Inside Northwestern Mutual’s General Account

The power of the portfolio

A pillar of our financial strength, Northwestern Mutual’s over $235 billion General Account investment portfolio backs our insurance policies and contributes to the dividends paid to policyowners.
GENERAL ACCOUNT – PRIMARY GOALS

HIGHEST FINANCIAL STRENGTH RATINGS AWARDED TO ANY LIFE INSURER

SUPERIOR RETURNS FOR POLICYOWNER DIVIDENDS

General Account investment performance is one of many factors used to determine Northwestern Mutual’s financial strength ratings.

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The power of the portfolio

We’re engaged in a $235 billion balancing act. On the one hand, providing the product value that is essential to keeping our clients on the path to financial security. And on the other, maintaining the financial strength that ensures that we’ll be here to meet our obligations to clients for the life of their policies. Together, these require seeking the highest possible returns while also managing risk.

This takes a large team of experts who determine and implement our strategy to achieve a diversified and balanced portfolio of carefully selected investments. We call this The Power of the Portfolio.
Putting clients first
what it means to be a mutual

Unlike public companies, Northwestern Mutual isn’t owned by stockholders, so we don’t face the constant pressure to increase our stock price and hit short-term earnings targets. This means that we can invest with an entirely different, long-term perspective – a significant advantage.

It also means that while public companies seek to make a profit for stockholders, as a mutual, our priority is our clients.

STOCKHOLDERS VS. POLICYOWNERS: A MATTER OF TIME

Stockholders tend to look for short-term gains. Policyowners often view their policies in terms of decades, not years. Public insurance companies can struggle to simultaneously satisfy these sometimes conflicting goals.

"Compared with stock companies, whose Insurer Financial Strength (IFS) ratings are capped at ‘AA+’, as a mutually owned company, NM is able to attain a ‘AAA’ IFS rating. Fitch believes the mutual ownership structure aligns the interests of management with those of policyholders, thus promoting a stronger focus on financial strength."  Fitch Ratings, June 2018

"Future dividends are not guaranteed, although Northwestern Mutual has paid a dividend every year since 1872."
A long-term, disciplined investment strategy

It’s about results over time. Active portfolio management, diversification and a long-term perspective are behind our investment portfolio’s track record of consistently strong performance.

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Asset Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>41%</td>
<td>Investment-grade corporate bonds</td>
</tr>
<tr>
<td>16%</td>
<td>Residential mortgage-backed securities</td>
</tr>
<tr>
<td>17%</td>
<td>Commercial mortgage loans</td>
</tr>
<tr>
<td>7%</td>
<td>U.S. government securities</td>
</tr>
<tr>
<td>2%</td>
<td>High-yield bonds</td>
</tr>
<tr>
<td>2%</td>
<td>Real estate equities</td>
</tr>
<tr>
<td>3%</td>
<td>Private equities</td>
</tr>
<tr>
<td>2%</td>
<td>Public common stock</td>
</tr>
<tr>
<td>3%</td>
<td>Asset-backed securities</td>
</tr>
<tr>
<td>2%</td>
<td>Commercial mortgage-backed securities</td>
</tr>
<tr>
<td>1%</td>
<td>Foreign government securities</td>
</tr>
<tr>
<td>1%</td>
<td>Collateralized loan obligations</td>
</tr>
<tr>
<td>5%</td>
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</table>

**Optimizing Our Allocation**

We develop the long-term allocation shown on this page to maximize long-term policyowner value while maintaining our exceptional financial strength across a variety of business cycles and economic conditions.

“Lower Risk” and “Higher Risk” are general indications of the relative risk of loss of a particular type of investment compared to other investments. Generally, in investing, higher-risk investments offer greater potential return. All investments carry some risk of loss.

The vast majority of the company’s managed assets back most of its life, disability income and Portfolio Income Annuity liabilities. The investment strategies described in this update apply to the investment of those assets. A portion of managed assets backs the remaining liabilities (primarily fixed deferred annuities, income plans and long-term care insurance), which have different investment exposures. When purchasing the company’s life insurance and annuity products, clients are not investing in the company’s General Account portfolio but purchasing products backed by the financial strength of Northwestern Mutual. Long-term care insurance is issued by Northwestern Long Term Care Insurance Company, Milwaukee, WI, a subsidiary of Northwestern Mutual.

Also see Reporting Considerations, page 15.
Portfolio quality

More than 90 percent of the bond and preferred stock portfolio is rated investment grade. And we’re committed to earning the highest financial strength ratings awarded to any insurer, a record we’ve maintained.

91% INVESTMENT GRADE

9% BELOW INVESTMENT GRADE

AVERAGE DURATION 5-6 YEARS short-intermediate

A shorter relative duration means our bond portfolio is not overly sensitive to changes in the interest rate environment.

Bond portfolio duration: Duration is a measure of the sensitivity of the price of a fixed-income investment to a change in interest rates. For example, a five-year duration means a bond is expected to increase in value by about 5% if interest rates fall 1% and decrease in value by about 5% if interest rates rise 1%.

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A LARGE SURPLUS BEHIND OUR STRENGTH

We maintain a healthy surplus, which is the amount over and above reserves that is set aside to cover benefits and losses that exceed expectations. This allows us to pursue higher returns by taking somewhat more risk than the industry average while maintaining our top financial strength ratings. Why take more risk? Higher-risk investments generally have higher potential for gain along with the increased potential for loss. The “art” of investing often involves determining where you’ll receive the greatest reward for the least risk.

Surplus ratio (past 40 years)

Surplus ratio is Northwestern Mutual’s surplus and asset valuation reserve as a percentage of General Account insurance reserves (consolidated statutory basis).

Northwestern Mutual’s General Account allocations vs. the industry average

<table>
<thead>
<tr>
<th>GENERAL ACCOUNT</th>
<th>INDUSTRY AVERAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Target allocations</td>
<td>Higher-risk assets</td>
</tr>
<tr>
<td>17%</td>
<td>IG private fixed income and mortgage loans</td>
</tr>
<tr>
<td>33%</td>
<td>IG public fixed income and other</td>
</tr>
<tr>
<td>49%</td>
<td></td>
</tr>
</tbody>
</table>

IG = Investment-grade

Target allocations do not add to 100% due to rounding.


Industry averages do not add to 100% — Policy Loans, Derivatives, Cash & Equivalents, and Other make up the remainder.
Diversification and balance

Diversification is the fundamental investing practice of purchasing different types of investments to avoid concentrating risk. But a diversified portfolio can still be high risk if the mix of investments within it come mainly from the riskier asset classes. Balance describes the proportion of higher-risk to lower-risk investments (see page 5). Our portfolio is well diversified and balanced to help provide above-average returns without excessive risk as we move through ever-changing economic conditions.

DIVERSIFICATION IN ACTION – ASSET CLASS PERFORMANCE RANKINGS

Because financial markets are always in flux, no asset class is consistently the best performer (or worst). Diversification across asset classes helps mitigate market unpredictability and capture opportunities as they arise.

Northwestern Mutual General Account asset class performance rank

One-year total returns
THE CONCEPT OF THE EFFICIENT FRONTIER

The relationship between risk and return is central to investing. Typically, lower-risk investments generate lower returns than higher-risk investments, which offer the potential for higher returns. Can a mix of lower- and higher-risk investments result in a portfolio that offers both more consistent performance and higher returns over time? The answer is yes, according to a concept from modern portfolio theory called “the efficient frontier.”

The actual average annual return and risk level of three common asset classes from 1999-2018 are shown on the graph below.

Now consider a hypothetical portfolio (see below), which is a diversified blend of all three. The proportions aren’t equal – the portfolio consists mostly of high-quality, lower-risk bonds (80%), while the higher-risk but higher-potential-return real estate (8%) and equities (12%) asset classes make up the balance. The result: Using the actual returns from 1999-2018 discussed earlier, our hypothetical diversified portfolio would have produced a greater total return with less risk during this time period than a portfolio made up entirely of bonds, the least risky single asset class.

THE EFFICIENT FRONTIER IS PART OF OUR THINKING

Our General Account investment strategy applies asset allocation principles like the efficient frontier to capture the long-term benefits of diversification. This has produced attractive results for our clients – over the past 20 years, our investment portfolio supported a dividend interest rate (DIR) that was greater and less volatile than the total return on a portfolio invested only in high-quality bonds (see below).

The Efficient Frontier illustrated

1999-2018

Bonds, real estate, equities and treasuries and their performance are represented by the following indices, respectively: BarCap US Agg Bond TR USD, NCREIF Property, S&P 500 TR and U.S. Government 3-mo. T-Bill TR. All those points in the graph assume no taxes or transaction costs.

* Average annual dividend interest rate (DIR) for unborrowed funds for most permanent life insurance policies with direct recognition for the years 1999-2018. The primary function of permanent life insurance is to provide a death benefit. The volatility of the DIR does not reflect that of the underlying assets of the general account portfolio in part because determination of the DIR in any given year considers investment performance over a period of years. The DIR is not the rate of return on a policy and is only one factor for determining the permanent life insurance dividend. Currently, nearly 70 percent of our life insurance dividend payout is a result of our industry-leading persistency, favorable mortality costs and diligent expense management. Policy value is best measured by annual studies of long-term performance and not by one component of the dividend scale, such as the DIR. For more information regarding the DIR and our dividends, see pages 14 and 15.
Essential diversifiers: Real estate and private equity

Change is constant in global markets. This has made diversification – a proven technique for capitalizing on the “ups” while minimizing the impact of the “downs” – essential to building successful long-term portfolios like Northwestern Mutual’s General Account. This diversification is enhanced by our extensive, nationwide real estate operations and significant international private equity activities.

These are just a few examples of the large number of investments Northwestern Mutual makes each year.

REAL ESTATE

Northwestern Mutual is one of largest real estate investors in the United States. And size matters. Our team has the capital and in-house capabilities to select from the broadest range of investments. The result: diversification and strong performance.

Northwestern Mutual prides itself on establishing relationships with new partners and borrowers each year. In 2018, Northwestern Mutual partnered with McCarthy Cook to acquire ownership in three first-class office buildings in a prime downtown location in the heart of the Silicon Valley. The office complex offers convenient access to the commuter rail and is walkable to restaurant and retail amenities.

Castro Station | Mountain View, CA
In 2018, Northwestern Mutual provided first mortgage and mezzanine loans totaling $145 million on a premier thirty-story residential tower featuring 240 luxury apartments above two floors of retail. The newly completed project is located just blocks away from Fenway Park, with its surrounding shopping, restaurants and nightlife.

**2018 PRIVATE INVESTMENTS**

Private equity is a natural fit for a life insurance company with long-dated liabilities and a high tolerance for illiquidity. These investments are often exclusive and relationship driven, so getting access to the most attractive opportunities is critical. That’s where Northwestern Mutual’s reputation as a respected, highly sought-after private equity business partner comes in. The result: diversification and superior risk-adjusted returns relative to public market alternatives.

In 2017, private equity firm GTCR approached Northwestern Mutual Capital with the opportunity to invest in GreatCall, the leading provider of connected health and safety services to seniors through easy-to-use cell phones and mobile personal emergency response systems. GreatCall was an attractive investment opportunity due to the company’s market leading position, strong track record of historical growth, and tailwinds for senior protection and aging assistance products. GTCR’s expertise in healthcare, technology, and business services also factored heavily into our decision to invest in GreatCall. In 2018, GreatCall was sold to Best Buy, generating an excellent return for our clients.

In 2011, Northwestern was approached by Frontenac, a Chicago-based private equity firm with deep healthcare expertise. Northwestern was an ideal choice because of our prior successful experience in the addiction treatment sector and our ability to provide both mezzanine debt and equity co-investment support. The deal started slowly as Frontenac built out the management team and professionalized the organization, but rapidly accelerated as the business gained traction with solid organic and acquisition-led growth accompanied by strong de-leveraging. The business was sold in Q4 2018 to a larger, healthcare focused buyout firm and Northwestern nearly tripled its equity investment. BHG was a rewarding deal where we were truly able to do well by doing good.

BHG was Northwestern’s second investment in a healthcare business treating serious substance abuse. In 2011, Northwestern was approached by Frontenac, a Chicago-based private equity firm with deep healthcare expertise. Northwestern was an ideal choice because of our prior successful experience in the addiction treatment sector and our ability to provide both mezzanine debt and equity co-investment support. The deal started slowly as Frontenac built out the management team and professionalized the organization, but rapidly accelerated as the business gained traction with solid organic and acquisition-led growth accompanied by strong de-leveraging. The business was sold in Q4 2018 to a larger, healthcare focused buyout firm and Northwestern nearly tripled its equity investment. BHG was a rewarding deal where we were truly able to do well by doing good.
A record of consistent growth

Over the past 10 years, total invested assets and net investment income have shown consistent growth. Together, these contribute significantly to Northwestern Mutual’s dividend-paying capacity and increases in total surplus, further improving the company’s financial strength.

TOTAL INVESTED ASSETS
in billions

Includes investment income due and accrued.

5.5%
Compound annual growth rate over the last 10 years
Investment portfolio performance

The performance of the General Account helps us deliver guaranteed product value and create the financial capacity to pay dividends.*

**NET INVESTMENT INCOME**

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Investment Income (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$7,772</td>
</tr>
<tr>
<td>2010</td>
<td>$8,306</td>
</tr>
<tr>
<td>2011</td>
<td>$8,439</td>
</tr>
<tr>
<td>2012</td>
<td>$8,625</td>
</tr>
<tr>
<td>2013</td>
<td>$8,693</td>
</tr>
<tr>
<td>2014</td>
<td>$9,104</td>
</tr>
<tr>
<td>2015</td>
<td>$9,467</td>
</tr>
<tr>
<td>2016</td>
<td>$9,607</td>
</tr>
<tr>
<td>2017</td>
<td>$9,541</td>
</tr>
<tr>
<td>2018</td>
<td>$9,791</td>
</tr>
</tbody>
</table>

*Dividends are not guaranteed.

2.4% Compound annual growth rate of net investment income over the last 10 years.
PORTFOLIO YIELD

Why the yield decrease? – The impact of low interest rates

Prolonged periods of low rates (like the present) invariably drive fixed-income yields lower. Nevertheless, to maintain our high investment quality standards, 83 percent of the General Account portfolio is allocated to these lower-risk assets. While superior performance from our other investments can help offset low bond yields, some decrease in the portfolio’s yield is unavoidable as older, higher coupon bonds mature and are replaced by lower coupon investments.

General Account fixed-income book yield

10-year U.S. Treasury yields, 1962–present

The General Account fixed-income book yield is not the same as the various dividend interest rates credited to participating insurance policies or annuity contracts, nor is it a measure of a policy’s internal rate of return.

DETERMINING DIVIDENDS – THE ROLE OF THE GENERAL ACCOUNT

The investment earnings generated by the general account portfolio – in addition to our level of claims paid and careful management of our expenses – contribute to our ability to pay dividends on products. The company’s dividend interest rate (DIR) for traditional permanent life insurance policies is declared annually by the Board of Trustees and is a reflection of what the company has earned on its investment portfolio in recent years. This rate is used for the determination of the interest component of a permanent life policy’s dividend, which currently contributes approximately 30 percent of the dividend payout.

Northwestern Mutual’s dividend interest rate (DIR)

Past 100 years

For years prior to 1982, the dividend interest rate (DIR) reflects the highest applicable dividend interest rate across all traditional permanent life insurance policies. After 1982, this graph reflects the dividend interest rate for unborrowed funds for most traditional permanent life insurance policies with direct recognition. See page 15 for more information on determining dividends.
Reporting considerations

ABOUT NORTHWESTERN MUTUAL’S GENERAL ACCOUNT INVESTMENTS AND INSURANCE PRODUCTS

The vast majority of the company’s managed assets backs most of its life, disability income and Portfolio Income Annuity liabilities. The investment strategies described in this booklet apply to the investment of those assets. A portion of managed assets backs the remaining liabilities (primarily fixed deferred annuities, income plans and long-term care insurance), which have different investment exposures than described in this report. When purchasing the company’s life insurance and annuity products, clients are not investing in the company’s General Account portfolio but purchasing products backed by the financial strength of Northwestern Mutual. Long-term care insurance is issued by Northwestern Long Term Care Insurance Company, Milwaukee, WI, a subsidiary of Northwestern Mutual.

GENERAL ACCOUNT INVESTMENTS REPORTING CONSIDERATIONS

Northwestern Mutual publishes The Power of the Portfolio annually to provide information on the asset mix of its portfolio and the investment results generated during the previous calendar year. For additional information on its investments, see Northwestern Mutual’s Annual Investment Report, available at www.northwesternmutual.com/financial-information. Certain types of investments have been grouped differently for this report than in Northwestern Mutual’s Audited Financial Statements (AFS). The most significant of these differences as of December 31, 2018, are:

• Other investments of $1.9 billion reported in the AFS include certain interests in subsidiaries and affiliates, joint ventures and partnerships. This report classifies these investments based on the character of the underlying assets, such as public bonds, private equities, real estate and public common stock.

• Mortgage loans of $36.8 billion reported in the AFS include $1.5 billion of loans made to real estate joint ventures in which the company is an equity investor. This report classifies these investments based on the accounting and valuation methods applied to the reported investment values. PricewaterhouseCoopers LLP is the company’s independent auditor.

• Due and accrued investment income of $2.0 billion is reported separately in the AFS. This report includes these amounts in their respective asset classes.

Northwestern Mutual’s AFS utilizes the statutory method of accounting. Investment values under generally accepted accounting principles may differ materially from the figures presented in this report. The notes to the AFS provide further details as to the accounting and valuation methods applied to the reported investment values.

A copy of Northwestern Mutual’s 2018 Audited Financial Statement is available at www.northwesternmutual.com/financial-information or by written request to Northwestern Mutual, Corporate Communications, NOA, 720 E. Wisconsin Ave., Milwaukee, WI 53202.

IMPORTANT INFORMATION ABOUT DETERMINING DIVIDENDS

In regard to Northwestern Mutual’s dividend payout and dividend interest rate (DIR), comments in this document pertain generally to life insurance policy dividends.

The company’s DIR for unborrowed funds for most traditional permanent life insurance policies reflects the investment performance of the applicable managed assets net of taxes and any contribution to surplus. This rate is used for the determination of the interest component of a policy’s dividend. The rate is applied to unborrowed funds for most traditional permanent life insurance policies after mortality and expense charges have been deducted from policy values. Depending on the terms of a particular policy, a different rate may be applied. For example, either a different rate is credited on borrowed funds to reflect individual policy loan activity, or all funds, both borrowed and unborrowed, are credited with a single rate that reflects the average level of borrowing for all similar policies.

The DIR is not the rate of return on a policy and is only one factor for determining the life insurance dividend. Currently, approximately 70 percent of our life insurance dividend payment is a result of our industry-leading persistency, favorable mortality costs and diligent expense management. Decisions with respect to the determination and allocation of divisible surplus are left to the discretion and sound business judgment of the company’s Board of Trustees. There is no guaranteed specific method or formula for the determination and allocation of divisible surplus. Accordingly, the company’s approach is subject to change. Neither the existence nor the amount of a dividend is guaranteed on any policy in any given policy year. Some policies may not receive any dividends in a particular year or years even while other policies receive dividends.

In its 2019 dividend scale resolution, the Board of Trustees has exercised its discretion to guarantee a minimum amount of dividends to be paid in 2019 to the policyholders as a group. If this guaranteed amount exceeds the aggregate amount of dividends actually paid to individual policyholders in 2019, that excess will be paid out in 2020 pursuant to the 2019 dividend scale resolution. The presence of a guaranteed minimum amount in the 2019 dividend scale resolution does not obligate Northwestern Mutual to declare a dividend in future years or to guarantee any portion of dividends that may be declared in future years.

DETERMINING DIVIDENDS

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MORE THAN 160 YEARS OF STRENGTH AND STABILITY
Since 1857, Northwestern Mutual’s strength and stability have backed our promise to be there for clients who plan for and take action to achieve their long-term financial goals.

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The ratings reflect “the company’s exceptional business and financial strength which includes a leading position and strong franchise in its core market with a significant focus on participating whole life insurance, a very productive distribution network, strong operating fundamentals reflected by its excellent persistency and mortality experience, and a robust and resilient balance sheet.”

Moody’s Investors Service, May 2019

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The ratings reflect Northwestern Mutual’s balance sheet strength, which AM Best categorizes as strongest, as well as its very strong operating performance, very favorable business profile and very strong enterprise risk management.

AM Best Company, May 2019

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Fitch views Northwestern’s successful distribution system, large and stable block of traditional life insurance, and low expense structure relative to peers as key competitive advantages.

Fitch Ratings, May 2019

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We view Northwestern’s management team, led by CEO John Schlifske, and its strategy positively and as clear rating strengths. Management is well seasoned with a strategy that emphasizes long-term stability and strength, and a commitment to mutuality and policyholders. It has shown consistent commitment to its core individual life insurance products and distribution.

S&P Global Ratings, June 2019