ALLSTATE CORP
Form 10-Q
May 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

/X/ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission file number 1-11840

THE ALLSTATE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-3871531**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2775 Sanders Road, Northbrook, Illinois **60062**
(Address of principal executive offices) (Zip Code)

(847) 402-5000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes _X_ No ___

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes _X_ No ___

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer _X_	Accelerated filer ____
Non-accelerated filer ____ (Do not check if a smaller reporting company)	Smaller reporting company ____

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ___ No _X_

As of April 22, 2014, the registrant had 433,991,146 common shares, $.01 par value, outstanding.

THE ALLSTATE CORPORATION

INDEX TO QUARTERLY REPORT ON FORM 10-Q

March 31, 2014

PART I	**FINANCIAL INFORMATION**	**PAGE**
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Operations for the Three-Month Periods Ended March 31, 2014 and 2013 (unaudited)	1
	Condensed Consolidated Statements of Comprehensive Income for the Three-Month Periods Ended March 31, 2014 and 2013 (unaudited)	2
	Condensed Consolidated Statements of Financial Position as of March 31, 2014 (unaudited) and December 31, 2013	3
	Condensed Consolidated Statements of Shareholders Equity for the Three-Month Periods Ended March 31, 2014 and 2013 (unaudited)	4
	Condensed Consolidated Statements of Cash Flows for the Three-Month Periods Ended March 31, 2014 and 2013 (unaudited)	5
	Notes to Condensed Consolidated Financial Statements (unaudited)	6
	Report of Independent Registered Public Accounting Firm	44
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	
	Highlights	45
	Consolidated Net Income	46
	Property-Liability Highlights	46
	Allstate Protection Segment	49
	Discontinued Lines and Coverages Segment	58
	Property-Liability Investment Results	59
	Allstate Financial Highlights	60
	Allstate Financial Segment	60
	Investments Highlights	66
	Investments	66
	Capital Resources and Liquidity Highlights	73
	Capital Resources and Liquidity	73
Item 4.	Controls and Procedures	77
PART II	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	78
Item 1A.	Risk Factors	78
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	78
Item 6.	Exhibits	79

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL INFORMATION

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

($ in millions, except per share data)	**Three months ended March 31, 2014**	**2013**
	(unaudited)	
Revenues		
Property-liability insurance premiums	$ 7,064	$ 6,770
Life and annuity premiums and contract charges	607	579
Net investment income	959	983
Realized capital gains and losses:		
Total other-than-temporary impairment losses	(80)	(27)
Portion of loss recognized in other comprehensive income	(1)	(10)
Net other-than-temporary impairment losses recognized in earnings	(81)	(37)
Sales and other realized capital gains and losses	135	168
Total realized capital gains and losses	54	131
	8,684	8,463
Costs and expenses		
Property-liability insurance claims and claims expense	4,759	4,460
Life and annuity contract benefits	488	458
Interest credited to contractholder funds	307	345
Amortization of deferred policy acquisition costs	1,035	946
Operating costs and expenses	1,094	1,102
Restructuring and related charges	6	26
Interest expense	87	98
	7,776	7,435
(Loss) gain on disposition of operations	(59)	2
Income from operations before income tax expense	849	1,030
Income tax expense	249	321
Net income	600	709
Preferred stock dividends	13	--
Net income available to common shareholders	$ 587	$ 709
Earnings per common share:		
Net income available to common shareholders per common share - Basic	$ 1.31	$ 1.49
Weighted average common shares - Basic	446.4	475.4
Net income available to common shareholders per common share - Diluted	$ 1.30	$ 1.47

Weighted average common shares - Diluted		452.8		480.8
Cash dividends declared per common share	$	0.28	$	0.25

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

($ in millions)	**Three months ended March 31,**	
	2014	**2013**
	(unaudited)	
Net income	$ 600	$ 709
Other comprehensive income, after-tax		
Changes in:		
Unrealized net capital gains and losses	445	71
Unrealized foreign currency translation adjustments	(16)	(12)
Unrecognized pension and other postretirement benefit cost	11	45
Other comprehensive income, after-tax	440	104
Comprehensive income	$ 1,040	$ 813

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

($ in millions, except par value data)	**March 31, 2014 (unaudited)**	**December 31, 2013**
Assets		
Investments		
Fixed income securities, at fair value (amortized cost $58,587 and $59,008)	$ 61,161	$ 60,910
Equity securities, at fair value (cost $4,575 and $4,473)	5,297	5,097
Mortgage loans	4,472	4,721
Limited partnership interests	5,024	4,967
Short-term, at fair value (amortized cost $2,573 and $2,393)	2,573	2,393
Other	3,163	3,067
Total investments	81,690	81,155
Cash	1,170	675
Premium installment receivables, net	5,271	5,237
Deferred policy acquisition costs	3,316	3,372
Reinsurance recoverables, net	7,512	7,621
Accrued investment income	610	624
Property and equipment, net	1,024	1,024
Goodwill	1,243	1,243
Other assets	2,187	1,937
Separate Accounts	4,878	5,039
Assets held for sale	15,390	15,593
Total assets	$ 124,291	$ 123,520
Liabilities		
Reserve for property-liability insurance claims and claims expense	$ 21,985	$ 21,857
Reserve for life-contingent contract benefits	12,435	12,386
Contractholder funds	23,989	24,304
Unearned premiums	10,821	10,932
Claim payments outstanding	785	631
Deferred income taxes	886	635
Other liabilities and accrued expenses	5,566	5,156
Long-term debt	6,200	6,201
Separate Accounts	4,878	5,039
Liabilities held for sale	14,641	14,899
Total liabilities	102,186	102,040
Commitments and Contingent Liabilities (Note 12)		
Equity		
Preferred stock and additional capital paid-in, $1 par value, 25 million shares authorized, 62.2 thousand and 32.3 thousand shares issued and outstanding, $1,555 and $807.5 aggregate liquidation preference	1,505	780
Common stock, $.01 par value, 2.0 billion shares authorized and 900 million issued, 434 million and 449 million shares outstanding	9	9
Additional capital paid-in	3,017	3,143
Retained income	36,041	35,580
Deferred ESOP expense	(31)	(31)
Treasury stock, at cost (466 million and 451 million shares)	(19,922)	(19,047)
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital gains and losses on fixed income securities with OTTI	66	50
Other unrealized net capital gains and losses	2,271	1,698
Unrealized adjustment to DAC, DSI and insurance reserves	(246)	(102)
Total unrealized net capital gains and losses	2,091	1,646
Unrealized foreign currency translation adjustments	22	38
Unrecognized pension and other postretirement benefit cost	(627)	(638)
Total accumulated other comprehensive income	1,486	1,046
Total shareholders equity	22,105	21,480

Total liabilities and shareholders equity	$	124,291	$	123,520

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

($ in millions)	Three months ended March 31, 2014	2013
	(unaudited)	
Preferred stock par value		
Balance, beginning of period	$ --	$ --
Preferred stock issuance	--	--
Balance, end of period	--	--
Preferred stock additional capital paid-in		
Balance, beginning of period	780	--
Preferred stock issuance	725	--
Balance, end of period	1,505	--
Common stock	9	9
Additional capital paid-in		
Balance, beginning of period	3,143	3,162
Forward contract on accelerated share repurchase agreement	(113)	(75)
Equity incentive plans activity	(13)	(59)
Balance, end of period	3,017	3,028
Retained income		
Balance, beginning of period	35,580	33,783
Net income	600	709
Dividends on common stock	(126)	(117)
Dividends on preferred stock	(13)	--
Balance, end of period	36,041	34,375
Deferred ESOP expense		
Balance, beginning of period	(31)	(41)
Payments	--	2
Balance, end of period	(31)	(39)
Treasury stock		
Balance, beginning of period	(19,047)	(17,508)
Shares acquired	(987)	(652)
Shares reissued under equity incentive plans, net	112	127
Balance, end of period	(19,922)	(18,033)
Accumulated other comprehensive income		
Balance, beginning of period	1,046	1,175
Change in unrealized net capital gains and losses	445	71
Change in unrealized foreign currency translation adjustments	(16)	(12)
Change in unrecognized pension and other postretirement benefit cost	11	45
Balance, end of period	1,486	1,279
Total shareholders equity	$ 22,105	$ 20,619

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)	Three months ended March 31, 2014	2013
	(unaudited)	
Cash flows from operating activities		
Net income	$ 600	$ 709
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	98	87
Realized capital gains and losses	(54)	(131)
Loss (gain) on disposition of operations	59	(2)
Interest credited to contractholder funds	307	345
Changes in:		
Policy benefits and other insurance reserves	(18)	(514)
Unearned premiums	(92)	(146)
Deferred policy acquisition costs	3	(30)
Premium installment receivables, net	(46)	(22)
Reinsurance recoverables, net	(45)	406
Income taxes	(68)	277
Other operating assets and liabilities	(270)	(239)
Net cash provided by operating activities	474	740
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	6,483	5,474
Equity securities	1,328	210
Limited partnership interests	238	160
Mortgage loans	10	2
Other investments	30	15
Investment collections		
Fixed income securities	849	1,745
Mortgage loans	324	237
Other investments	50	54
Investment purchases		
Fixed income securities	(6,252)	(6,084)
Equity securities	(1,330)	(317)
Limited partnership interests	(277)	(255)
Mortgage loans	(2)	(75)
Other investments	(243)	(196)
Change in short-term investments, net	189	(808)
Change in other investments, net	36	34
Purchases of property and equipment, net	(55)	(60)
Disposition of operations	(2)	--
Net cash provided by investing activities	1,376	136
Cash flows from financing activities		
Proceeds from issuance of long-term debt	--	492
Repayments of long-term debt	(1)	--
Proceeds from issuance of preferred stock	725	--
Contractholder fund deposits	403	591
Contractholder fund withdrawals	(1,084)	(1,259)
Dividends paid on common stock	(113)	--
Dividends paid on preferred stock	(12)	--
Treasury stock purchases	(1,115)	(739)
Shares reissued under equity incentive plans, net	77	17
Excess tax benefits on share-based payment arrangements	13	23
Other	(6)	13
Net cash used in financing activities	(1,113)	(862)
Cash classified as held for sale	(242)	--
Net increase in cash	495	14

Cash at beginning of period		675		806
Cash at end of period	$	1,170	$	820

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Basis of presentation

The accompanying condensed consolidated financial statements include the accounts of The Allstate Corporation (the Corporation) and its wholly owned subsidiaries, primarily Allstate Insurance Company (AIC), a property-liability insurance company with various property-liability and life and investment subsidiaries, including Allstate Life Insurance Company (ALIC) (collectively referred to as the Company or Allstate).

The condensed consolidated financial statements and notes as of March 31, 2014 and for the three-month periods ended March 31, 2014 and 2013 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring accruals) which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year. All significant intercompany accounts and transactions have been eliminated.

Pending accounting standard

Accounting for Investments in Qualified Affordable Housing Projects

In January 2014, the FASB issued guidance which allows entities that invest in certain qualified affordable housing projects through limited liability entities the option to account for these investments using the proportional amortization method if certain conditions are met. Under the proportional amortization method, the entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense or benefit. The guidance is effective for reporting periods beginning after December 15, 2014 and is to be applied retrospectively. Early adoption is permitted. The Company is in the process of evaluating the impact of adoption, which is not expected to be material to the Company s results of operations and financial position.

2. Earnings per Common Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding, including unvested participating restricted stock units. Diluted earnings per common share is computed using the weighted average number of common and dilutive potential common shares outstanding. For the Company, dilutive potential common shares consist of outstanding stock options and unvested non-participating restricted stock units and contingently issuable performance stock awards.

The computation of basic and diluted earnings per common share for the three months ended March 31 is presented in the following table.

($ in millions, except per share data)		**2014**		**2013**
Numerator:			$	
Net income	$	600		709
Less: Preferred stock dividends		13		--
Net income available to common shareholders		587		709
Denominator:				
Weighted average common shares outstanding		446.4		475.4
Effect of dilutive potential common shares:				
Stock options		4.4		3.7
Restricted stock units and performance stock awards (non-participating)		2.0		1.7
Weighted average common and dilutive potential common shares outstanding		452.8		480.8
Earnings per common share - Basic	$	1.31	$	1.49
Earnings per common share - Diluted	$	1.30	$	1.47

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per common share because their exercise prices exceed the average market price of Allstate common shares during the period or for which the unrecognized compensation cost would have an anti-dilutive effect. Options to purchase 6.7 million and 17.0 million Allstate common shares, with exercise prices ranging from $45.61 to $62.42 and $37.40 to $62.84, were outstanding for the three-month periods ended March 31, 2014 and 2013, respectively, but were not included in the computation of diluted earnings per common share in those periods.

3. Held for Sale Transaction and Subsequent Event

On July 17, 2013, the Company entered into a definitive agreement with Resolution Life Holdings, Inc. to sell Lincoln Benefit Life Company (LBL), LBL s life insurance business generated through independent master brokerage agencies, and all of LBL s deferred fixed annuity and long-term care insurance business. LBL is reported in the Allstate Financial segment. This transaction met the criteria for held for sale accounting. As a result, the related assets and liabilities are included as single line items in the asset and liability sections of the Condensed Consolidated Statements of Financial Position as of March 31, 2014 and December 31, 2013. The following table summarizes the assets and liabilities held for sale.

($ in millions)		**March 31, 2014**		**December 31, 2013**
Assets				
Investments				
Fixed income securities	$	9,959	$	10,167
Mortgage loans		1,289		1,367
Short-term investments		--		160
Other investments		258		289
Total investments		11,506		11,983
Cash		242		--
Deferred policy acquisition costs		714		743
Reinsurance recoverables, net		1,782		1,660
Accrued investment income		108		109
Other assets		85		79
Separate Accounts		1,661		1,701
Assets held for sale		16,098		16,275
Less: Loss accrual		(708)		(682)
Total assets held for sale	$	15,390	$	15,593
Liabilities				
Reserve for life-contingent contract benefits	$	2,000	$	1,894
Contractholder funds		10,661		10,945
Unearned premiums		11		12
Deferred income taxes		151		151
Other liabilities and accrued expenses		157		196
Separate Accounts		1,661		1,701
Total liabilities held for sale	$	14,641	$	14,899

Included in shareholders equity is $155 million and $85 million of accumulated other comprehensive income related to assets held for sale as of March 31, 2014 and December 31, 2013, respectively.

The estimated loss on disposition, excluding any impact of unrealized net capital gains and losses, increased by $61 million, pre-tax, ($18 million, after-tax) in first quarter 2014.

On April 1, 2014, the Company closed the sale. The estimated gross sale price is $796 million, representing $594 million of cash and the retention of tax benefits. The actual cash proceeds will be based on the actual valuation as of the closing date of April 1, 2014.

4. Supplemental Cash Flow Information

Non-cash modifications of certain mortgage loans, fixed income securities, limited partnership interests and other investments, as well as mergers completed with equity securities, totaled $49 million and $57 million for the three months ended March 31, 2014 and 2013, respectively. Non-cash financing activities include $39 million and $87 million related to the issuance of Allstate common shares for vested restricted stock units for the three months ended March 31, 2014 and 2013, respectively.

Liabilities for collateral received in conjunction with the Company s securities lending program and over-the-counter (OTC) and cleared derivatives are reported in other liabilities and accrued expenses or other investments. The accompanying cash flows are included in cash flows from operating activities in the Condensed Consolidated Statements of Cash Flows along with the activities resulting from management of the proceeds, which for the three months ended March 31 are as follows:

($ in millions)	2014	2013
Net change in proceeds managed		
Net change in short-term investments	$ (155)	$ (25)
Operating cash flow used	(155)	(25)
Net change in cash	(1)	6
Net change in proceeds managed	$ (156)	$ (19)
Net change in liabilities		
Liabilities for collateral, beginning of period	$ (624)	$ (808)
Liabilities for collateral, end of period	(780)	(827)
Operating cash flow provided	$ 156	$ 19

5. Investments

Fair values

The amortized cost, gross unrealized gains and losses and fair value for fixed income securities are as follows:

($ in millions)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
March 31, 2014				
U.S. government and agencies	$ 3,674	$ 135	$ (3)	$ 3,806
Municipal	8,295	472	(51)	8,716
Corporate	39,416	1,951	(208)	41,159

Foreign government		1,641		100		(4)		1,737
Asset-backed securities (ABS)		3,459		71		(33)		3,497
Residential mortgage-backed securities (RMBS)		1,345		114		(21)		1,438
Commercial mortgage-backed securities (CMBS)		736		52		(5)		783
Redeemable preferred stock		21		4		--		25
Total fixed income securities	$	58,587	$	2,899	$	(325)	$	61,161
December 31, 2013								
U.S. government and agencies	$	2,791	$	129	$	(7)	$	2,913
Municipal		8,446		364		(87)		8,723
Corporate		39,331		1,659		(387)		40,603
Foreign government		1,736		99		(11)		1,824
ABS		4,491		71		(44)		4,518
RMBS		1,403		101		(30)		1,474
CMBS		788		48		(7)		829
Redeemable preferred stock		22		4		--		26
Total fixed income securities	$	59,008	$	2,475	$	(573)	$	60,910

Scheduled maturities

The scheduled maturities for fixed income securities are as follows as of March 31, 2014:

($ in millions)	**Amortized cost**	**Fair value**
Due in one year or less	$ 3,062	$ 3,105
Due after one year through five years	25,246	26,005
Due after five years through ten years	16,198	16,955
Due after ten years	8,541	9,378
	53,047	55,443
ABS, RMBS and CMBS	5,540	5,718
Total	$ 58,587	$ 61,161

Actual maturities may differ from those scheduled as a result of calls and make-whole payments by the issuers. ABS, RMBS and CMBS are shown separately because of the potential for prepayment of principal prior to contractual maturity dates.

Net investment income

Net investment income for the three months ended March 31 is as follows:

($ in millions)	**2014**	**2013**
Fixed income securities	$ 705	$ 762
Equity securities	28	25
Mortgage loans	81	98
Limited partnership interests	142	107
Short-term investments	1	2
Other	42	37
Investment income, before expense	999	1,031
Investment expense	(40)	(48)
Net investment income	$ 959	$ 983

Realized capital gains and losses

Realized capital gains and losses by asset type for the three months ended March 31 are as follows:

($ in millions)	**2014**	**2013**
Fixed income securities	$ 36	$ 72
Equity securities	22	29

Mortgage loans		3		31
Limited partnership interests		2		5
Derivatives		(12)		(4)
Other		3		(2)
Realized capital gains and losses	$	54	$	131

Realized capital gains and losses by transaction type for the three months ended March 31 are as follows:

($ in millions)		**2014**		**2013**
Impairment write-downs	$	(16)	$	(10)
Change in intent write-downs		(65)		(27)
Net other-than-temporary impairment losses recognized in earnings		(81)		(37)
Sales		147		172
Valuation of derivative instruments		(4)		(4)
Settlements of derivative instruments		(8)		--
Realized capital gains and losses	$	54	$	131

Gross gains of $166 million and $183 million and gross losses of $36 million and $21 million were realized on sales of fixed income and equity securities during the three months ended March 31, 2014 and 2013, respectively.

Other-than-temporary impairment losses by asset type for the three months ended March 31 are as follows:

($ in millions)	2014			2013		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	$ (5)	$ --	$ (5)	$ (13)	$ (2)	$ (15)
ABS	(1)	--	(1)	--	--	--
RMBS	--	(1)	(1)	--	(1)	(1)
CMBS	--	--	--	(19)	(7)	(26)
Total fixed income securities	(6)	(1)	(7)	(32)	(10)	(42)
Equity securities	(65)	--	(65)	(19)	--	(19)
Mortgage loans	4	--	4	26	--	26
Limited partnership interests	(13)	--	(13)	--	--	--
Other	--	--	--	(2)	--	(2)
Other-than-temporary impairment losses	$ (80)	$ (1)	$ (81)	$ (27)	$ (10)	$ (37)

The total amount of other-than-temporary impairment losses included in accumulated other comprehensive income at the time of impairment for fixed income securities, which were not included in earnings, are presented in the following table. The amount excludes $279 million and $260 million as of March 31, 2014 and December 31, 2013, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

($ in millions)	March 31, 2014	December 31, 2013
Municipal	$ (9)	$ (9)
ABS	(10)	(10)
RMBS	(147)	(152)
CMBS	(12)	(12)
Total	$ (178)	$ (183)

Rollforwards of the cumulative credit losses recognized in earnings for fixed income securities held as of the end of the period are as follows:

($ in millions)	Three months ended March 31,	
	2014	2013
Beginning balance	$ (513)	$ (617)
Additional credit loss for securities previously other-than-temporarily impaired	(5)	(15)
Additional credit loss for securities not previously other-than-temporarily impaired	(1)	(15)
Reduction in credit loss for securities disposed or collected	26	47
Reduction in credit loss for securities the Company has made the decision to sell or more likely than not will be required to sell	--	--
Change in credit loss due to accretion of increase in cash flows	--	--
Ending balance (1)	$ (493)	$ (600)

(1) The March 31, 2014 ending balance includes $59 million of cumulative credit losses recognized in earnings for fixed income securities that are classified as held for sale.

The Company uses its best estimate of future cash flows expected to be collected from the fixed income security, discounted at the security s original or current effective rate, as appropriate, to calculate a recovery value and determine whether a credit loss exists. The determination of cash flow estimates is inherently subjective and methodologies may vary depending on facts and circumstances specific to the security. All reasonably available information relevant to the collectability of the security, including past events, current conditions, and reasonable and supportable assumptions and forecasts, are considered when developing the estimate of cash flows expected to be collected. That information generally includes, but is not limited to, the remaining payment terms of the security, prepayment speeds, foreign exchange rates, the financial condition and future earnings potential of the issue or issuer, expected defaults, expected recoveries, the value of underlying collateral, vintage, geographic concentration, available reserves or escrows, current subordination levels, third party guarantees and other credit enhancements. Other information, such as industry analyst reports and forecasts, sector credit ratings, financial condition of the bond insurer for insured fixed income securities, and other market data relevant to the realizability of contractual cash flows, may also be considered. The estimated fair value of collateral will be used to estimate recovery value if the Company determines that the security is dependent on the liquidation of collateral for ultimate settlement. If the estimated recovery value is less than the amortized cost of the security, a credit loss exists and an other-than-temporary impairment for the difference between the estimated recovery value and amortized cost is recorded in earnings. The portion of the unrealized loss related to factors other than credit remains classified in accumulated other comprehensive income. If the Company determines that the fixed income security does not have sufficient cash flow or other information to estimate a recovery value for the security, the Company may conclude that the entire decline in fair value is deemed to be credit related and the loss is recorded in earnings.

Unrealized net capital gains and losses

Unrealized net capital gains and losses included in accumulated other comprehensive income are as follows:

($ in millions)	**Fair**	**Gross unrealized**		**Unrealized net**
March 31, 2014	**value**	**Gains**	**Losses**	**gains (losses)**
Fixed income securities	$ 61,161	$ 2,899	$ (325)	$ 2,574
Equity securities	5,297	736	(14)	722
Short-term investments	2,573	--	--	--
Derivative instruments (1)	(15)	1	(20)	(19)
EMA limited partnerships (2)				(4)
Investments classified as held for sale				327
Unrealized net capital gains and losses, pre-tax				3,600
Amounts recognized for:				
Insurance reserves (3)				(134)
DAC and DSI (4)				(245)
Amounts recognized				(379)
Deferred income taxes				(1,130)
Unrealized net capital gains and losses, after-tax				$ 2,091

(1) Included in the fair value of derivative instruments are $1 million classified as assets and $16 million classified as liabilities.

(2) Unrealized net capital gains and losses for limited partnership interests represent the Company s share of EMA limited partnerships other comprehensive income. Fair value and gross gains and losses are not applicable.

(3) The insurance reserves adjustment represents the amount by which the reserve balance would increase if the net unrealized gains in the applicable product portfolios were realized and reinvested at current lower interest rates, resulting in a premium deficiency. Although the Company evaluates premium deficiencies on the combined performance of life insurance and immediate annuities with life contingencies, the adjustment primarily relates to structured settlement annuities with life contingencies, in addition to annuity buy-outs and certain payout annuities with life contingencies.

(4) The DAC and DSI adjustment balance represents the amount by which the amortization of DAC and DSI would increase or decrease if the unrealized gains or losses in the respective product portfolios were realized.

($ in millions) December 31, 2013	Fair value	Gross unrealized Gains	Gross unrealized Losses	Unrealized net gains (losses)
Fixed income securities	$ 60,910	$ 2,475	$ (573)	$ 1,902
Equity securities	5,097	658	(34)	624
Short-term investments	2,393	--	--	--
Derivative instruments (1)	(13)	1	(19)	(18)
EMA limited partnerships				(3)
Investments classified as held for sale				190
Unrealized net capital gains and losses, pre-tax				2,695
Amounts recognized for:				
Insurance reserves				--
DAC and DSI				(158)
Amounts recognized				(158)
Deferred income taxes				(891)
Unrealized net capital gains and losses, after-tax				$ 1,646

(1) Included in the fair value of derivative instruments are $1 million classified as assets and $14 million classified as liabilities.

Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the three months ended March 31, 2014 is as follows:

($ in millions)	
Fixed income securities	$ 672
Equity securities	98
Derivative instruments	(1)
EMA limited partnerships	(1)
Investments classified as held for sale	137
Total	905
Amounts recognized for:	
Insurance reserves	(134)
DAC and DSI	(87)
Amounts recognized	(221)
Deferred income taxes	(239)
Increase in unrealized net capital gains and losses, after-tax	$ 445

Portfolio monitoring

The Company has a comprehensive portfolio monitoring process to identify and evaluate each fixed income and equity security whose carrying value may be other-than-temporarily impaired.

For each fixed income security in an unrealized loss position, the Company assesses whether management with the appropriate authority has made the decision to sell or whether it is more likely than not the Company will be required to sell the security before recovery of the amortized cost basis for reasons such as liquidity, contractual or regulatory purposes. If a security meets either of these criteria, the security s decline in fair value is considered other than temporary and is recorded in earnings.

If the Company has not made the decision to sell the fixed income security and it is not more likely than not the Company will be required to sell the fixed income security before recovery of its amortized cost basis, the Company evaluates whether it expects to receive cash flows sufficient to recover the entire amortized cost basis of the security. The Company calculates the estimated recovery value by discounting the best estimate of future cash flows at the security s original or current effective rate, as appropriate, and compares this to the amortized cost of the security. If the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the fixed income security, the credit loss component of the impairment is recorded in earnings, with the remaining amount of the unrealized loss related to other factors recognized in other comprehensive income.

For equity securities, the Company considers various factors, including whether it has the intent and ability to hold the equity security for a period of time sufficient to recover its cost basis. Where the Company lacks the intent and ability to hold to recovery, or believes the recovery period is extended, the equity security s decline in fair value is considered other than temporary and is recorded in earnings.

For fixed income and equity securities managed by third parties, either the Company has contractually retained its decision making authority as it pertains to selling securities that are in an unrealized loss position or it recognizes any unrealized loss at the end of the period through a charge to earnings.

The Company s portfolio monitoring process includes a quarterly review of all securities to identify instances where the fair value of a security compared to its amortized cost (for fixed income securities) or cost (for equity securities) is below established thresholds. The process also includes the monitoring of other impairment indicators such as ratings, ratings downgrades and payment defaults. The securities identified, in addition to other securities for which the Company may have a concern, are evaluated for potential other-than-temporary impairment using all reasonably available information relevant to the collectability or recovery of the security. Inherent in the Company s evaluation of other-than-temporary impairment for these fixed income and equity securities are assumptions and estimates about the financial condition and future earnings potential of the issue or issuer. Some of the factors that may be considered in evaluating whether a decline in fair value is other than temporary are: 1) the financial condition, near-term and long-term prospects of the issue or issuer, including relevant industry specific market conditions and trends, geographic location and implications of rating agency actions and offering prices; 2) the specific reasons that a security is in an unrealized loss position, including overall market conditions which could affect liquidity; and 3) the length of time and extent to which the fair value has been less than amortized cost or cost.

The following table summarizes the gross unrealized losses and fair value of fixed income and equity securities by the length of time that individual securities have been in a continuous unrealized loss position.

($ in millions)	Less than 12 months			12 months or more			Total
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	Total unrealized losses
March 31, 2014							
Fixed income securities							
U.S. government and agencies	23	$ 1,335	$ (3)	--	$ --	$ --	$ (3)
Municipal	252	1,646	(18)	35	183	(33)	(51)
Corporate	513	7,310	(141)	54	541	(67)	(208)
Foreign government	13	110	(2)	2	25	(2)	(4)
ABS	35	639	(6)	31	303	(27)	(33)
RMBS	127	146	(2)	167	200	(19)	(21)
CMBS	7	28	--	5	41	(5)	(5)
Total fixed income securities	970	11,214	(172)	294	1,293	(153)	(325)
Equity securities	14	464	(14)	--	--	--	(14)
Total fixed income and equity securities	984	$ 11,678	$ (186)	294	$ 1,293	$ (153)	$ (339)
Investment grade fixed income securities	871	$ 10,432	$ (158)	210	$ 848	$ (91)	$ (249)
Below investment grade fixed income securities	99	782	(14)	84	445	(62)	(76)
Total fixed income securities	970	$ 11,214	$ (172)	294	$ 1,293	$ (153)	$ (325)
December 31, 2013							
Fixed income securities							
U.S. government and agencies	22	$ 700	$ (7)	--	$ --	$ --	$ (7)
Municipal	315	2,065	(41)	38	208	(46)	(87)
Corporate	796	10,375	(308)	54	550	(79)	(387)
Foreign government	36	262	(9)	1	18	(2)	(11)
ABS	85	1,715	(10)	43	429	(34)	(44)
RMBS	134	149	(4)	175	247	(26)	(30)
CMBS	8	22	--	7	52	(7)	(7)
Total fixed income securities	1,396	15,288	(379)	318	1,504	(194)	(573)
Equity securities	158	982	(34)	1	--	--	(34)
Total fixed income and equity securities	1,554	$ 16,270	$ (413)	319	$ 1,504	$ (194)	$ (607)
Investment grade fixed income securities	1,217	$ 14,019	$ (340)	221	$ 975	$ (116)	$ (456)
Below investment grade fixed income securities	179	1,269	(39)	97	529	(78)	(117)
Total fixed income securities	1,396	$ 15,288	$ (379)	318	$ 1,504	$ (194)	$ (573)

As of March 31, 2014, $279 million of unrealized losses are related to securities with an unrealized loss position less than 20% of amortized cost or cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the $279 million, $212 million are related to unrealized losses on investment grade fixed income securities. Investment grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody s, a rating of AAA, AA, A or BBB from Standards and Poor s (S&P), Fitch, Dominion, Kroll or Realpoint, a rating of aaa, aa, a or bbb from A.M. Best, or a comparable internal rating if an externally provided rating is not available. Unrealized losses on investment grade securities are principally related to increasing risk-free interest rates or widening credit spreads since the time of initial purchase.

As of March 31, 2014, the remaining $60 million of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of amortized cost or cost. Investment grade fixed income securities comprising $37 million of these unrealized losses were evaluated based on factors such as discounted cash flows and the financial condition and near-term and long-term prospects of the issue or issuer and were determined to have adequate resources to fulfill contractual obligations. Of the $60 million, $22 million are related to below investment grade fixed income securities and $1 million are related to equity securities. Of these amounts, $10 million are related to below investment grade fixed income securities that had been in an unrealized loss position greater than or equal to 20% of amortized cost for a period of twelve or more consecutive months as of March 31, 2014.

ABS, RMBS and CMBS in an unrealized loss position were evaluated based on actual and projected collateral losses relative to the securities positions in the respective securitization trusts, security specific expectations of cash flows, and credit ratings. This evaluation also takes into consideration credit enhancement, measured in terms of (i) subordination from other classes of securities in the trust that are contractually obligated to absorb losses before the class of security the Company owns, (ii) the expected impact of other structural features embedded in the securitization trust beneficial to the class of securities the Company owns, such as overcollateralization and excess spread, and (iii) for ABS and RMBS in an unrealized loss position, credit enhancements from reliable bond insurers, where applicable. Municipal bonds in an unrealized loss position were evaluated based on the quality of the underlying securities. Unrealized losses on equity securities are primarily related to temporary equity market fluctuations of securities that are expected to recover.

As of March 31, 2014, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis. As of March 31, 2014, the Company had the intent and ability to hold equity securities with unrealized losses for a period of time sufficient for them to recover.

Limited partnerships

As of March 31, 2014 and December 31, 2013, the carrying value of equity method limited partnerships totaled $3.68 billion and $3.52 billion, respectively. The Company recognizes an impairment loss for equity method limited partnerships when evidence demonstrates that the loss is other than temporary. Evidence of a loss in value that is other than temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment. The Company had no write-downs related to equity method limited partnerships for the three months ended March 31, 2014 and 2013.

As of March 31, 2014 and December 31, 2013, the carrying value for cost method limited partnerships was $1.35 billion and $1.44 billion, respectively. To determine if an other-than-temporary impairment has occurred, the Company evaluates whether an impairment indicator has occurred in the period that may have a significant adverse effect on the carrying value of the investment. Impairment indicators may include: significantly reduced valuations of the investments held by the limited partnerships; actual recent cash flows received being significantly less than expected cash flows; reduced valuations based on financing completed at a lower value; completed sale of a material underlying investment at a price significantly lower than expected; or any other adverse events since the last financial statements received that might affect the fair value of the investee s capital. Additionally, the Company s portfolio monitoring process includes a quarterly review of all cost method limited partnerships to identify instances where the net asset value is below established thresholds for certain periods of time, as well as investments that are performing below expectations, for further impairment consideration. If a cost method limited partnership is other-than-temporarily impaired, the carrying value is written down to fair value, generally estimated to be equivalent to the reported net asset value of the underlying funds. The Company had $13 million of write-downs related to cost method limited partnerships for the three months ended March 31, 2014. The Company had no write-downs related to cost method limited partnerships for the three months ended March 31, 2013.

Mortgage loans

Mortgage loans are evaluated for impairment on a specific loan basis through a quarterly credit monitoring process and review of key credit quality indicators. Mortgage loans are considered impaired when it is probable that the Company will not collect the contractual principal and interest. Valuation allowances are established for impaired loans to reduce the carrying value to the fair value of the collateral less costs to sell or the present value of the loan s expected future repayment cash flows discounted at the loan s original effective interest rate. Impaired mortgage loans may not have a valuation allowance when the fair value of the collateral less costs to sell is higher than the carrying value. Valuation allowances are adjusted for subsequent changes in the fair value of the collateral less costs to sell. Mortgage loans are charged off against their corresponding valuation allowances when there is no reasonable expectation of recovery. The impairment evaluation is non-statistical in respect to the aggregate portfolio but considers facts and circumstances attributable to each loan. It is not considered probable that additional impairment losses, beyond those identified on a specific loan basis, have been incurred as of March 31, 2014.

Accrual of income is suspended for mortgage loans that are in default or when full and timely collection of principal and interest payments is not probable. Cash receipts on mortgage loans on nonaccrual status are generally recorded as a reduction of carrying value.

Debt service coverage ratio is considered a key credit quality indicator when mortgage loans are evaluated for impairment. Debt service coverage ratio represents the amount of estimated cash flows from the property available to the borrower to meet principal and interest payment obligations. Debt service coverage ratio estimates are updated annually or more frequently if conditions are warranted based on the Company s credit monitoring process.

The following table reflects the carrying value of non-impaired fixed rate and variable rate mortgage loans summarized by debt service coverage ratio distribution.

($ in millions)	**March 31, 2014**			**December 31, 2013**		
Debt service coverage ratio distribution	**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**	**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**
Below 1.0	$ 179	$ --	$ 179	$ 153	$ --	$ 153
1.0 - 1.25	597	--	597	613	--	613
1.26 - 1.50	1,184	2	1,186	1,233	2	1,235
Above 1.50	2,433	63	2,496	2,562	77	2,639
Total non-impaired mortgage loans	$ 4,393	$ 65	$ 4,458	$ 4,561	$ 79	$ 4,640

Mortgage loans with a debt service coverage ratio below 1.0 that are not considered impaired primarily relate to instances where the borrower has the financial capacity to fund the revenue shortfalls from the properties for the foreseeable term, the decrease in cash flows from the properties is considered temporary, or there are other risk mitigating circumstances such as additional collateral, escrow balances or borrower guarantees.

The net carrying value of impaired mortgage loans is as follows:

($ in millions)	**March 31, 2014**	**December 31, 2013**
Impaired mortgage loans with a valuation allowance	$ 14	$ 81
Impaired mortgage loans without a valuation allowance	--	--
Total impaired mortgage loans	$ 14	$ 81
Valuation allowance on impaired mortgage loans	$ 9	$ 21

The average balance of impaired loans was $48 million and $99 million for the three months ended March 31, 2014 and 2013, respectively.

The rollforward of the valuation allowance on impaired mortgage loans for the three months ended March 31 is as follows:

($ in millions)	**2014**	**2013**
Beginning balance	$ 21	$ 42
Net decrease in valuation allowance	(4)	(26)
Charge offs	(8)	(1)
Ending balance	$ 9	$ 15

Payments on all mortgage loans were current as of March 31, 2014 and December 31, 2013.

6. Fair Value of Assets and Liabilities

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. The hierarchy for inputs used in determining fair value maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Assets and liabilities recorded on the Condensed Consolidated Statements of Financial Position at fair value are categorized in the fair value hierarchy based on the observability of inputs to the valuation techniques as follows:

Level 1: Assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

Level 2: Assets and liabilities whose values are based on the following:

(a) Quoted prices for similar assets or liabilities in active markets;

(b) Quoted prices for identical or similar assets or liabilities in markets that are not active; or

(c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Unobservable inputs reflect the Company s estimates of the assumptions that market participants would use in valuing the assets and liabilities.

The availability of observable inputs varies by instrument. In situations where fair value is based on internally developed pricing models or inputs that are unobservable in the market, the determination of fair value requires more judgment. The degree of judgment exercised by the Company in determining fair value is typically greatest for instruments categorized in Level 3. In many instances, valuation inputs used to measure fair value fall into different levels of the fair value hierarchy. The category level in the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company uses prices and inputs that are current as of the measurement date, including during periods of market disruption. In periods of market disruption, the ability to observe prices and inputs may be reduced for many instruments.

The Company is responsible for the determination of fair value and the supporting assumptions and methodologies. The Company gains assurance that assets and liabilities are appropriately valued through the execution of various processes and controls designed to ensure the overall reasonableness and consistent application of valuation methodologies, including inputs and assumptions, and compliance with accounting standards. For fair values received from third parties or internally estimated, the Company s processes and controls are designed to ensure that the valuation methodologies are appropriate and consistently applied, the inputs and assumptions are reasonable and consistent with the objective of determining fair value, and the fair values are accurately recorded. For example, on a continuing basis, the Company assesses the reasonableness of individual fair values that have stale security prices or that exceed certain thresholds as compared to previous fair values received from valuation service providers or brokers or derived from internal models. The Company performs procedures to understand and assess the methodologies, processes and controls of valuation service providers. In addition, the Company may validate the reasonableness of fair values by comparing information obtained from valuation service providers or brokers to other third party valuation sources for selected securities. The Company performs ongoing price validation procedures such as back-testing of actual sales, which corroborate the various inputs used in internal models to market observable data. When fair value determinations are expected to be more variable, the Company validates them through reviews by members of management who have relevant expertise and who are independent of those charged with executing investment transactions.

The Company has two types of situations where investments are classified as Level 3 in the fair value hierarchy. The first is where quotes continue to be received from independent third-party valuation service providers and all significant inputs are market observable; however, there has been a significant decrease in the volume and level of activity for the asset when compared to normal market activity such that the degree of market observability has declined to a point where categorization as a Level 3 measurement is considered appropriate. The indicators considered in determining whether a significant decrease in the volume and level of activity for a specific asset has occurred include the level of new issuances in the primary market, trading volume in the secondary market, the level of credit spreads over historical levels, applicable bid-ask spreads, and price consensus among market participants and other pricing sources.

The second situation where the Company classifies securities in Level 3 is where specific inputs significant to the fair value estimation models are not market observable. This primarily occurs in the Company s use of broker quotes to value certain securities where the inputs have not been corroborated to be market observable, and the use of valuation models that use significant non-market observable inputs.

Certain assets are not carried at fair value on a recurring basis, including investments such as mortgage loans, limited partnership interests, bank loans and policy loans. Accordingly, such investments are only included in the fair value hierarchy disclosure when the investment is subject to remeasurement at fair value after initial recognition and the resulting remeasurement is reflected in the condensed consolidated financial statements. In addition, derivatives embedded in fixed income securities are not disclosed in the hierarchy as free-standing derivatives since they are presented with the host contracts in fixed income securities.

In determining fair value, the Company principally uses the market approach which generally utilizes market transaction data for the same or similar instruments. To a lesser extent, the Company uses the income approach which involves determining fair values from discounted cash flow methodologies. For the majority of Level 2 and Level 3 valuations, a combination of the market and income approaches is used.

Summary of significant valuation techniques for assets and liabilities measured at fair value on a recurring basis

Level 1 measurements

- Fixed income securities: Comprise certain U.S. Treasury fixed income securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

- Equity securities: Comprise actively traded, exchange-listed equity securities. Valuation is based on unadjusted quoted prices for identical assets in active markets that the Company can access.

- Short-term: Comprise actively traded money market funds that have daily quoted net asset values for identical assets that the Company can access.

- Separate account assets: Comprise actively traded mutual funds that have daily quoted net asset values for identical assets that the Company can access. Net asset values for the actively traded mutual funds in which the separate account assets are invested are obtained daily from the fund managers.

- Assets held for sale: Comprise U.S. Treasury fixed income securities, short-term investments and separate account assets. The valuation is based on the respective asset type as described above.

Level 2 measurements

- Fixed income securities:

U.S. government and agencies: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

Municipal: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

Corporate, including privately placed: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads. Also included are privately placed securities valued using a discounted cash flow model that is widely accepted in the financial services industry and uses market observable inputs and inputs derived principally from, or corroborated by, observable market data. The primary inputs to the discounted cash flow model include an interest rate yield curve, as well as published credit spreads for similar assets in markets that are not active that incorporate the credit quality and industry sector of the issuer.

Foreign government: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads.

ABS and RMBS: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, prepayment speeds, collateral performance and credit spreads. Certain ABS are valued based on non-binding broker quotes whose inputs have been corroborated to be market observable.

CMBS: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, collateral performance and credit spreads.

Redeemable preferred stock: The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields, underlying stock prices and credit spreads.

- <u>Equity securities</u>: The primary inputs to the valuation include quoted prices or quoted net asset values for identical or similar assets in markets that are not active.

- <u>Short-term:</u> The primary inputs to the valuation include quoted prices for identical or similar assets in markets that are not active, contractual cash flows, benchmark yields and credit spreads. For certain short-term investments, amortized cost is used as the best estimate of fair value.

- <u>Other investments:</u> Free-standing exchange listed derivatives that are not actively traded are valued based on quoted prices for identical instruments in markets that are not active.

OTC derivatives, including interest rate swaps, foreign currency swaps, foreign exchange forward contracts, certain options and certain credit default swaps, are valued using models that rely on inputs such as interest rate yield curves, currency rates, and counterparty credit spreads that are observable for substantially the full term of the contract. The valuation techniques underlying the models are widely accepted in the financial services industry and do not involve significant judgment.

- <u>Assets held for sale:</u> Comprise U.S. government and agencies, municipal, corporate, foreign government, ABS, RMBS and CMBS fixed income securities, and short-term investments. The valuation is based on the respective asset type as described above.

<u>Level 3 measurements</u>

- <u>Fixed income securities:</u>

Municipal: Municipal bonds that are not rated by third party credit rating agencies but are rated by the National Association of Insurance Commissioners (NAIC). The primary inputs to the valuation of these municipal bonds include quoted prices for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements, contractual cash flows, benchmark yields and credit spreads. Also includes auction rate securities (ARS) primarily backed by student loans that have become illiquid due to failures in the auction market and are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, including the anticipated date liquidity will return to the market.

Corporate, including privately placed: Primarily valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable. Also included are equity-indexed notes which are valued using a discounted cash flow model that is widely accepted in the financial services industry and uses significant non-market observable inputs, such as volatility. Other inputs include an interest rate yield curve, as well as published credit spreads for similar assets that incorporate the credit quality and industry sector of the issuer.

ABS, RMBS and CMBS: Valued based on non-binding broker quotes received from brokers who are familiar with the investments and where the inputs have not been corroborated to be market observable.

- <u>Equity securities:</u> The primary inputs to the valuation include quoted prices or quoted net asset values for identical or similar assets in markets that exhibit less liquidity relative to those markets supporting Level 2 fair value measurements.

- <u>Other investments:</u> Certain OTC derivatives, such as interest rate caps, certain credit default swaps and certain options (including swaptions), are valued using models that are widely accepted in the financial services industry. These are categorized as Level 3 as a result of the significance of non-market observable inputs such as volatility. Other primary inputs include interest rate yield curves and credit spreads.

- Assets held for sale: Comprise municipal, corporate, ABS and CMBS fixed income securities. The valuation is based on the respective asset type as described above.

- Contractholder funds: Derivatives embedded in certain life and annuity contracts are valued internally using models widely accepted in the financial services industry that determine a single best estimate of fair value for the embedded derivatives within a block of contractholder liabilities. The models primarily use stochastically determined cash flows based on the contractual elements of embedded derivatives, projected option cost and applicable market data, such as interest rate yield curves and equity index volatility assumptions. These are categorized as Level 3 as a result of the significance of non-market observable inputs.

- Liabilities held for sale: Comprise derivatives embedded in life and annuity contracts. The valuation is the same as described above for contractholder funds.

Assets and liabilities measured at fair value on a non-recurring basis

Mortgage loans written-down to fair value in connection with recognizing impairments are valued based on the fair value of the underlying collateral less costs to sell. Limited partnership interests written-down to fair value in