by third parties that affect the fair value of the Company’s interest in these assets.

*Mortgage loans, net of allowance.* The Company holds commercial and residential mortgage loans that are collateralized by properties throughout the U.S. Commercial mortgage loans are further segregated into the following classes based on the unique risk profiles of the underlying property types: office, industrial, retail, apartment and other. Mortgage loans held-for-investment are held at amortized cost less a valuation allowance.

As part of the underwriting process, specific guidelines are followed to ensure the initial quality of a new mortgage loan. Third-party appraisals are obtained to support loaned amounts, as the loans are usually collateral dependent.

The collectability and value of a mortgage loan are based on the ability of the borrower to repay and/or the value of the underlying collateral. The Company’s commercial mortgage loans are typically structured with balloon payment maturities, exposing the Company to risks associated with the borrower’s ability to make the balloon payment or refinance the property.

Mortgage loans require a loan-specific reserve when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When management determines that a loan requires a loan-specific reserve, a provision for loss is established equal to the difference between the carrying value and either the fair value of the collateral less costs to sell or the present value of expected future cash flows, discounted at the loan’s market interest rate. Loan-specific reserve charges are recorded in net realized investment gains and losses. In the event a loan-specific reserve charge is reversed, the recovery is also recorded in net realized investment gains and losses.

In addition to the loan-specific reserves, the Company maintains a non-specific reserve based primarily on loan surveillance categories and property type classes, which reflects management’s best estimates of probable credit losses inherent in the portfolio of loans without specific reserves as of the balance sheet date. Management’s periodic evaluation of the adequacy of the non-specific reserve is based on past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect a borrower’s ability to repay, the estimated value of the underlying collateral, the composition of the loan portfolio, current economic conditions and other relevant factors. Non-specific reserve changes are recorded in net realized investment gains and losses.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

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Management evaluates the credit quality of individual commercial mortgage loans and the portfolio as a whole through a number of loan quality measurements, including but not limited to LTV and debt service coverage (“DSC”) ratios. The LTV ratio is calculated as a ratio of the amortized cost of a loan to the estimated value of the underlying collateral. DSC is the amount of cash flow generated by the underlying collateral of the mortgage loan available to meet periodic interest and principal payments of the loan. This process identifies commercial mortgage loans representing the lowest risk profile and lowest potential for loss and those representing the highest risk profile and highest potential for loss. These factors are updated and evaluated at least annually.

To facilitate the monitoring of credit quality for residential mortgage loans, and for the purposes of determining an appropriate valuation allowance for these loans, the Company utilizes the following categories of credit grades: performing and not graded, pass, special mention, substandard, doubtful and loss. These categories, which are derived from standard regulatory rating definitions, are assigned upon initial approval of the loan and updated periodically thereafter.

Interest income on performing mortgage loans is recognized over the life of the loan using the effective-yield method. Loans in default or in the process of foreclosure are placed on non-accrual status. Interest received on non-accrual status mortgage loans is included in net investment income in the period received. Loans are restored to accrual status when the principal and interest is current and it is determined the future principal and interest payments are probable or when the loan is modified. Loans are considered delinquent when contractual payments are 90 days past due.

*Policy loans.* Policy loans, which are collateralized by the related insurance policy, are held at the outstanding principal balance and do not exceed the net cash surrender value of the policy. As such, no valuation allowance for policy loans is required.

*Short-term investments.* Short-term investments consist primarily of highly liquid mutual funds and government agency discount notes with maturities of twelve months or less at acquisition. The Company and various affiliates maintain agreements with Nationwide Cash Management Company (“NCMC”), an affiliate, under which NCMC acts as a common agent in handling the purchase and sale of short-term securities for the respective accounts of the participants. Amounts on deposit with NCMC for the benefit of the Company are included in short-term investments on the consolidated balance sheets. The Company carries short-term investments at fair value.

*Other investments.* Other investments consist primarily of alternative investments in private equity funds, private debt funds, tax credit funds and real estate partnerships accounted for under the equity method of accounting. The Company recognizes valuation changes in equity method investments in net investment income. The Company's unfunded commitments related to these investments were \$495 million and \$315 million December 31, 2016 and 2015, respectively. The carrying values of these investments were \$362 million and \$200 million as of December 31, 2016 and 2015, respectively. Other investments also include other loans receivable, COLI, trading securities, equity securities, and capital stock with the FHLB. The Company applies mark-to-market accounting to trading securities and recognizes changes in fair value in net realized investment gains and losses.

The Company has sold \$1.5 billion and \$1.4 billion in tax credit funds to unrelated third parties as of December 31, 2016 and 2015, respectively. The Company has guaranteed after-tax benefits to the third party investors through periods ending in 2032. These guarantees are in effect for periods of approximately 15 years each. The tax credit funds provide a stream of tax benefits to the investors that will generate a yield and return of capital. If the tax benefits are not sufficient to provide these cumulative after-tax yields, the Company must fund any shortfall. The maximum amount of undiscounted future payments that the Company could be required to pay the investors under the terms of the guarantees is \$836 million, but the Company does not anticipate making any material payments related to the guarantees. The Company's risks are mitigated in the following ways: (1) the Company has the right to buyout the equity related to the guarantee under certain circumstances, (2) the Company may replace underperforming properties to mitigate exposure to guarantee payments and (3) the Company oversees the asset management of the deals.

In the normal course of business, the Company has relationships with VIEs. If the Company determines that it has a variable interest and is the primary beneficiary, it consolidates the VIE. The Company is the primary beneficiary if the Company has the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and the obligation to absorb losses or receive benefits from the entity that could be potentially significant to the VIE. This determination is based on a review of the entity's contract and other deal-related information, such as the entity's equity investment at risk, decision-making abilities, obligations to absorb economic risks and right to receive economic rewards of the entity. These consolidated VIEs are primarily made up of the tax credit funds discussed above.



## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

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Net assets (controlling and noncontrolling interests) of all consolidated VIEs totaled \$667 million and \$644 million as of December 31, 2016 and 2015, respectively, and are included within the consolidated balance sheets primarily as other investments of \$614 million, other assets of \$77 million and other liabilities of \$67 million as of December 31, 2016, and other investments of \$585 million, other assets of \$113 million and other liabilities of \$67 million as of December 31, 2015. The Company's general credit is not exposed to the creditors or beneficial interest holders of these consolidated VIEs. The results of operations and financial positions of each VIE for which the Company is the primary beneficiary, as well as the corresponding noncontrolling interests, are recorded in the consolidated financial statements. Ownership interests held by unrelated third parties in the consolidated VIEs are presented as noncontrolling interests in the equity section of the consolidated financial statements. Losses attributable to noncontrolling interests are excluded from the net income attributable to the Company on the consolidated statements of operations.

The Company is not required and does not intend to provide financial or other support outside of contractual requirements to any VIE.

The Company has junior subordinated debentures issued to Nationwide Financial Services Capital Trust I ("Trust I"), a related party. The Company is not the primary beneficiary and accordingly has not consolidated Trust I.

#### **Derivative Instruments**

The Company uses derivative instruments to manage exposures and mitigate risks primarily associated with interest rates, equity markets and foreign currency. These derivative instruments primarily include interest rate swaps, futures contracts and options. Certain features embedded in the Company's indexed products and certain variable annuity contracts require derivative accounting. All derivative instruments are held at fair value and are reflected as other assets or liabilities in the consolidated balance sheets.

The fair value of derivative instruments is determined using various valuation techniques relying predominantly on observable market inputs. These inputs include interest rate swap curves, credit spreads, interest rates, counterparty credit risk, equity volatility and equity index levels. In cases where observable inputs are not available, the Company will utilize non-binding broker quotes to determine fair value, and these instruments are classified accordingly in the fair value hierarchy. Price movements of these broker quotes are subject to validation and require approval from the Company's management. Management uses models to internally value the instruments for comparison to the values received through broker quotes.

For derivatives that are not designated for hedge accounting, the gain or loss on the derivative is recognized in net realized investment gains and losses.

For derivative instruments that are designated and qualify for cash flow hedge accounting, the effective portion of the gain or loss on the derivative instrument is reported as a component of accumulated other comprehensive income and reclassified into earnings in the same period or periods that the hedged transaction impacts earnings. The ineffective portion of the derivative's change in value, if any, along with any of the derivative's change in value that is excluded from the assessment of hedge effectiveness, are recorded in net realized investment gains and losses.

The Company's derivative transaction counterparties are generally financial institutions. To reduce the credit risk associated with open contracts, the Company enters into master netting agreements, which permit the closeout and netting of transactions with the same counterparty upon the occurrence of certain events. In addition, the Company attempts to reduce credit risk by obtaining collateral from counterparties. The determination of the need for and the levels of collateral vary based on an assessment of the credit risk of the counterparty. The Company accepts collateral in the forms of cash and marketable securities. Non-cash collateral received is recorded off-balance sheet.

#### **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. Fair value measurements are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. In determining fair value, the Company uses various methods, including market, income and cost approaches.

The Company categorizes its financial instruments into a three-level hierarchy based on the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument in its entirety.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

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The Company categorizes assets and liabilities held at fair value in the consolidated balance sheets as follows:

*Level 1.* Unadjusted quoted prices accessible in active markets for identical assets or liabilities at the measurement date and mutual funds, where the value per share (unit) is determined and published daily and is the basis for current transactions.

*Level 2.* Unadjusted quoted prices for similar assets or liabilities in active markets or inputs (other than quoted prices) that are observable or that are derived principally from or corroborated by observable market data through correlation or other means. Primary inputs to this valuation technique may include comparative trades, bid/asks, interest rate movements, U.S. Treasury rates, London Interbank Offered Rate ("LIBOR"), prime rates, cash flows, maturity dates, call ability, estimated prepayments and/or underlying collateral values.

*Level 3.* Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Inputs reflect management's best estimates of the assumptions market participants would use at the measurement date in pricing the asset or liability. Consideration is given to the risk inherent in both the method of valuation and the valuation inputs.

The Company reviews its fair value hierarchy classifications for assets and liabilities quarterly. Changes in the observability of significant valuation inputs identified during these reviews may trigger reclassifications. Reclassifications are reported as transfers at the beginning of the period in which the change occurs.

*Fair Value Option.* The Company assesses the fair value option election for newly acquired assets or liabilities on a prospective basis. There are no material assets or liabilities for which the Company has elected the fair value option.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include highly liquid investments with original maturities of less than three months.

#### **Goodwill**

In connection with business acquisitions, the Company recognizes goodwill as the excess of the purchase price or fair value of consideration exchanged over the fair values of tangible assets acquired, liabilities assumed and separately identified intangible assets. Goodwill is not amortized, but is evaluated for impairment at the reporting unit level annually. Goodwill of a reporting unit is tested for impairment on an interim basis, in addition to the annual evaluation, if an event occurs or circumstances change which would more likely than not reduce the fair value of a reporting unit below its carrying amount. If a reporting unit's fair value is less than its carrying value, the Company will calculate implied goodwill. Goodwill is impaired at the reporting unit level if its carrying value exceeds the implied value of its goodwill.

The process of evaluating goodwill for impairment requires several judgments and assumptions to be made to determine the fair value of the reporting units, including the method used to determine fair value, discount rates, expected levels of cash flows, revenues and earnings, and the selection of comparable companies used to develop market-based assumptions. Total impairments and additions to goodwill were immaterial for the years ended December 31, 2016 and 2015.

#### **Closed Block**

In connection with the sponsored demutualization of Provident Mutual Life Insurance Company ("Provident") prior to its acquisition by the Company, Provident established a closed block for the benefit of certain classes of individual participating policies that had a dividend scale payable in 2001. Assets were allocated to the closed block in an amount that produces cash flows which, together with anticipated revenues from closed block business, is reasonably expected to be sufficient to provide for (1) payment of policy benefits, specified expenses and taxes, and (2) the continuation of dividends throughout the life of the Provident policies included in the closed block based upon the dividend scales payable for 2001, if the experience underlying such dividend scales continues.

Assets allocated to the closed block benefit only the holders of the policies included in the closed block and will not revert to the benefit of the Company. No reallocation, transfer, borrowing or lending of assets can be made between the closed block and other portions of the Company's general account, any of its separate accounts, or any affiliate of the Company without the approval of the Pennsylvania Insurance Department and Ohio Department of Insurance ("ODI"). The closed block will remain in effect as long as any policy in the closed block is in force.

If, over time, the aggregate performance of the closed block assets and policies is better than was assumed in funding the closed block, dividends to policyholders will increase. If, over time, the aggregate performance of the closed block assets and policies is less favorable than was assumed in the funding, dividends to policyholders could be reduced. If the closed block has insufficient funds to make guaranteed policy benefit payments, such payments will be made from the Company's assets outside of the closed block, which are general account assets.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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The assets and liabilities allocated to the closed block are recorded in the Company's consolidated financial statements on the same basis as other similar assets and liabilities. The carrying amount of closed block liabilities in excess of the carrying amount of closed block assets at the date Provident was acquired by the Company represents the maximum future earnings from the assets and liabilities designated to the closed block that can be recognized in income, for the benefit of stockholders, over the period the policies in the closed block remain in force.

If actual cumulative earnings exceed expected cumulative earnings, the expected earnings are recognized in income. This is because the excess actual cumulative earnings over expected cumulative earnings, which represents undistributed accumulated earnings attributable to policyholders, is recorded as a policyholder dividend obligation. Therefore, the excess will be paid to closed block policyholders as an additional policyholder dividend expense in the future unless it is otherwise offset by future performance of the closed block that is less favorable than originally expected. If actual cumulative performance is less favorable than expected, actual earnings will be recognized in income.

The principal cash flow items that affect the amount of closed block assets and liabilities are premiums, net investment income, purchases and sales of investments, policyholder benefits, policyholder dividends, premium taxes and income taxes. The principal income and expense items excluded from the closed block are management and maintenance expenses, commissions and net investment income and realized gains and losses on investments held outside of the closed block that support the closed block business, all of which enter into the determination of total gross margins of closed block policies. See Note 9 for further disclosure.

#### **Separate Accounts**

Separate account assets and liabilities represent contractholders' funds that have been legally segregated into accounts with specific investment objectives. In the separate account, investment income and gains and losses on investments accrue directly to, and investment risk is borne by, the contractholder. Separate account assets are recorded at fair value, with the value of separate account liabilities set to equal the fair value of separate account assets. Separate account assets are primarily comprised of public, privately-registered and non-registered mutual funds, whose fair value is primarily based on the funds' net asset value. Other separate account assets are recorded at fair value based on the methodology that is applicable to the underlying assets.

#### **Customer Bank Deposits**

Customer bank deposits consist of money market deposits, certificates of deposit, savings accounts and demand deposits. The Company carries customer bank deposits at the amount payable on demand.

#### **Federal Income Taxes**

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, net operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income or loss in the years in which those temporary differences are expected to be recovered or settled. Under this method, the effect on deferred tax assets and liabilities due to a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are recorded to reduce a deferred tax asset to the amount expected to be realized. Interest expense and any associated penalties which relate to tax years still subject to review by the Internal Revenue Service ("IRS") are recorded as income tax expenses.

The Company provides for federal income taxes based on amounts the Company believes it ultimately will owe. Inherent in the provision for federal income taxes are estimates regarding the deductibility of certain items and the realization of certain tax credits. In the event the ultimate deductibility of certain items or the realization of certain tax credits differs from estimates, the Company may be required to change the provision for federal income taxes recorded in the consolidated financial statements, which could be significant.

Tax reserves are reviewed regularly and are adjusted as events occur that the Company believes impact its liability for additional taxes, such as the lapsing of applicable statutes of limitations, conclusion of tax audits or substantial agreement with taxing authorities on the deductibility/nondeductibility of uncertain items, additional exposure based on current calculations, identification of new issues, release of administrative guidance or rendering of a court decision affecting a particular tax issue. The Company believes its tax reserves reasonably provide for potential assessments that may result from IRS examinations and other tax-related matters for all open tax years.

The Company files with the NMIC consolidated federal income tax return. Prior to 2015, NLIC filed a separate consolidated federal income tax return with its subsidiaries.



## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

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#### Participating Business

Participating business, which refers to policies that participate in profits through policyholder dividends, represented approximately 3% of the Company's life insurance in force in 2016 and 2015 and 33% of the number of life insurance policies in force in 2016 (35% in 2015). The provision for policyholder dividends was based on the respective year's dividend scales and has been included in future policy benefits and claims in the consolidated balance sheets.

#### Subsequent Events

The Company evaluated subsequent events through February 28, 2017, the date the consolidated financial statements were issued.

#### (3) Reinsurance

The following table summarizes the effects of reinsurance on life, accident and health insurance premiums and in force for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
<b>Premiums</b>		
Direct	\$ 1,011	\$ 1,144
Assumed from other companies	-	-
Ceded to other companies	(369)	(358)
<b>Net</b>	<b>\$ 642</b>	<b>\$ 786</b>
<b>Life, accident and health insurance in force</b>		
Direct	\$ 275,404	\$ 260,465
Assumed from other companies	2	5
Ceded to other companies	(61,674)	(60,976)
<b>Net</b>	<b>\$ 213,732</b>	<b>\$ 199,494</b>

Amounts recoverable under reinsurance contracts totaled \$683 million and \$647 million as of December 31, 2016 and 2015, respectively, and are included in other assets in the consolidated balance sheets.

#### (4) Certain Long-Duration Contracts

##### Variable Annuity Contracts

The Company provides various forms of guarantees to benefit the related contractholders of variable annuity contracts issued through general and separate accounts. The primary guarantee types include GMDB and GLWB.

The GMDB, offered on variable annuity contracts, provides a specified minimum return upon death. Many of these death benefits are spousal, whereby a death benefit will be paid upon death of the first spouse. The survivor has the option to terminate the contract or continue it by having the death benefit paid into the contract and having a second death benefit paid upon the survivor's death.

The GLWB, primarily offered in the Company's Lifetime Income products, are living benefits that provide for enhanced retirement income security without the liquidity loss associated with annuitization. The withdrawal rates vary based on the age when withdrawals begin and are applied to a benefit base to determine the guaranteed lifetime income amount available to a contractholder. The benefit base is equal to the variable annuity premium at contract issuance and may increase as a result of a feature driven by minimum return and contract duration.

Other guarantee types the Company previously offered include guaranteed minimum accumulation benefits ("GMAB") and guaranteed minimum income benefits ("GMIB"). The GMAB is a living benefit that provides the contractholder with a guaranteed return of deposits, adjusted proportionately for withdrawals, after a specified time period (5, 7 or 10 years). The GMIB is a living benefit that provides the contractholder with a guaranteed annuitization stream of income. The separate account value subject to GMAB was \$359 million and \$496 million for the years ended December 31, 2016 and December 31, 2015, respectively. The separate account value subject to GMIB was \$347 million and \$380 million for the years ended December 31, 2016 and December 31, 2015, respectively. The net amount at risk, general account value, reserve balances and paid claims for GMAB and GMIB were immaterial for the years ended December 31, 2016 and 2015.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes information regarding variable annuity contracts with GMDB and GLWB invested in general and separate accounts, as of the dates indicated (a contract may contain multiple guarantees):

<i>(in millions)</i>	December 31, 2016				December 31, 2015			
	General account value	Separate account value	Net amount at risk <sup>1</sup>	Average age <sup>2</sup>	General account value	Separate account value	Net amount at risk <sup>1</sup>	Average age <sup>2</sup>
Contracts with GMDB:								
Return of net deposits	\$ 922	\$ 27,459	\$ 76	66	\$ 885	\$ 24,452	\$ 208	66
Minimum return or anniversary contract value	1,813	31,380	555	71	1,817	31,511	1,133	70
<b>Total contracts with GMDB</b>	<b>\$ 2,735</b>	<b>\$ 58,839</b>	<b>\$ 631</b>	<b>69</b>	<b>\$ 2,702</b>	<b>\$ 55,963</b>	<b>\$ 1,341</b>	<b>68</b>

Contracts with GLWB:

Minimum return or anniversary contract value	\$ 149	\$ 34,974	\$ 166	67	\$ 141	\$ 32,187	\$ 142	67
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1 Net amount at risk is calculated on a policy-level basis and equals the respective guaranteed benefit less the account value (or zero if the account value exceeds the guaranteed benefit).

2 Represents the weighted average attained age of contractholders at the respective date.

The following table summarizes the reserve balances for the primary guarantees on variable annuity contracts, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
GMDB	\$ 170	\$ 148
GLWB	\$ 297	\$ 180

During 2016, the Company recognized an increase in the liability for future policy benefits and claims in conjunction with the annual comprehensive review of assumptions for guarantees on variable annuity contracts, primarily related to the Company's assumptions related to lapses, mortality, interest rates and market rates of return. For the year ended December 31, 2016, the updated assumptions resulted in an increase to life insurance benefits and claims of \$62 million and lower amortization of DAC of \$21 million.

During 2015, the Company recognized a net decrease in the liability for future policy benefits and claims in conjunction with the annual comprehensive review of assumptions, primarily related to the Company's assumptions of participant benefit utilization of the net settlement option within the GLWB. The Company updated its estimate to reduce expected utilization of the net settlement option. For the year ended December 31, 2015, the change in estimate resulted in net realized investment gains of \$187 million, an increase to life insurance benefits and claims of \$164 million and lower amortization of DAC of \$28 million.

Paid claims for GMDB were \$36 million and \$20 million for the years ended December 31, 2016 and 2015, respectively. Paid claims for GLWB were immaterial for the years ended December 31, 2016 and 2015.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes the account balances of deferred variable annuity contracts with guarantees invested in separate accounts, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
Mutual funds:		
Bond	\$ 5,986	\$ 5,371
Domestic equity	48,824	46,469
International equity	3,010	3,001
<b>Total mutual funds</b>	<b>\$ 57,820</b>	<b>\$ 54,841</b>
Money market funds	1,019	1,122
<b>Total<sup>1</sup></b>	<b>\$ 58,839</b>	<b>\$ 55,963</b>

<sup>1</sup> Excludes \$30.2 billion and \$31.3 billion as of December 31, 2016 and 2015, respectively, of separate account assets not related to deferred variable annuity contracts with guarantees, primarily attributable to retirement plan, variable universal life and COLI products.

#### Fixed Annuity Contracts

The Company offers certain fixed indexed annuity products with GMDB and GLWB. As of December 31, 2016 and 2015, the general account value for contracts with GMDB was \$5.2 billion and \$2.7 billion, respectively, which includes \$2.5 billion and \$1.4 billion, respectively, of general account value relating to contracts that also have GLWB. The net amount at risk, reserve balance and paid claims for these guarantees were immaterial as of December 31, 2016 and 2015.

#### Universal and Variable Universal Life Insurance Contracts

The Company offers certain universal life and variable universal life insurance products with no-lapse guarantees. These no-lapse guarantees provide that a policy will not lapse so long as the policyholder makes minimum premium payments. The reserve balances on these guarantees were \$710 million and \$548 million as of December 31, 2016 and 2015, respectively. Paid claims on these guarantees were immaterial for the years ended December 31, 2016 and 2015.

The following table summarizes information regarding universal and variable universal life insurance contracts with no-lapse guarantees invested in general and separate accounts, as of the dates indicated:

<i>(in millions)</i>	General account value	Separate account value	Adjusted insurance in force <sup>1</sup>	Average age <sup>2</sup>
December 31, 2016	\$ 2,991	\$ 2,117	\$ 55,053	51
December 31, 2015	\$ 2,473	\$ 2,053	\$ 48,140	51

<sup>1</sup> The adjusted insurance in force is calculated on a policy-level basis and equals the respective guaranteed death benefit less the account value and reinsurance.

<sup>2</sup> Represents the weighted average attained age of contractholders at the respective date.

**NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES**  
**Notes to December 31, 2016 and 2015 Consolidated Financial Statements**

**(5) Deferred Policy Acquisition Costs**

The following table summarizes changes in the DAC balance, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
Balance at beginning of year	\$ 5,200	\$ 4,063
Capitalization of DAC	823	870
Amortization of DAC, excluding unlocks	(412)	(326)
Amortization of DAC related to unlocks	(21)	258
Adjustments to DAC related to unrealized gains and losses on available-for-sale securities	(158)	335
<b>Balance at end of year</b>	<b>\$ 5,432</b>	<b>\$ 5,200</b>

During 2016, the Company conducted its annual comprehensive review of model assumptions used to project DAC and other related balances, including valuation of business acquired (“VOBA”) and unearned revenue reserves. As part of this review, the Company recognized an increase in amortization for DAC of \$21 million and a decrease in amortization for other related balances of \$75 million. The updated assumptions were primarily related to a decrease in expected lapse rates and mortality performance. This was partially offset by updated assumptions for persistency, interest rates and market rates of return.

During 2015, the Company recognized a decrease in amortization for DAC of \$258 million and a decrease in amortization for other related balances of \$21 million as a result of the annual comprehensive review of model assumptions and enhancements. The updated assumptions were primarily related to revisions made to the Company’s economic hedging strategies in conjunction with the change in estimate discussed in Note 4, as well as a decrease in the expected lapse rates for certain variable annuity products.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

#### (6) Investments

##### *Available-for-Sale Securities*

The following table summarizes the amortized cost, unrealized gains and losses and fair value of available-for-sale securities, as of the dates indicated:

<i>(in millions)</i>	Amortized cost	Unrealized gains	Unrealized losses	Fair value
December 31, 2016				
Fixed maturity securities:				
U.S. government and agencies	\$ 595	\$ 50	\$ -	\$ 645
Obligations of states and political subdivisions	2,486	265	23	2,728
Corporate public securities	27,727	1,050	362	28,415
Corporate private securities	5,731	227	147	5,811
Residential mortgage-backed securities	3,862	139	45	3,956
Commercial mortgage-backed securities	1,400	24	7	1,417
Asset-backed securities	2,549	31	41	2,539
<b>Total fixed maturity securities</b>	<b>\$ 44,350</b>	<b>\$ 1,786</b>	<b>\$ 625</b>	<b>\$ 45,511</b>
Equity securities	62	9	1	70
<b>Total available-for-sale securities</b>	<b>\$ 44,412</b>	<b>\$ 1,795</b>	<b>\$ 626</b>	<b>\$ 45,581</b>
December 31, 2015				
Fixed maturity securities:				
U.S. government and agencies	\$ 343	\$ 59	\$ -	\$ 402
Obligations of states and political subdivisions	2,174	243	11	2,406
Corporate public securities	23,431	870	758	23,543
Corporate private securities	5,082	203	115	5,170
Residential mortgage-backed securities	4,199	176	45	4,330
Commercial mortgage-backed securities	1,710	40	13	1,737
Asset-backed securities	2,083	19	77	2,025
<b>Total fixed maturity securities</b>	<b>\$ 39,022</b>	<b>\$ 1,610</b>	<b>\$ 1,019</b>	<b>\$ 39,613</b>
Equity securities	81	14	4	91
<b>Total available-for-sale securities</b>	<b>\$ 39,103</b>	<b>\$ 1,624</b>	<b>\$ 1,023</b>	<b>\$ 39,704</b>

The fair value of the Company's available-for-sale securities may fluctuate significantly in response to changes in interest rates, investment quality ratings and credit spreads. The Company has the ability and intent to hold equity securities until anticipated recovery. The Company does not have the intent to sell, nor is it more likely than not that it will be required to sell, fixed maturity securities in an unrealized loss position.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes the amortized cost and fair value of fixed maturity securities, by contractual maturity, as of December 31, 2016. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without early redemption penalties.

<i>(in millions)</i>	Amortized cost	Fair value
Fixed maturity securities:		
Due in one year or less	\$ 1,143	\$ 1,156
Due after one year through five years	11,781	12,272
Due after five years through ten years	11,904	11,944
Due after ten years	11,711	12,227
<b>Subtotal</b>	<b>\$ 36,539</b>	<b>\$ 37,599</b>
Residential mortgage-backed securities	3,862	3,956
Commercial mortgage-backed securities	1,400	1,417
Asset-backed securities	2,549	2,539
<b>Total fixed maturity securities</b>	<b>\$ 44,350</b>	<b>\$ 45,511</b>

The following table summarizes the components of net unrealized gains and losses, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
Net unrealized gains on available-for-sale securities, before adjustments and taxes <sup>1</sup>	\$ 1,169	\$ 601
Adjustment to DAC	(191)	(33)
Adjustment to future policy benefits and claims	(68)	(16)
Adjustment to policyholder dividend obligation	(74)	(67)
Deferred federal income tax expense	(282)	(156)
<b>Net unrealized gains on available-for-sale securities</b>	<b>\$ 554</b>	<b>\$ 329</b>

<sup>1</sup> Includes net unrealized gains (losses) of \$1 million and (\$20) million as of December 31, 2016 and 2015, respectively, related to the non-credit portion of other-than-temporarily impaired securities. Includes immaterial change attributable to available-for-sale securities designated in fair value hedging relationships.

The following table summarizes the change in net unrealized gains and losses reported in accumulated other comprehensive income, for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
Balance at beginning of year	\$ 329	\$ 1,068
Unrealized gains and losses arising during the year:		
Net unrealized gains (losses) on available-for-sale securities before adjustments	479	(1,691)
Non-credit impairments and subsequent changes in fair value of impaired debt securities	21	(11)
Net adjustment to DAC and other expense	(158)	339
Net adjustment to future policy benefits and claims	(52)	143
Net adjustment to policyholder dividend obligations	(7)	53
Related federal income tax (expense) benefit	(102)	411
<b>Unrealized gains (losses) on available-for-sale securities</b>	<b>\$ 181</b>	<b>\$ (756)</b>
Less: Reclassification adjustment for net losses realized on available-for-sale securities, net of tax benefit (\$24 and \$9 as of December 31, 2016 and 2015, respectively)	(44)	(17)
<b>Increase in net unrealized gains (losses) on available-for-sale</b>	<b>\$ 225</b>	<b>\$ (739)</b>
<b>Balance at end of year</b>	<b>\$ 554</b>	<b>\$ 329</b>

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes, by asset class, available-for-sale securities in an unrealized loss position based on the amount of time each type of security has been in an unrealized loss position, as well as the related fair value, as of the dates indicated:

<i>(in millions)</i>	Less than or equal to one year		More than one year		Total
	Fair value	Unrealized losses	Fair value	Unrealized losses	Unrealized losses <sup>1</sup>
December 31, 2016					
Fixed maturity securities:					
Corporate public securities	\$ 7,567	\$ 267	\$ 990	\$ 95	\$ 362
Corporate private securities	1,447	65	508	82	147
Residential mortgage-backed securities	566	11	435	34	45
Asset-backed securities	471	2	410	39	41
Other	812	24	97	6	30
<b>Total fixed maturity securities</b>	<b>10,863</b>	<b>369</b>	<b>2,440</b>	<b>256</b>	<b>625</b>
Equity securities	5	-	20	1	1
<b>Total<sup>2</sup></b>	<b>\$ 10,868</b>	<b>\$ 369</b>	<b>\$ 2,460</b>	<b>\$ 257</b>	<b>\$ 626</b>
December 31, 2015					
Fixed maturity securities:					
Corporate public securities	\$ 8,317	\$ 457	\$ 1,011	\$ 301	\$ 758
Corporate private securities	1,642	56	418	59	115
Residential mortgage-backed securities	707	5	492	40	45
Asset-backed securities	898	10	823	67	77
Other	908	21	110	3	24
<b>Total fixed maturity securities</b>	<b>12,472</b>	<b>549</b>	<b>2,854</b>	<b>470</b>	<b>1,019</b>
Equity securities	67	4	-	-	4
<b>Total<sup>2</sup></b>	<b>\$ 12,539</b>	<b>\$ 553</b>	<b>\$ 2,854</b>	<b>\$ 470</b>	<b>\$ 1,023</b>

<sup>1</sup> As of December 31, 2016 and 2015, there were \$119 million and \$450 million, respectively, of unrealized losses related to available-for-sale securities with a fair value to amortized cost ratio of less than 80%.

<sup>2</sup> Represents 1,060 and 1,164 of available-for-sale securities in an unrealized loss position as of December 31, 2016 and 2015, respectively.

The Company believes the unrealized losses on these available-for-sale securities represent temporary fluctuations in economic factors that are not indicative of OTTI.

# NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

## Notes to December 31, 2016 and 2015 Consolidated Financial Statements

### Mortgage Loans, Net of Allowance

The following table summarizes the amortized cost of mortgage loans by portfolio segment, by method of evaluation for credit loss, and the related valuation allowances by type of credit loss, as of the dates indicated:

(in millions)	December 31, 2016			December 31, 2015		
	Commercial	Residential	Total	Commercial	Residential	Total
Amortized cost:						
Loans with non-specific reserves	\$ 10,213	\$ 2,238	\$ 12,451	\$ 8,730	\$ 1,442	\$ 10,172
Loans with specific reserves <sup>1</sup>	17	2	19	19	-	19
<b>Total amortized cost</b>	<b>\$ 10,230</b>	<b>\$ 2,240</b>	<b>\$ 12,470</b>	<b>\$ 8,749</b>	<b>\$ 1,442</b>	<b>\$ 10,191</b>
Valuation allowance:						
Non-specific reserves	\$ 28	\$ 1	\$ 29	\$ 23	\$ 2	\$ 25
Specific reserves	4	1	5	3	-	3
<b>Total valuation allowance<sup>2</sup></b>	<b>\$ 32</b>	<b>\$ 2</b>	<b>\$ 34</b>	<b>\$ 26</b>	<b>\$ 2</b>	<b>\$ 28</b>
<b>Mortgage loans, net of allowance</b>	<b>\$ 10,198</b>	<b>\$ 2,238</b>	<b>\$ 12,436</b>	<b>\$ 8,723</b>	<b>\$ 1,440</b>	<b>\$ 10,163</b>

<sup>1</sup> Interest income recognized on mortgage loans with a specific reserve was immaterial for the years ended December 31, 2016 and 2015. The average recorded investment was \$19 million and \$14 million for the years ended December 31, 2016 and 2015, respectively.

<sup>2</sup> Charges in the valuation allowance are due to current period provisions and recoveries. These changes in the valuation allowance for the years ended December 31, 2016 and 2015 were immaterial.

As of December 31, 2016 and 2015, the Company's commercial and residential mortgage loans classified as delinquent and/or in non-accrual status were immaterial in relation to the total mortgage loan portfolio. The Company had no commercial or residential mortgage loans 90 days or more past due and still accruing interest.

The following table summarizes the LTV ratio and DSC ratios of the commercial mortgage loan portfolio, as of the dates indicated:

(in millions)	LTV ratio			DSC ratio		
	Less than 90%	90% or greater	Total <sup>1</sup>	Greater than 1.00	Less than 1.00	Total <sup>1</sup>
December 31, 2016						
Apartment	\$ 3,722	\$ 11	\$ 3,733	\$ 3,732	\$ -	\$ 3,732
Industrial	1,499	14	1,513	1,480	34	1,514
Office	1,601	3	1,604	1,570	34	1,604
Retail	2,998	30	3,028	3,014	14	3,028
Other	352	-	352	352	-	352
<b>Total<sup>2</sup></b>	<b>\$ 10,172</b>	<b>\$ 58</b>	<b>\$ 10,230</b>	<b>\$ 10,148</b>	<b>\$ 82</b>	<b>\$ 10,230</b>
December 31, 2015						
Apartment	\$ 2,944	\$ -	\$ 2,944	\$ 2,944	\$ -	\$ 2,944
Industrial	1,255	24	1,279	1,227	52	1,279
Office	1,346	3	1,349	1,313	36	1,349
Retail	2,878	2	2,880	2,869	11	2,880
Other	297	-	297	297	-	297
<b>Total<sup>3</sup></b>	<b>\$ 8,720</b>	<b>\$ 29</b>	<b>\$ 8,749</b>	<b>\$ 8,650</b>	<b>\$ 99</b>	<b>\$ 8,749</b>

<sup>1</sup> While these loan quality measurements contribute to management's assessment of relative credit risk in the commercial mortgage loan portfolio for the dates indicated, based on underwriting criteria and ongoing assessment of the properties' performance, management believes the amounts, net of valuation allowance, are collectible.

<sup>2</sup> As of December 31, 2016, the weighted average DSC ratios for the respective LTV ratio ranges above were 2.08 and 1.26, with a total weighted average DSC ratio of 2.07. As of December 31, 2016, the weighted average LTV ratios for the respective DSC ratio ranges above were 58% and 74%, with a total weighted average LTV ratio of 58%.

<sup>3</sup> As of December 31, 2015, the weighted average DSC ratios for the respective LTV ratio ranges above were 2.02 and 0.83, with a total weighted average DSC ratio of 2.02. As of December 31, 2015, the weighted average LTV ratios for the respective DSC ratio ranges above were 60% and 85%, with a total weighted average LTV ratio of 60%.



## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

As of December 31, 2016 and 2015, 99.9% and 99.8%, respectively, of the amortized cost of residential mortgage loans are classified as performing and not graded. The Company assigns a performing and not graded rating to residential mortgage loans that are not past due, and as such do not have the characteristics of potential weaknesses that warrant management's attention.

#### *Other Loans Receivable*

The Company's other investments include other loans receivable with a carrying value of \$2.1 billion and \$2.4 billion as of December 31, 2016 and 2015, respectively. Other loans receivable consist primarily of auto loans and home equity loans. The valuation allowance on these other loans receivable was \$13 million and \$22 million as of December 31, 2016 and 2015, respectively. The valuation allowance is a reserve representing management's best estimate of probable losses inherent in the existing loan portfolio. Management evaluates the adequacy of the allowance at least quarterly. This evaluation is inherently subjective as it requires estimates that may be susceptible to significant change. As of December 31, 2016 and 2015, 99.3% and 99.5%, respectively, of the other loans receivable were classified as performing and not graded.

#### *Available-For-Sale Securities on Deposit, Held in Trust and Pledged as Collateral*

Available-for-sale securities with a carrying value of \$168 million and \$218 million were on deposit with various regulatory agencies as required by law as of December 31, 2016 and 2015, respectively. Additionally, available-for-sale securities with a carrying value of \$503 million and \$805 million were placed in trusts or pledged as collateral to secure public deposits, recoveries under reinsurance contracts and other financing agreements as of December 31, 2016 and 2015, respectively. These securities are primarily included in fixed maturity securities in the consolidated balance sheets.

#### *Net Investment Income*

The following table summarizes net investment income by investment type, for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
Fixed maturity securities, available-for-sale	\$ 1,832	\$ 1,697
Mortgage loans	475	451
Other loans receivable	77	90
Alternative investments	(60)	(56)
Policy loans	52	51
Other	27	15
<b>Gross investment income</b>	<b>\$ 2,403</b>	<b>\$ 2,248</b>
Investment expenses	64	62
<b>Net investment income</b>	<b>\$ 2,339</b>	<b>\$ 2,186</b>

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

#### Net Realized Investment Gains and Losses, Including Other-Than-Temporary Impairments

The following table summarizes net realized investment gains and losses, including other-than-temporary impairments, by source, for the years ended:

<i>(in millions)</i>	December 31, 2016			December 31, 2015		
	Available for sale	Other	Total	Available for sale	Other	Total
Realized gains on sales <sup>1,2</sup>	\$ 53	\$ 4	\$ 57	\$ 11	\$ 7	\$ 18
Realized losses on sales <sup>1,2</sup>	(96)	(1)	(97)	(36)	(6)	(42)
Net realized derivative (losses) gains	-	(42)	(42)	-	119	119
Valuation losses and other	-	(14)	(14)	-	(10)	(10)
OTTI losses <sup>3</sup>	(26)	-	(26)	(1)	-	(1)
<b>Net realized investment (losses) gains</b>	<b>\$ (69)</b>	<b>\$ (53)</b>	<b>\$ (122)</b>	<b>\$ (26)</b>	<b>\$ 110</b>	<b>\$ 84</b>

1 Proceeds from the sale of available-for-sale securities were \$1.7 billion and \$540 million during the years ended December 31, 2016 and 2015, respectively.

2 Certain prior year amounts have been reclassified to conform to current year's presentation.

3 OTTI on fixed maturity securities excludes non-credit losses of \$6 million and \$2 million included in other comprehensive income for the years ended December 31, 2016 and 2015, respectively.

The following table summarizes the cumulative credit losses, for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
Cumulative credit losses at beginning of year <sup>1</sup>	\$ (224)	\$ (254)
New credit losses	(22)	(1)
Losses related to securities included in the beginning balance sold or paid down during the period	51	31
<b>Cumulative credit losses at end of year<sup>1</sup></b>	<b>\$ (195)</b>	<b>\$ (224)</b>

1 Cumulative credit losses are defined as amounts related to the Company's credit portion of the other-than-temporary impairment losses on debt securities that the Company does not intend to sell and that it is not more likely than not the Company will be required to sell prior to recovery of the amortized cost basis.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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#### (7) Derivative Instruments

The Company is exposed to certain risks related to its ongoing business operations, which are managed using derivative instruments.

*Interest rate risk management.* In the normal course of business, the Company enters into transactions that expose the Company to interest rate risk arising from mismatches between assets and liabilities. The Company uses interest rate swaps and futures to reduce or alter interest rate exposure.

Interest rate contracts are used by the Company in association with fixed and variable rate investments to achieve cash flow streams that support certain financial obligations of the Company and to produce desired investment returns. As such, interest rate contracts are generally used to convert fixed rate cash flow streams to variable rate cash flow streams or vice versa. In addition, prior to expiry in June 2015, the Company engaged in an interest rate swap program, which was structured to provide an offset against the negative impact of higher interest rates on the Company's statutory surplus position and to mitigate the negative impact of lower interest rates on certain guarantees related to variable annuity contracts.

*Equity market risk management.* The Company issues a variety of insurance and annuity products that expose the Company to equity risks. To mitigate these risks, the Company enters into a variety of derivatives including equity index futures, options and total return swaps.

*Other risk management.* As part of its regular investing activities, the Company may purchase foreign currency denominated investments. These investments and the associated income expose the Company to volatility associated with movements in foreign exchange rates. As foreign exchange rates change, the increase or decrease in the cash flows of the derivative instrument are intended to mitigate the changes in the functional-currency equivalent cash flows of the hedged item. To mitigate this risk, the Company uses cross-currency swaps, which are included in other derivative contracts in the following tables.

*Credit risk associated with derivatives transactions.* The Company periodically evaluates the risks within the derivative portfolios due to credit exposure. When evaluating these risks, the Company considers several factors which include, but are not limited to, the counterparty credit risk associated with derivative receivables, the Company's own credit as it relates to derivative payables, the collateral thresholds associated with each counterparty and changes in relevant market data in order to gain insight into the probability of default by the counterparty. The Company also considers the impact credit exposure could have on the effectiveness of the Company's hedging relationships. As of December 31, 2016 and 2015, the impact of the exposure to credit risk on the fair value measurement of derivatives and the effectiveness of the Company's hedging relationships was immaterial.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes the fair value and related notional amounts of derivative instruments, as of the dates indicated:

<i>(in millions)</i>	Derivative assets		Derivative liabilities	
	Fair value	Notional	Fair value	Notional
December 31, 2016				
Derivatives designated and qualifying as hedging instruments	\$ 132	\$ 1,142	\$ 12	\$ 463
Derivatives not designated as hedging instruments:				
Interest rate contracts	\$ 75	\$ 2,078	\$ 110	\$ 1,729
Equity contracts	633	9,562	-	-
Total return swaps and other derivative contracts	-	-	2	2
<b>Total derivatives<sup>1</sup></b>	<b>\$ 840</b>	<b>\$ 12,782</b>	<b>\$ 124</b>	<b>\$ 2,194</b>
December 31, 2015				
Derivatives designated and qualifying as hedging instruments	\$ 86	\$ 725	\$ 2	\$ 89
Derivatives not designated as hedging instruments:				
Interest rate contracts	\$ 39	\$ 1,225	\$ 98	\$ 1,059
Equity contracts	445	7,329	-	-
Total return swaps and other derivative contracts	-	141	6	92
<b>Total derivatives<sup>1</sup></b>	<b>\$ 570</b>	<b>\$ 9,420</b>	<b>\$ 106</b>	<b>\$ 1,240</b>

1 Fair value balance excludes accrued interest on derivative assets and liabilities of \$10 million and \$11 million, respectively, as of December 31, 2016 and 2015.

Of the \$840 million and \$570 million of fair value of total derivative assets at December 31, 2016 and 2015, \$72 million and \$48 million, respectively, are subject to master netting agreements. The Company received \$662 million and \$374 million of cash collateral and held \$89 million and \$99 million, respectively, of securities as off-balance sheet collateral, resulting in an immaterial uncollateralized position as of December 31, 2016 and 2015. Of the \$124 million and \$106 million of fair value of total derivative liabilities at December 31, 2016 and 2015, \$72 million and \$48 million, respectively, are subject to master netting agreements. The Company posted \$151 million and \$92 million of cash collateral and pledged securities with a fair value of \$60 million and \$64 million, respectively, resulting in an immaterial uncollateralized position as of December 31, 2016 and 2015.

The following table summarizes gains and losses for derivative instruments recognized in net realized investment gains and losses in the consolidated statements of operations, for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
<b>Derivative instruments</b>		
Interest rate contracts	\$ 13	\$ (142)
Equity contracts	(81)	(257)
Total return swaps	-	(44)
Other derivative contracts	8	(6)
Net interest settlements	(2)	32
<b>Total derivative losses<sup>1</sup></b>	<b>\$ (62)</b>	<b>\$ (417)</b>
Change in embedded derivative liabilities and related fees <sup>2</sup>	20	536
<b>Net realized derivative (losses) gains</b>	<b>\$ (42)</b>	<b>\$ 119</b>

1 Included in total derivative losses are economic hedging losses of \$2 million and \$402 million related to the guaranteed benefit annuity programs for the years ended December 31, 2016 and 2015, respectively. Included in total derivative losses for the year ended December 31, 2015 are economic hedging gains of \$52 million related to the program that protects against the negative impact of higher interest rates on the Company's statutory surplus position through expiry.

2 The annual comprehensive review of model assumptions for the individual variable annuity business produced an immaterial impact for the year ended December 31, 2016. The annual comprehensive review of model assumptions for the individual variable annuity business produced a favorable impact of \$187 million for the year ended December 31, 2015, attributable to the change in estimate discussed in Note 4.

# NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

## Notes to December 31, 2016 and 2015 Consolidated Financial Statements

### (8) Fair Value Measurements

The following table summarizes assets and liabilities held at fair value on a recurring basis as of December 31, 2016:

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Investments:				
Fixed maturity securities, available-for-sale:				
U.S. government and agencies	\$ 642	\$ 1	\$ 2	\$ 645
Obligations of states and political subdivisions	57	2,671	-	2,728
Corporate public securities	-	28,200	215	28,415
Corporate private securities	-	4,748	1,063	5,811
Residential mortgage-backed securities	1,926	2,024	6	3,956
Commercial mortgage-backed securities	-	1,417	-	1,417
Asset-backed securities	-	2,394	145	2,539
Total fixed maturity securities, available-for-sale, at fair value	\$ 2,625	\$ 41,455	\$ 1,431	\$ 45,511
Other investments at fair value	1,107	1,049	14	2,170
Investments at fair value	\$ 3,732	\$ 42,504	\$ 1,445	\$ 47,681
Derivative instruments - assets	-	207	633	840
Separate account assets <sup>1</sup>	87,266	1,374	65	88,705
<b>Assets at fair value</b>	<b>\$ 90,998</b>	<b>\$ 44,085</b>	<b>\$ 2,143</b>	<b>\$ 137,226</b>
<b>Liabilities</b>				
Future policy benefits and claims	\$ -	\$ -	\$ 346	\$ 346
Derivative instruments - liabilities	-	\$ 122	\$ 2	124
<b>Liabilities at fair value</b>	<b>\$ -</b>	<b>\$ 122</b>	<b>\$ 348</b>	<b>\$ 470</b>

1 Excludes \$366 million of separate account assets that use net asset value ("NAV") as a practical expedient to estimate fair value.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the year ended December 31, 2016:

<i>(in millions)</i>	Fixed maturity securities <sup>2</sup>	Other investments	Derivative assets <sup>3</sup>	Separate account assets <sup>4</sup>	Total assets at fair value	Liabilities at fair value <sup>3</sup>
<b>Balance as of December 31, 2015</b>	\$ 1,234	\$ 43	\$ 445	\$ 361	\$ 2,083	\$ 71
Net (losses) gains						
In operations <sup>1</sup>	(24)	7	92	(13)	62	277
In other comprehensive income	41	(11)	-	-	30	-
Purchases	87	9	115	-	211	-
Sales	(190)	(34)	(19)	(283)	(526)	-
Transfers into Level 3	375	-	-	-	375	-
Transfers out of Level 3	(92)	-	-	-	(92)	-
<b>Balance as of December 31, 2016</b>	<b>\$ 1,431</b>	<b>\$ 14</b>	<b>\$ 633</b>	<b>\$ 65</b>	<b>\$ 2,143</b>	<b>\$ 348</b>

1 Net gains and losses included in operations are reported in net realized investment gains and losses and interest credited to policyholder accounts. The net unrealized gains on separate account assets are attributable to contractholders, and therefore are not included in the Company's earnings. The change in unrealized gains (losses) included in operations on assets and liabilities still held at the end of the year was \$157 million for future policy benefits and claims, \$146 million for derivative assets, \$(3) million for derivative liabilities and \$(2) million for other investments at fair value.

2 Non-binding broker quotes were utilized to determine a fair value of \$1.0 billion of total fixed maturity securities as of December 31, 2016.

3 Non-binding broker quotes were utilized to determine a fair value of all Level 3 derivative assets and liabilities.

4 Certain prior period amounts related to separate account assets that use NAV as a practical expedient to estimate fair value has changed to conform with the current period presentation as a result of new guidance.

Transfers into and out of Level 3 during the year ended December 31, 2016 are primarily due to the change in observability of pricing inputs used for certain corporate public and private securities. There were no material transfers between Levels 1 and 2 during the year ended December 31, 2016.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table summarizes assets and liabilities held at fair value on a recurring basis as of December 31, 2015:

<i>(in millions)</i>	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Investments:				
Fixed maturity securities, available-for-sale:				
U.S. government and agencies	\$ 399	\$ 1	\$ 2	\$ 402
Obligations of states and political subdivisions	63	2,343	-	2,406
Corporate public securities	-	23,389	154	23,543
Corporate private securities	-	4,226	944	5,170
Residential mortgage-backed securities	1,480	2,841	9	4,330
Commercial mortgage-backed securities	-	1,737	-	1,737
Other asset-backed securities	-	1,900	125	2,025
Total fixed maturity securities, available-for-sale, at fair value	\$ 1,942	\$ 36,437	\$ 1,234	\$ 39,613
Other investments at fair value	346	564	43	953
Investments at fair value	\$ 2,288	\$ 37,001	\$ 1,277	\$ 40,566
Derivative instruments - assets	-	125	445	570
Separate account assets <sup>1</sup>	83,466	1,323	361	85,150
<b>Assets at fair value</b>	<b>\$ 85,754</b>	<b>\$ 38,449</b>	<b>\$ 2,083</b>	<b>\$ 126,286</b>
<b>Liabilities</b>				
Future policy benefits and claims	\$ -	\$ -	\$ 65	\$ 65
Derivative instruments - liabilities	-	100	6	106
<b>Liabilities at fair value</b>	<b>\$ -</b>	<b>\$ 100</b>	<b>\$ 71</b>	<b>\$ 171</b>

<sup>1</sup> Excludes \$2.1 billion of separate account assets that use NAV as a practical expedient to estimate fair value, which presentation has changed to conform with the current period presentation as a result of new guidance. This included an investment in a mutual fund that was not redeemed until the guarantee period expired in 2016 with a net asset value of \$1.7 billion. The investment strategy of this fund was to build a portfolio where the assets were sufficient to achieve a target portfolio value by the end of the guarantee period.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the year ended December 31, 2015:

<i>(in millions)</i>	Fixed maturity securities <sup>2</sup>	Other investments	Derivative assets <sup>3</sup>	Separate account assets <sup>4</sup>	Total assets at fair value	Liabilities at fair value <sup>3</sup>
<b>Balance as of December 31, 2014</b>	\$ 1,274	\$ 41	\$ 412	\$ 354	\$ 2,081	\$ 264
Net gains (losses)					-	
In operations <sup>1</sup>	(6)	-	(46)	7	(45)	(313)
In other comprehensive income	(43)	1	-	-	(42)	-
Purchases	142	1	103	-	246	144
Sales	(164)	-	(24)	-	(188)	(24)
Transfers into Level 3	201	-	-	-	201	-
Transfers out of Level 3	(170)	-	-	-	(170)	-
<b>Balance as of December 31, 2015</b>	\$ 1,234	\$ 43	\$ 445	\$ 361	\$ 2,083	\$ 71

1 Net gains and losses included in operations are reported in net realized investment gains and losses and interest credited to policyholder accounts. The net unrealized gains on separate account assets are attributable to contractholders, and therefore are not included in the Company's earnings. The change in unrealized gains (losses) included in operations on assets and liabilities still held at the end of the year was \$316 million for future policy benefits and claims, \$(9) million for derivative assets and \$2 million for derivative liabilities.

2 Non-binding broker quotes were utilized to determine a fair value of \$1.1 billion of total fixed maturity securities as of December 31, 2015.

3 Non-binding broker quotes were utilized to determine a fair value of all Level 3 derivative assets and liabilities.

4 Certain prior period amounts related to separate account assets that use NAV as a practical expedient to estimate fair value has changed to conform with the current period presentation as a result of new guidance.

Transfers into and out of Level 3 during the year ended December 31, 2015 are primarily due to the change in observability of pricing inputs used for certain corporate private securities.

# NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

## Notes to December 31, 2016 and 2015 Consolidated Financial Statements

### (9) Closed Block

The amounts shown in the following tables for assets, liabilities, revenues and expenses of the closed block are those that enter into the determination of amounts that are to be paid to policyholders.

The following table summarizes financial information for the closed block, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
<b>Liabilities:</b>		
Future policyholder benefits	\$ 1,602	\$ 1,637
Policyholder funds and accumulated dividends	138	138
Policyholder dividends payable	20	21
Policyholder dividend obligation	100	99
Other policy obligations and liabilities	38	35
<b>Total liabilities</b>	<b>\$ 1,898</b>	<b>\$ 1,930</b>
<b>Assets:</b>		
Available-for-sale securities	\$ 1,286	\$ 1,316
Mortgage loans, net of allowance	223	235
Policy loans	138	146
Other assets	98	71
<b>Total assets</b>	<b>\$ 1,745</b>	<b>\$ 1,768</b>
<b>Excess of reported liabilities over assets</b>	<b>\$ 153</b>	<b>\$ 162</b>
<b>Portion of above representing other comprehensive income:</b>		
Increase (decrease) in unrealized gain on fixed maturity securities, available-for-sale	\$ 7	\$ (53)
Adjustment to policyholder dividend obligation	(7)	53
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Maximum future earnings to be recognized from assets and liabilities</b>	<b>\$ 153</b>	<b>\$ 162</b>
<b>Other comprehensive income:</b>		
Available-for-sale securities:		
Fair value	\$ 1,286	\$ 1,316
Amortized cost	1,212	1,249
Shadow policyholder dividend obligation	(74)	(67)
<b>Net unrealized appreciation</b>	<b>\$ -</b>	<b>\$ -</b>



**NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES**  
**Notes to December 31, 2016 and 2015 Consolidated Financial Statements**

The following table summarizes closed block operations for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
<b>Revenues</b>		
Premiums	\$ 56	\$ 58
Net investment income	84	87
Realized investment (losses) gains	(3)	1
Realized losses credited to policyholder benefit obligation	(1)	(5)
<b>Total revenues</b>	<b>\$ 136</b>	<b>\$ 141</b>
<b>Benefits and expenses</b>		
Policy and contract benefits	\$ 125	\$ 122
Change in future policyholder benefits and interest credited to policyholder accounts	(36)	(33)
Policyholder dividends	40	40
Change in policyholder dividend obligation	(8)	(4)
Other expenses	1	1
<b>Total benefits and expenses</b>	<b>\$ 122</b>	<b>\$ 126</b>
<b>Total revenues, net of benefits and expenses, before federal income tax expense</b>	<b>\$ 14</b>	<b>\$ 15</b>
Federal income tax expense	5	5
<b>Revenues, net of benefits and expenses and federal income tax expense</b>	<b>\$ 9</b>	<b>\$ 10</b>
<b>Maximum future earnings from assets and liabilities</b>		
Beginning of period	\$ 162	\$ 172
Change during period	(9)	(10)
<b>End of period</b>	<b>\$ 153</b>	<b>\$ 162</b>

Cumulative closed block earnings from inception through December 31, 2016 and 2015 were higher than expected as determined in the actuarial calculation. Therefore, policyholder dividend obligations (excluding the adjustment for unrealized gains on available-for-sale securities) was \$26 million and \$32 million as of December 31, 2016 and 2015, respectively.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

#### (10) Debt

The following table summarizes the carrying value of debt, as of the dates indicated:

<i>(in millions)</i>	December 31,	
	2016	2015
\$600 million principal, 5.375% senior notes, due March 25, 2021	\$ 598	\$ 598
\$400 million principal, 5.30% senior notes, due November 18, 2044	399	399
\$400 million principal, 6.75% fixed-to-floating rate junior subordinated notes, due May 15, 2037, final maturity May 15, 2067 extendible to 2087	399	399
\$100 million principal, 7.899% junior subordinated debentures, due March 1, 2037	103	103
Various fixed rate financial institution borrowings, due through June 2031 <sup>1</sup>	765	592
Other	7	7
<b>Long-term debt</b>	<b>\$ 2,271</b>	<b>\$ 2,098</b>
Short-term debt <sup>2</sup>	980	786
<b>Total</b>	<b>\$ 3,251</b>	<b>\$ 2,884</b>

1 As of December 31, 2016, the Company had contractual maturities of \$130 million, \$125 million and \$375 million in 2017, 2018 and 2019, respectively, and no contractual maturities in 2020 and 2021.

2 The Company classifies debt as short-term if the maturity date at inception is less than one year.

*Senior and subordinated notes.* All of the notes are redeemable in advance of their respective maturity dates under varying conditions at the option of the Company. The terms of the senior notes contain various restrictive covenants including limitations on the disposition of subsidiaries.

The 7.899% junior subordinated debentures were sold by the Company to an unconsolidated VIE in March 1997. The junior subordinated debentures are the sole assets of the unconsolidated VIE and are redeemable by NFS, in whole or in part, at par plus an applicable make-whole premium.

*Short-term debt.* In April 2016, the Company entered into an agreement with the FHLB to increase its \$900 million revolving variable rate line of credit to \$1.0 billion. The Company also has a line of credit of \$100 million with the FHLB. These lines of credit provide financing for the operations of Nationwide Bank. The borrowings are collateralized by certain eligible investments and single family residential loans owned by the Company. The available portion of the credit facilities is limited by the collateral value of loans or securities pledged. As of December 31, 2016 and 2015, the credit facilities were fully collateralized. The \$1.0 billion line of credit had outstanding short-term borrowings of \$155 million and \$386 million as of December 31, 2016 and 2015, respectively, with an overnight interest rate of 0.64% and 0.35% as of December 31, 2016 and 2015, respectively. In addition to the short-term borrowings under the \$1.0 billion revolving variable rate line of credit agreement, the Company has the ability to enter into long-term financial institution borrowings under the same agreement, in which there were no amounts outstanding as of December 31, 2016 and 2015. The \$100 million line of credit agreement had no amounts outstanding as of December 31, 2016 and 2015.

*Other open lines of short-term credit.* In March 2016, NLIC renewed an agreement to extend its ability to borrow with the FHLB. This extension, which expires on March 24, 2017, allows NLIC access to borrow up to \$250 million, which would be collateralized by pledged securities. As of December 31, 2016 and 2015, the Company had \$6.1 billion and \$6.7 billion, respectively, in eligible collateral and no amounts outstanding under the agreement.

*Interest payments.* The Company made interest payments on its long-term debt totaling \$62 million and \$79 million for the years ended December 31, 2016 and 2015, respectively. The Company made interest payments on its short-term debt totaling \$4 million for the years ended December 31, 2016 and 2015, respectively. In addition, distributions related to junior subordinated notes and debentures were classified as interest expense in the consolidated statements of operations. The Company made distributions of \$35 million for the years ended December 31, 2016 and 2015.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

#### (11) Federal Income Taxes

The following table summarizes the federal income tax expense attributable to income, before loss attributable to noncontrolling interests, for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
Current tax expense	\$ 79	\$ 83
Deferred tax expense	67	230
<b>Total tax expense</b>	<b>\$ 146</b>	<b>\$ 313</b>

The following table summarizes how the total federal income tax expense differs from the amount computed by applying the U.S. federal income tax rate to net income for the years ended:

<i>(in millions)</i>	December 31, 2016		December 31, 2015	
	Amount	%	Amount	%
Rate reconciliation:				
Computed (expected tax expense)	\$ 337	35	\$ 450	35
Dividends received deduction	(144)	(15)	(118)	(9)
Tax credits	(81)	(8)	(62)	(5)
Other, net	34	3	43	3
<b>Total</b>	<b>\$ 146</b>	<b>15</b>	<b>\$ 313</b>	<b>24</b>

The Company's current federal income tax liability was \$67 million and \$65 million as of December 31, 2016 and 2015, respectively.

The Company made payments of \$7 million and \$34 million for the years ended December 31, 2016 and 2015, respectively.

During 2016 and 2015, the Company recorded a tax benefit of \$6 million and \$1 million, respectively, primarily related to differences in the Company's separate account dividends received deduction between the prior year estimate and the amount reported on the Company's tax return.

The Company had total deferred tax assets before valuation allowance of \$1.9 billion and \$1.8 billion for years ending December 31, 2016 and 2015, respectively. The Company had total deferred tax liabilities of \$2.4 billion and \$2.1 billion for years ending December 31, 2016 and 2015, respectively. The significant temporary differences creating deferred tax assets and liabilities relate to life insurance reserves, investments, DAC and reinsurance, as well as deferred tax assets for tax credit carryforwards. The Company had total valuation allowances of \$17 million for both December 31, 2016 and 2015.

As of December 31, 2016, the Company has gross federal net operating and capital loss carryforwards of \$4 million, which expire between 2032 and 2036. As of December 31, 2016, the Company has \$254 million in low-income-housing credit carryforwards, which expire between 2024 and 2036, and \$268 million in alternative minimum tax credit carryforwards, which have an unlimited carryforward. In addition, the Company has \$77 million in foreign tax credit carryforwards which expire between 2017 and 2025. The Company expects to fully utilize all carryforwards.

In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion of the total gross deferred tax assets will not be realized. Valuation allowances are established when necessary to reduce the deferred tax assets to amounts expected to be realized. Based on the Company's analysis, it is more likely than not that the results of future operations and the implementation of tax planning strategies will generate sufficient taxable income to enable the Company to realize the deferred tax assets for which the Company has not established valuation allowances.

The Company believes it is reasonably possible that the liability for unrecognized tax benefits could decrease \$15 million within the next 12 months as a result of IRS exam settlement.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

The Company files consolidated income tax returns in the U.S. federal jurisdiction and various state jurisdictions. NMIC and its eligible subsidiaries are no longer subject to U.S. federal, state or local income tax examinations by tax authorities through the 2010 tax year. NLIC and its eligible subsidiaries are no longer subject to examinations by tax authorities through the 2010 tax year. In 2015, the IRS commenced an examination of the Company's U.S. income tax returns for the years 2011 and 2012. Any adjustments that may result from either IRS examination of tax returns or appeals settlement are not expected to have a material effect on the results of operations, cash flows or financial position of the Company.

#### (12) Statutory Financial Information and Other Regulations

##### Statutory Results

The Company's life insurance subsidiaries prepare their statutory financial statements in conformity with the statutory accounting practices prescribed and permitted by insurance regulatory authorities, subject to any deviations prescribed or permitted by the applicable state departments of insurance.

Olentangy Reinsurance, LLC ("Olentangy"), a special purpose financial captive insurance company subsidiary of Nationwide Life and Annuity Insurance Company ("NLAIC") domiciled in the State of Vermont, was granted a permitted practice from the State of Vermont that increased NLAIC's valuation of this subsidiary by \$56 million as of December 31, 2016 and 2015, which also allowed NLIC to admit additional deferred tax assets of \$8 million as of December 31, 2016 and 2015.

Eagle Captive Reinsurance, LLC ("Eagle"), a special purpose financial captive insurance company subsidiary of NLIC domiciled in the State of Ohio, applies a prescribed practice from the State of Ohio that allows an alternative reserve basis on assumed liabilities, net of third party reinsurance, with respect to specified GMDB and GLWB obligations provided under substantially all of the variable annuity contracts issued and to be issued by NLIC. This prescribed practice decreased NLIC's valuation of this subsidiary by \$97 million and \$64 million as of December 31, 2016 and 2015, respectively, and also reduced NLIC's admitted deferred tax assets by \$15 million and \$10 million as of December 31, 2016 and 2015, respectively.

Statutory accounting practices focus on insurer solvency and differ materially from GAAP primarily due to charging policy acquisition and other costs to expense as incurred, establishing future policy benefits and claims reserves based on different actuarial assumptions, excluding certain assets from statutory admitted assets and valuing investments and establishing deferred taxes on a different basis.

The following table summarizes the statutory net income (loss) and statutory capital surplus for the Company's primary life insurance subsidiaries for the years ended:

<i>(in millions)</i>	December 31,	
	2016	2015
<b>Statutory net income (loss)</b>		
NLIC	\$ 751	\$ 167
NLAIC	\$ (227)	\$ (99)
<b>Statutory capital and surplus</b>		
NLIC	\$ 5,208	\$ 4,567
NLAIC	\$ 968	\$ 735

##### Dividend Restrictions

As an insurance holding company, NFS' ability to meet debt service obligations and pay operating expenses and dividends depends primarily on the receipt of sufficient funds from its primary operating subsidiary, NLIC. The inability of NLIC to pay dividends to NFS in an amount sufficient to meet debt service obligations and pay operating expenses and dividends would have a material adverse effect on the Company. The payment of dividends by NLIC is subject to restrictions set forth in the insurance laws and regulations of the State of Ohio, its domiciliary state. The State of Ohio insurance laws require Ohio-domiciled life insurance companies to notify the Ohio Superintendent of Insurance of all dividends prior to payment and must seek prior regulatory approval to pay a dividend or distribute cash or other property if the fair market value thereof, together with that of other dividends or distributions made in the preceding twelve months, exceeds the greater of (1) 10% of statutory-basis policyholders' surplus as of the prior December 31 or (2) the statutory-basis net income of the insurer for the prior year. During the years ended December 31, 2016 and 2015, NLIC did not pay any dividends to NFS. As of January 1, 2017, NLIC has the ability to pay dividends to NFS totaling \$751 million without obtaining prior approval.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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The State of Ohio insurance laws also require insurers to seek prior regulatory approval for any dividend paid from other than earned surplus. Earned capital and surplus is defined under the State of Ohio insurance laws as the amount equal to the Company's unassigned funds as set forth in its most recent statutory financial statements, including net unrealized capital gains and losses or revaluation of assets. Additionally, following any dividend, an insurer's policyholder capital and surplus must be reasonable in relation to the insurer's outstanding liabilities and adequate for its financial needs. The payment of dividends by NLIC may also be subject to restrictions set forth in the insurance laws of the State of New York that limit the amount of statutory profits on NLIC's participating policies (measured before dividends to policyholders) available for the benefit of the Company and its stockholders.

The Company currently does not expect such regulatory requirements to impair the ability of its insurance company subsidiaries to pay sufficient dividends in order for NFS to have the necessary funds available to meet its obligations.

#### **Regulatory Risk-Based Capital**

The National Association of Insurance Commissioners' ("NAIC") Risk-Based Capital ("RBC") model law requires every insurer to calculate its total adjusted capital and RBC requirement to ensure insurer solvency. Regulatory guidelines provide for an insurance commissioner to intervene if the insurer experiences financial difficulty. The RBC model includes components for asset risk, liability risk, interest rate exposure and other factors. Each insurance company's state of domicile imposes minimum RBC requirements that are developed by the NAIC. The formulas in the model for determining the amount of RBC specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Regulatory compliance is determined by a ratio of total adjusted capital to authorized control level RBC, as defined by the NAIC. Companies below specific trigger points or ratios are classified within certain levels, all of which require specified corrective action. The Company and its insurance subsidiaries each exceeded the minimum RBC requirements for all the periods presented.

#### **Other Regulations**

Nationwide Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors. The regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate corrective action.

The Office of the Comptroller of the Currency ("OCC") regulations establish a tiered system of capital requirements, with the greatest flexibility afforded to institutions that are both well-capitalized and given favorable qualitative examination ratings. The regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. As of December 31, 2016, Nationwide Bank is considered to be well capitalized. There are no conditions or events since the most recent notification that management believes have changed Nationwide Bank's category.

#### **(13) Related Party Transactions**

The Company has entered into significant, recurring transactions and agreements with NMIC, other affiliates and subsidiaries as a part of its ongoing operations. These include annuity and life insurance contracts, agreements related to reinsurance, cost sharing, tax sharing, administrative services, marketing, intercompany loans, intercompany repurchases, cash management services, investment management and software licensing. In addition, employees of the Company participate in several benefit plans sponsored by NMIC, for which the Company has no legal obligations. Measures used to allocate expenses among companies include individual employee estimates of time spent, special cost studies, claims counts, policies in force, direct written premium, paid losses, pro rate share of employees or their salaries, the number of full-time employees, commission expense and other methods agreed to by the participating companies.

Effective January 1, 2015, the Company became party to a revised tax sharing agreement that reflects the new NMIC consolidated federal return group which includes its eligible life and non-life insurance company subsidiaries. The method of allocation among the companies is based upon separate return calculations with current benefit for tax losses and credits utilized in the consolidated return.

In addition, Nationwide Services Company, LLC ("NSC"), a subsidiary of NMIC, provides data processing, systems development, hardware and software support, telephone, mail and other services to the Company, based on specified rates for units of service consumed pursuant to the enterprise cost sharing agreement. For the years ended December 31, 2016 and 2015, the Company was allocated costs from NMIC and NSC totaling \$314 million and \$325 million, respectively.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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The Company has issued group annuity and life insurance contracts and performs administrative services for various employee benefit plans sponsored by NMIC or its affiliates. Total account values of these contracts were \$3.4 billion and \$3.3 billion as of December 31, 2016 and 2015, respectively. Total revenues from these contracts were \$127 million and \$129 million for the years ended December 31, 2016 and 2015, respectively, and include policy charges, net investment income from investments backing the contracts and administrative fees. Total interest credited to the account balances was \$111 million and \$106 million for the years ended December 31, 2016 and 2015, respectively.

The Company may underwrite insurance policies and issue loans to its agents, employees, officers and/or directors. The Company may offer discounts on certain products that are subject to applicable state insurance laws and approvals.

Under the enterprise cost sharing agreement, the Company has a cost sharing arrangement with NMIC to occupy office space. For the years ended December 31, 2016 and 2015, the Company made payments to NMIC of \$23 million and \$22 million, respectively.

NLIC has a reinsurance agreement with NMIC whereby all of NLIC's accident and health business not ceded to unaffiliated reinsurers is ceded to NMIC on a modified coinsurance basis. Either party may terminate the agreement on January 1 of any year with prior notice. Under a modified coinsurance agreement, the ceding company retains invested assets, and investment earnings are paid to the reinsurer. Under the terms of NLIC's agreements, the investment risk associated with changes in interest rates is borne by the reinsurer. The ceding of risk does not discharge the original insurer from its primary obligation to the policyholder. Revenues ceded to NMIC for the years ended December 31, 2016 and 2015 were \$209 million, while benefits, claims and expenses ceded during these years were \$185 million and \$207 million, respectively.

Amounts on deposit with NCMC for the benefit of the Company were \$953 million and \$512 million as of December 31, 2016 and 2015, respectively.

Nationwide Bank has made loans to agents of NMIC of \$27 million and \$30 million as of December 31, 2016 and 2015, respectively. These loans were made in the ordinary course of business under normal credit and underwriting terms and do not represent more than the normal risk of collection. Nationwide Bank has a guarantee from NMIC it will repurchase the loan from Nationwide Bank in the event of default. There were immaterial loans repurchased for the years ended December 31, 2016 and 2015.

The Company provides financing to subsidiaries of Nationwide Realty Investors, LTD, a subsidiary of NMIC. As of December 31, 2016 and 2015, the Company had notes receivable outstanding of \$332 million and \$238 million, respectively.

The Company provides financing to NAMC. As of December 31, 2016 and 2015, the Company had notes receivable outstanding of \$26 million and \$29 million, respectively.

On July 28, 2016, the Company paid dividends of \$15 million to Nationwide Corporation.

#### (14) Contingencies

##### *Legal and Regulatory Matters*

The Company is subject to legal and regulatory proceedings in the ordinary course of its business. These include proceedings specific to the Company and proceedings generally applicable to business practices in the industries in which the Company operates. The outcomes of these proceedings cannot be predicted due to their complexity, scope, and many uncertainties. Regulatory proceedings may also affect the outcome of one or more of the Company's litigation matters. Furthermore, it is often not possible with any degree of certainty to determine the likely ultimate outcomes of the pending regulatory and legal proceedings or to provide reasonable ranges of potential losses. Some matters are in very preliminary stages, and the Company does not have sufficient information to make an assessment of the claims for liability or damages. In some of the legal proceedings which are seeking to be certified as class actions, the court has not yet decided whether a class will be certified or (in the event of certification) the size of the class and class period. In many of the legal proceedings, the plaintiffs are seeking undefined amounts of damages or other relief, including punitive damages and equitable remedies, which are difficult to quantify and cannot be defined based on the information currently available. The Company believes, however, that based on currently known information, the ultimate outcome of all pending legal and regulatory proceedings is not likely to have a material adverse effect on the Company's consolidated financial position. Nonetheless, it is possible that such outcomes could materially affect the Company's consolidated financial position or results of operations in a particular quarter or annual period given the large or indeterminate amounts sought in certain of these legal proceedings and the inherent unpredictability of litigation. The Company maintains Professional Liability Insurance and Director and Officer Liability insurance policies that may cover losses for certain legal and regulatory matters. The Company recognizes an asset for insurance recoveries, not to exceed cumulative accrued losses, when recovery under such policies is probable and reasonably estimable.

## NATIONWIDE FINANCIAL SERVICES, INC. AND SUBSIDIARIES

### Notes to December 31, 2016 and 2015 Consolidated Financial Statements

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The various businesses conducted by the Company are subject to oversight by numerous federal and state regulatory entities, including but not limited to the Securities and Exchange Commission, the Financial Industry Regulatory Authority, the Department of Labor (“DOL”), the IRS, the Federal Reserve Bank and state insurance authorities. Such regulatory entities may, in the normal course, be engaged in general or targeted inquiries, examinations and investigations of the Company and/or its affiliates. With respect to all such scrutiny directed at the Company or its affiliates, the Company is cooperating with regulators. The Company will cooperate with its ultimate parent company, NMIC insofar as any inquiry, examination or investigation encompasses NMIC’s operations. In addition, recent regulatory activity, including activity by the DOL, may impact the Company’s business and operations, and certain estimates and assumptions used by the Company in determining the amounts presented in the financial statements and accompanying notes. Actual results could differ significantly from those estimates and assumptions.

#### *Indemnifications*

In the normal course of business, the Company provides standard indemnifications to contractual counterparties. The types of indemnifications typically provided include breaches of representations and warranties, taxes and certain other liabilities, such as third party lawsuits. The indemnification clauses are often standard contractual terms and are entered into in the normal course of business based on an assessment that the risk of loss would be remote. The terms of the indemnifications vary in duration and nature. In many cases, the maximum obligation is not explicitly stated, and the contingencies triggering the obligation to indemnify have not occurred and are not expected to occur. Consequently, the amount of the obligation under such indemnifications is not determinable. Historically, the Company has not made any material payments pursuant to these obligations.