REINSURANCE GROUP OF AMERICA INC
Form 10-Q
August 04, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 1-11848

REINSURANCE GROUP OF AMERICA, INCORPORATED
(Exact name of Registrant as specified in its charter)

MISSOURI	**43-1627032**
(State or other jurisdiction of incorporation or organization)	**(IRS employer identification number)**

1370 Timberlake Manor Parkway
Chesterfield, Missouri 63017
(Address of principal executive offices)
(636) 736-7000
(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 þ No o

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 þ No o

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. (Check one):

Large accelerated filer þ	**Accelerated filer** o	**Non-accelerated filer** o **(Do not check if a smaller reporting company)**	**Smaller reporting company** o

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

Yes o No þ

As of July 30, 2010, 73,156,938 shares of the registrant s common stock were outstanding.

REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES
TABLE OF CONTENTS

Table of Contents

REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2010	December 31, 2009
	(Dollars in thousands, except per share data)	
Assets		
Fixed maturity securities:		
Available-for-sale at fair value (amortized cost of $12,381,638 and $11,616,957 at June 30, 2010 and December 31, 2009, respectively)	$ 13,077,607	$ 11,763,358
Mortgage loans on real estate (net of allowances of $8,179 and $5,784 at at June 30, 2010 and December 31, 2009, respectively)	838,827	791,668
Policy loans	1,173,016	1,136,564
Funds withheld at interest	5,257,929	4,895,356
Short-term investments	63,962	121,060
Other invested assets	637,827	516,086
Total investments	21,049,168	19,224,092
Cash and cash equivalents	557,756	512,027
Accrued investment income	144,658	107,447
Premiums receivable and other reinsurance balances	898,522	850,096
Reinsurance ceded receivables	721,830	716,480
Deferred policy acquisition costs	3,597,865	3,698,972
Other assets	250,807	140,387
Total assets	$ 27,220,606	$ 25,249,501
Liabilities and Stockholders Equity		
Future policy benefits	$ 8,518,817	$ 7,748,480
Interest-sensitive contract liabilities	7,781,407	7,666,002
Other policy claims and benefits	2,387,579	2,229,083
Other reinsurance balances	143,723	106,706
Deferred income taxes	977,873	613,222
Other liabilities	742,940	792,775
Long-term debt	1,216,230	1,216,052
Collateral finance facility	850,030	850,037
Company-obligated mandatorily redeemable preferred securities of subsidiary trust holding solely junior subordinated debentures of the Company	159,316	159,217
Total liabilities	22,777,915	21,381,574
Commitments and contingent liabilities (See Note 8)		
Stockholders Equity:		

Preferred stock (par value $.01 per share; 10,000,000 shares authorized; no shares issued or outstanding)		
Common stock (par value $.01 per share; 140,000,000 shares authorized; shares issued: 73,363,523 at June 30, 2010 and December 31, 2009)	734	734
Warrants	66,912	66,912
Additional paid-in-capital	1,473,305	1,463,101
Retained earnings	2,282,968	2,055,549
Treasury stock, at cost; 209,962 and 373,861 shares at June 30, 2010 and December 31, 2009, respectively	(9,570)	(17,578)
Accumulated other comprehensive income (loss):		
Accumulated currency translation adjustment, net of income taxes	173,985	210,878
Unrealized appreciation of securities, net of income taxes	470,365	104,457
Pension and postretirement benefits, net of income taxes	(16,008)	(16,126)
Total stockholders equity	4,442,691	3,867,927
Total liabilities and stockholders equity	$ 27,220,606	$ 25,249,501

See accompanying notes to condensed consolidated financial statements (unaudited).

3

Table of Contents

REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
	(Dollars in thousands, except per share data)			
Revenues:				
Net premiums	$ 1,582,017	$ 1,375,181	$ 3,210,481	$ 2,721,228
Investment income, net of related expenses	291,671	284,636	595,929	507,832
Investment related gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(3,489)	(36,942)	(10,919)	(71,337)
Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income	(139)	16,135	2,205	16,135
Other investment related gains (losses), net	26,620	98,995	162,891	61,128
Total investment related gains (losses), net	22,992	78,188	154,177	5,926
Other revenues	35,197	75,161	71,475	109,020
Total revenues	1,931,877	1,813,166	4,032,062	3,344,006
Benefits and Expenses:				
Claims and other policy benefits	1,307,239	1,123,696	2,682,419	2,293,440
Interest credited	79,169	72,897	136,103	109,806
Policy acquisition costs and other insurance expenses	237,149	308,403	603,451	507,204
Other operating expenses	83,147	71,095	174,346	137,844
Interest expense	25,141	19,595	40,590	41,712
Collateral finance facility expense	1,960	2,057	3,766	4,371
Total benefits and expenses	1,733,805	1,597,743	3,640,675	3,094,377
Income before income taxes	198,072	215,423	391,387	249,629
Provision for income taxes	71,053	62,244	141,929	73,160
Net income	$ 127,019	$ 153,179	$ 249,458	$ 176,469
Earnings per share:				
Basic earnings per share	$ 1.74	$ 2.11	$ 3.41	$ 2.43
Diluted earnings per share	$ 1.70	$ 2.10	$ 3.34	$ 2.42
Dividends declared per share	$ 0.12	$ 0.09	$ 0.24	$ 0.18

See accompanying notes to condensed consolidated financial statements (unaudited).

4

REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30,	
	2010	2009
	(Dollars in thousands)	
Cash Flows from Operating Activities:		
Net income	$ 249,458	$ 176,469
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in operating assets and liabilities:		
Accrued investment income	(38,770)	(29,934)
Premiums receivable and other reinsurance balances	(118,265)	(55,706)
Deferred policy acquisition costs	37,995	50,801
Reinsurance ceded balances	(5,351)	(3,771)
Future policy benefits, other policy claims and benefits, and other reinsurance balances	1,176,366	437,355
Deferred income taxes	105,285	46,667
Other assets and other liabilities, net	(190,883)	32,908
Amortization of net investment premiums, discounts and other	(64,779)	(59,792)
Investment related gains, net	(154,177)	(5,926)
Gain on repurchase of long-term debt		(38,875)
Excess tax benefits from share-based payment arrangement	(782)	(1,452)
Other, net	39,116	(9,527)
Net cash provided by operating activities	1,035,213	539,217
Cash Flows from Investing Activities:		
Sales of fixed maturity securities available-for-sale	1,490,869	1,268,318
Maturities of fixed maturity securities available-for-sale	72,758	26,117
Purchases of fixed maturity securities available-for-sale	(2,372,035)	(1,994,477)
Cash invested in mortgage loans	(61,676)	
Cash invested in policy loans	(38,864)	(9,508)
Cash invested in funds withheld at interest	(74,093)	(37,140)
Principal payments on mortgage loans on real estate	12,500	14,367
Principal payments on policy loans	2,412	20,470
Change in short-term investments and other invested assets	91,175	4,771
Net cash used in investing activities	(876,954)	(707,082)
Cash Flows from Financing Activities:		
Dividends to stockholders	(17,561)	(13,085)
Repurchase of long-term debt		(39,960)
Net repayments under credit agreements		(22,539)
Purchases of treasury stock	(718)	(1,607)
Excess tax benefits from share-based payment arrangement	782	1,452
Exercise of stock options, net	8,008	532
Change in cash collateral for derivative positions	72,894	(143,353)

Net withdrawals on universal life and other investment type policies and contracts	(170,776)	(82,242)
Net cash used in financing activities	(107,371)	(300,802)
Effect of exchange rate changes on cash	(5,159)	10,211
Change in cash and cash equivalents	45,729	(458,456)
Cash and cash equivalents, beginning of period	512,027	875,403
Cash and cash equivalents, end of period	$ 557,756	$ 416,947
Supplementary information:		
Cash paid for interest	$ 48,353	$ 37,871
Cash paid for income taxes, net of refunds	$ 32,981	$ 13,009

See accompanying notes to condensed consolidated financial statements (unaudited).

5

Table of Contents

REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Organization and Basis of Presentation

Reinsurance Group of America, Incorporated (RGA) is an insurance holding company that was formed on December 31, 1992. The accompanying unaudited condensed consolidated financial statements of RGA and its subsidiaries (collectively, the Company) have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The Company has determined that there were no subsequent events that would require disclosure or adjustments to the accompanying condensed consolidated financial statements through the date the financial statements were issued. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s 2009 Annual Report on Form 10-K (2009 Annual Report) filed with the Securities and Exchange Commission on March 2, 2010.

The accompanying unaudited condensed consolidated financial statements include the accounts of RGA and its subsidiaries. All intercompany accounts and transactions have been eliminated. The Company has reclassified the presentation of certain prior-period information to conform to the current presentation.

2. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share on net income (in thousands, except per share information):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Earnings:				
Net income (numerator for basic and diluted calculations)	$ 127,019	$ 153,179	$ 249,458	$ 176,469
Shares:				
Weighted average outstanding shares (denominator for basic calculation)	73,141	72,770	73,094	72,740
Equivalent shares from outstanding stock options(1)	1,580	169	1,556	172
Denominator for diluted calculation	74,721	72,939	74,650	72,912
Earnings per share:				
Basic	$ 1.74	$ 2.11	$ 3.41	$ 2.43
Diluted	$ 1.70	$ 2.10	$ 3.34	$ 2.42

(1) Year-to-date amounts are weighted average of the individual quarterly amounts.

The calculation of common equivalent shares does not include the impact of options or warrants having a strike or conversion price that exceeds the average stock price for the earnings period, as the result would be antidilutive. The calculation of common equivalent shares also excludes the impact of outstanding performance contingent shares, as the conditions necessary for their issuance have not been satisfied as of the end of the reporting period. For the three months ended June 30, 2010, approximately 0.7 million stock options and approximately 0.7 million performance contingent shares were excluded from the calculation. For the three months ended June 30, 2009, approximately 1.5 million stock options and approximately 0.6 million performance contingent shares were excluded from the calculation.

Table of Contents

3. Comprehensive Income

The following table presents the components of the Company s other comprehensive income (loss) (dollars in thousands):

	Three months ended		Six months ended	
	June 30, 2010	June 30, 2009	June 30, 2010	June 30, 2009
Net income	$ 127,019	$ 153,179	$ 249,458	$ 176,469
Other comprehensive income (loss), net of income tax:				
Unrealized investment gains, net of reclassification adjustment for gains included in net income	217,369	377,336	367,341	235,673
Reclassification adjustment for other-than-temporary impairments	91	(10,488)	(1,433)	(10,488)
Currency translation adjustments	(63,564)	108,681	(36,893)	85,837
Unrealized pension and postretirement benefit adjustment	58	83	118	285
Comprehensive income	$ 280,973	$ 628,791	$ 578,591	$ 487,776

The balance of and changes in each component of accumulated other comprehensive income (loss) for the six months ended June 30, 2010 are as follows (dollars in thousands):

	Accumulated Other Comprehensive Income (Loss), Net of Income Tax			
	Accumulated Currency Translation Adjustments	Unrealized Appreciation of Securities	Pension and Postretirement Benefits	Total
Balance, December 31, 2009	$ 210,878	$ 104,457	$ (16,126)	$ 299,209
Change in component during the period	(36,893)	365,908	118	329,133
Balance, June 30, 2010	$ 173,985	$ 470,365	$ (16,008)	$ 628,342

4. Investments

The Company had total cash and invested assets of $21.6 billion and $19.7 billion at June 30, 2010 and December 31, 2009, respectively, as illustrated below (dollars in thousands):

	June 30, 2010	December 31, 2009
Fixed maturity securities, available-for-sale	$ 13,077,607	$ 11,763,358
Mortgage loans on real estate	838,827	791,668
Policy loans	1,173,016	1,136,564
Funds withheld at interest	5,257,929	4,895,356
Short-term investments	63,962	121,060
Other invested assets	637,827	516,086
Cash and cash equivalents	557,756	512,027

Total cash and invested assets	$ 21,606,924	$ 19,736,119

All investments held by the Company are monitored for conformance to the qualitative and quantitative limits prescribed by the applicable jurisdiction s insurance laws and regulations. In addition, the operating companies boards of directors periodically review their respective investment portfolios. The Company s investment strategy is to maintain a predominantly investment-grade, fixed maturity portfolio, which will provide adequate liquidity for expected reinsurance obligations and maximize total return through prudent asset management. The Company s asset/liability duration matching differs between operating segments. Based on Canadian reserve requirements, the Canadian liabilities are matched with long-duration Canadian assets. The duration of the Canadian portfolio exceeds twenty years. The average duration for all the Company s portfolios, when consolidated, ranges between eight and ten years.

Table of Contents

Investment Income, Net of Related Expenses

Major categories of investment income, net of related expenses consist of the following (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Fixed maturity securities available-for-sale	$ 175,638	$ 150,916	$ 353,130	$ 290,097
Mortgage loans on real estate	11,954	11,379	24,160	22,956
Policy loans	18,037	16,938	37,879	33,349
Funds withheld at interest	84,392	102,524	175,573	152,986
Short-term investments	1,130	1,283	2,378	2,001
Other invested assets	6,256	5,967	14,767	15,165
Investment revenue	297,407	289,007	607,887	516,554
Investment expense	(5,736)	(4,371)	(11,958)	(8,722)
Investment income, net of related expenses	$ 291,671	$ 284,636	$ 595,929	$ 507,832

Investment Related Gains (Losses), Net

Investment related gains (losses), net consist of the following (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Fixed maturity and equity securities available for sale:				
Other-than-temporary impairment losses on fixed maturities	$ (3,489)	$ (36,942)	$ (10,919)	$ (71,337)
Portion of loss recognized in accumulated other comprehensive income (before taxes)	(139)	16,135	2,205	16,135
Net other-than-temporary impairment losses on fixed maturities recognized in earnings	(3,628)	(20,807)	(8,714)	(55,202)
Impairment losses on equity securities	(10)		(32)	(5,430)
Gain on investment activity	19,363	25,281	35,462	37,511
Loss on investment activity	(5,662)	(18,828)	(14,194)	(38,477)
Other impairment losses	(1,165)	(1,268)	(2,395)	(2,965)
Derivatives and other, net	14,094	93,810	144,050	70,489
Net gains	$ 22,992	$ 78,188	$ 154,177	$ 5,926

The net other-than-temporary impairment losses on fixed maturity securities recognized in earnings of $3.6 million and $8.7 million in the second quarter and first six months of 2010, respectively, were primarily due to a decline in value of structured securities with exposure to commercial mortgages. The much larger other-than-temporary impairments in 2009 were primarily due to the turmoil in the U.S. and global financial markets which resulted in bankruptcies, credit defaults, consolidations and government interventions. Those conditions had moderated considerably by the beginning of 2010. The volatility in derivatives and other is primarily due to changes in the fair value of embedded derivative liabilities associated with modified coinsurance and funds withheld treaties and guaranteed minimum benefit riders.

During the three months ended June 30, 2010 and 2009, the Company sold fixed maturity securities and equity securities with fair values of $159.2 million and $214.2 million at gross losses of $5.7 million and $18.8 million, respectively, or at 96.6% and 91.9% of amortized cost, respectively. During the six months ended June 30, 2010 and 2009, the Company sold fixed maturity securities and equity securities with fair values of $399.3 million and $322.6 million at gross losses of $14.2 million and $38.5 million, respectively, or at 96.6% and 89.3% of amortized cost, respectively. The Company generally does not engage in short-term buying and selling of securities.

Other-Than-Temporary Impairments

The Company has a process in place to identify fixed maturity and equity securities that could potentially have credit impairments that are other-than-temporary. This process involves monitoring market events that could impact issuers credit ratings, business climates, management changes, litigation, government actions and other similar factors. This process also involves monitoring late payments, pricing levels, rating agency actions, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

The Company reviews all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. The Company considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in fair value; (3) the issuer s financial position and access to capital and (4) for fixed maturity securities, the Company s intent to sell a security or whether it is more likely than not it will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, its ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent the Company determines that a security is deemed to be other-than-temporarily impaired, an impairment loss is recognized.

On April 1, 2009, (Date of Adoption), the Company adopted the amended general accounting principles for *Investments* as it relates to the recognition and presentation of other-than-temporary impairments. See Note 12 New Accounting Standards for further discussion of the adoption. The amended recognition provisions apply only to fixed maturity securities classified as available-for-sale and held-to-maturity, while the presentation and disclosure requirements apply to both fixed maturity and equity securities.

Impairment losses on equity securities are recognized in net income. Recognition of impairment losses on fixed maturity securities is dependent on the facts and circumstances related to a specific security. If the Company intends to sell a security or it is more likely than not that it would be required to sell a security before the recovery of its amortized cost, it recognizes an other-than-temporary impairment in net income for the difference between amortized cost and fair value, less any current period credit loss. If the Company does not expect to recover the amortized cost basis, it does not plan to sell the security and if it is not more likely than not that it would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, the recognition of the other-than-temporary impairment is bifurcated. The Company recognizes the credit loss portion in net income and the non-credit loss portion in accumulated other comprehensive income (AOCI).

For the three and six months ended June 30, 2010, the Company recognized $3.6 million and $8.7 million, respectively, of credit related losses, primarily in various mortgage-backed securities and to a lesser extent, U.S. corporate securities. For the three-month period between the Date of Adoption and June 30, 2009, the Company recognized $20.8 million of credit related losses in mortgage-backed securities and U.S. corporate securities combined. The Company estimates the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating-rate security. The techniques and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on security-specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate fixed maturity security cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using security specific facts and circumstances including timing, security interests and loss severity.

The following tables set forth the amount of credit loss impairments on fixed maturity securities held by the Company as of the dates indicated, for which a portion of the other-than-temporary impairment (OTTI) loss was recognized in AOCI, and the corresponding changes in such amounts (dollars in thousands):

	Three months ended June 30,	
	2010	2009
Balance, beginning of period	$ (51,578)	$ (17,132)
Initial impairments credit loss OTTI recognized on securities not previously impaired	(1,152)	(3,242)
Additional impairments credit loss OTTI recognized on securities previously impaired	(3,303)	(3,562)
Sales during the period of securities previously credit loss OTTI impaired	2,685	

Balance, end of period	$ (53,348)	$ (23,936)

	Six months ended June 30, 2010	Three months ended[1] June 30, 2009
Balance, beginning of period	$ (47,905)	$ (17,132)
Initial impairments credit loss OTTI recognized on securities not previously impaired	(2,724)	(3,242)
Additional impairments credit loss OTTI recognized on securities previously impaired	(5,404)	(3,562)
Sales during the period of securities previously credit loss OTTI impaired	2,685	
Balance, end of period	$ (53,348)	$ (23,936)

(1) Shortened period due to adoption of amended general accounting principles on April 1, 2009.

Table of Contents

Fixed Maturity and Equity Securities Available-for-Sale

As mentioned above, the amended general accounting principles for *Investments* change how an entity recognizes an other-than-temporary impairment for a fixed maturity security by separating the other-than-temporary impairment loss between the amount representing the credit loss and the amount relating to other factors, such as an increase in interest rates, if the Company does not have the intent to sell or it more likely than not will not be required to sell prior to recovery of the amortized cost less any current period credit loss. Credit losses are recognized in net income and losses relating to other non-credit factors are recognized in AOCI and included in unrealized losses in the tables below. The following tables provide information relating to investments in fixed maturity securities and equity securities by sector as of June 30, 2010 and December 31, 2009 (dollars in thousands):

June 30, 2010:	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	% of Total	Other-than-temporary impairments in AOCI
Available-for-sale:						
U.S. corporate securities	$ 4,269,575	$ 309,130	$ 118,585	$ 4,460,120	34.1%	$
Canadian and Canadian provincial governments	2,032,471	489,262	6,312	2,515,421	19.2	
Residential mortgage-backed securities	1,554,585	57,289	38,514	1,573,360	12.0	(3,227)
Foreign corporate securities	1,895,573	113,455	19,097	1,989,931	15.2	
Asset-backed securities	496,652	14,093	61,122	449,623	3.5	(3,404)
Commercial mortgage-backed securities	1,229,237	56,477	118,777	1,166,937	8.9	(12,114)
U.S. government and agencies	443,024	25,546		468,570	3.6	
State and political subdivisions	106,978	404	9,295	98,087	0.8	
Other foreign government securities	353,543	6,231	4,216	355,558	2.7	
Total fixed maturity securities	$ 12,381,638	$ 1,071,887	$ 375,918	$ 13,077,607	100.0%	$ (18,745)
Non-redeemable preferred stock	$ 111,566	$ 2,574	$ 9,550	$ 104,590	63.1%	
Other equity securities	54,800	7,638	1,185	61,253	36.9	
Total equity securities	$ 166,366	$ 10,212	$ 10,735	$ 165,843	100.0%	

December 31, 2009:	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	% of Total	Other-than-temporary impairments in AOCI

Available-for-sale:						
U.S. corporate securities	$ 3,689,797	$ 180,635	$ 147,384	$ 3,723,048	31.7%	$
Canadian and Canadian provincial governments	1,984,475	394,498	25,746	2,353,227	20.0	
Residential mortgage-backed securities	1,494,021	32,538	70,015	1,456,544	12.4	(7,018)
Foreign corporate securities	1,627,806	77,340	33,398	1,671,748	14.2	
Asset-backed securities	522,760	9,307	80,131	451,936	3.8	(2,194)
Commercial mortgage-backed securities	1,177,621	20,670	169,427	1,028,864	8.7	(13,690)
U.S. government and agencies	540,001	1,085	15,027	526,059	4.5	
State and political subdivisions	107,233	273	17,744	89,762	0.8	
Other foreign government securities	473,243	2,198	13,271	462,170	3.9	
Total fixed maturity securities	$ 11,616,957	$ 718,544	$ 572,143	$ 11,763,358	100.0%	$ (22,902)
Non-redeemable preferred stock	$ 123,648	$ 1,878	$ 12,328	$ 113,198	66.0%	
Other equity securities	58,008	760	409	58,359	34.0	
Total equity securities	$ 181,656	$ 2,638	$ 12,737	$ 171,557	100.0%	

As of June 30, 2010, the Company held securities with a fair value of $802.8 million that were issued by the Canadian province of Ontario and $707.5 million in one entity that were guaranteed by the Canadian province of Quebec, all of which exceeded 10% of consolidated stockholders equity. As of December 31, 2009, the Company held securities with a fair value of $448.3 million issued by the Federal National Mortgage Corporation, $482.6 million that were issued by the United States Treasury, $895.7 million that were issued by the Canadian province of Ontario, and $679.9 million in one entity that were guaranteed by the Canadian province of Quebec, all of which exceeded 10% of consolidated stockholders equity. The amortized cost and estimated fair value of fixed maturity securities available-for-sale at June 30, 2010 are shown by contractual maturity for all securities except certain U.S. government agency securities, which are distributed by maturity year based on the Company s estimate of the rate of future prepayments of principal over the remaining lives of the securities. These estimates are derived from prepayment rates experienced at the interest rate levels projected for the applicable underlying collateral and can be expected to vary from actual experience. Actual maturities can differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties. At June 30, 2010, the contractual maturities of investments in fixed maturity securities were as follows (dollars in thousands):

	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	$ 294,029	$ 297,722
Due after one year through five years	1,462,074	1,516,916
Due after five year through ten years	3,234,623	3,455,137
Due after ten years	4,110,438	4,617,912
Asset and mortgage-backed securities	3,280,474	3,189,920
Total	$ 12,381,638	$ 13,077,607

The table below includes major industry types and weighted average credit ratings of the Company s U.S. and foreign corporate fixed maturity holdings as of June 30, 2010 and December 31, 2009 (dollars in thousands):

June 30, 2010:	Amortized Cost	Estimated Fair Value	% of Total	Average Credit Ratings
Finance	$ 1,510,575	$ 1,510,087	23.4%	A-
Industrial	2,102,396	2,247,318	34.8	BBB+
Foreign (1)	1,895,573	1,989,931	30.9	A+
Utility	652,785	698,450	10.8	BBB+
Other	3,819	4,265	0.1	A+
Total	$ 6,165,148	$ 6,450,051	100.0%	A-

December 31, 2009:	Amortized Cost	Estimated Fair Value	% of Total	Average Credit Ratings
Finance	$ 1,411,464	$ 1,358,925	25.2%	A-
Industrial	1,670,610	1,735,522	32.2	BBB+
Foreign (1)	1,627,352	1,671,090	30.9	A
Utility	603,958	624,710	11.6	BBB+
Other	4,219	4,549	0.1	A
Total	$ 5,317,603	$ 5,394,796	100.0%	A-

(1) Includes U.S. dollar-denominated debt obligations of foreign obligors and other foreign investments.

Table of Contents

At June 30, 2010 and December 31, 2009, the Company had $386.7 million and $584.9 million, respectively, of gross unrealized losses related to its fixed maturity and equity securities. The distribution of the gross unrealized losses related to these securities is shown below.

	June 30, 2010	December 31, 2009
Sector:		
U.S. corporate securities	33%	26%
Canadian and Canada provincial governments	2	4
Residential mortgage-backed securities	10	12
Foreign corporate securities	5	7
Asset-backed securities	16	14
Commercial mortgage-backed securities	31	29
State and political subdivisions	2	3
U.S. government and agencies		3
Other foreign government securities	1	2
Total	100%	100%
Industry:		
Finance	26%	25%
Asset-backed	16	13
Industrial	10	7
Mortgage-backed	41	41
Government	5	12
Utility	2	2
Total	100%	100%

The following table presents total gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, for 900 and 1,316 fixed maturity securities and equity securities as of June 30, 2010 and December 31, 2009, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (dollars in thousands):

	June 30, 2010			December 31, 2009		
	Number of Securities	Gross Unrealized Losses	% of Total	Number of Securities	Gross Unrealized Losses	% of Total
Less than 20%	765	$ 137,788	35.6%	1,112	$ 254,075	43.4%
20% or more for less than six months	30	56,428	14.6	38	69,322	11.9
20% or more for six months or greater	105	192,437	49.8	166	261,483	44.7
Total	900	$ 386,653	100.0%	1,316	$ 584,880	100.0%

As of June 30, 2010 and December 31, 2009, respectively, 58.7% and 71.4% of these securities were investment grade. The Company has experienced a higher recovery of market value for investment-grade securities in recent periods. The amount of the unrealized loss on these securities was primarily attributable to a widening of credit default spreads since the time securities were purchased.

While all of these securities are monitored for potential impairment, the Company believes due to fluctuating market conditions and liquidity concerns, and the relatively recent high levels of price volatility, the extent and duration of a decline in value have become less indicative of when there has been credit deterioration with respect to an issuer. The Company s determination of whether a decline in value is other-than-temporary includes analysis of the underlying credit and the extent and duration of a decline in value. The Company s credit analysis of an investment includes determining whether the issuer is current on its contractual payments, evaluating whether it is probable that the Company will be able to collect all amounts due according to the contractual terms of the security and analyzing the overall ability of the Company to recover the amortized cost of the investment. The Company continues to consider valuation declines as a potential indicator of credit deterioration.

The following tables present the estimated fair values and gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, for the 900 and 1,316 fixed maturity securities and equity securities that have estimated fair values below amortized cost as of June 30, 2010 and December 31, 2009, respectively (dollars in thousands). These investments are presented by class and grade of security, as well as the length of time the related market value has remained below amortized cost.

June 30, 2010:	Less than 12 months Estimated Fair Value	Less than 12 months Gross Unrealized Losses	12 months or greater Estimated Fair Value	12 months or greater Gross Unrealized Losses	Total Estimated Fair Value	Total Gross Unrealized Losses
Investment grade securities:						
U.S. corporate securities	$ 172,127	$ 28,320	$ 356,979	$ 63,781	$ 529,106	$ 92,101
Canadian and Canadian provincial governments	110,191	2,321	129,393	3,991	239,584	6,312
Residential mortgage-backed securities	220,187	8,692	158,173	10,059	378,360	18,751
Foreign corporate securities	166,246	4,036	168,247	11,562	334,493	15,598
Asset-backed securities	12,037	1,360	137,569	35,303	149,606	36,663
Commercial mortgage-backed securities	60,812	7,503	160,272	31,513	221,084	39,016
State and political subdivisions	23,443	921	53,484	5,693	76,927	6,614
Other foreign government securities	28,355	176	89,826	4,040	118,181	4,216
Total investment grade securities	793,398	53,329	1,253,943	165,942	2,047,341	219,271
Non-investment grade securities:						
U.S. corporate securities	91,934	9,278	133,958	17,206	225,892	26,484
Asset-backed securities	11,174	2,158	29,522	22,301	40,696	24,459
Foreign corporate securities	3,017	3,446	597	53	3,614	3,499
Residential mortgage-backed securities	397	551	67,120	19,212	67,517	19,763
Commercial mortgage-backed securities			60,956	79,761	60,956	79,761
State and political subdivisions			5,432	2,681	5,432	2,681
Total non-investment grade securities	106,522	15,433	297,585	141,214	404,107	156,647
Total fixed maturity securities	$ 899,920	$ 68,762	$ 1,551,528	$ 307,156	$ 2,451,448	$ 375,918

Non-redeemable preferred stock	$ 29,219	$ 1,755	$ 35,596	$ 7,795	$ 64,815	$ 9,550
Other equity securities	12,927	909	1,352	276	14,279	1,185
Total equity securities	$ 42,146	$ 2,664	$ 36,948	$ 8,071	$ 79,094	$ 10,735
Total number of securities in an unrealized loss position	371		529		900	

	Less than 12 months		12 months or greater		Total	
December 31, 2009:	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Investment grade securities:						
U.S. corporate securities	$ 373,049	$ 27,625	$ 679,908	$ 89,711	$ 1,052,957	$ 117,336
Canadian and Canadian provincial governments	494,718	15,374	135,315	10,372	630,033	25,746
Residential mortgage-backed securities	402,642	23,671	197,320	20,185	599,962	43,856
Foreign corporate securities	362,406	5,262	182,300	24,693	544,706	29,955
Asset-backed securities	48,651	1,927	166,603	57,262	215,254	59,189
Commercial mortgage-backed securities	177,360	10,312	425,793	79,297	603,153	89,609
U.S. government and agencies	496,514	15,027			496,514	15,027
State and political subdivisions	34,612	3,397	40,945	11,437	75,557	14,834
Other foreign government securities	240,216	8,370	30,321	4,901	270,537	13,271
Total investment grade securities	2,630,168	110,965	1,858,505	297,858	4,488,673	408,823
Non-investment grade securities:						
U.S. corporate securities	35,477	11,293	168,375	18,755	203,852	30,048
Asset-backed securities	6,738	3,256	24,408	17,686	31,146	20,942
Foreign corporate securities	1,755	17	3,771	3,426	5,526	3,443
Residential mortgage-backed	10,657	1,909	66,756	24,250	77,413	26,159

securities						
Commercial mortgage-backed securities			57,179	79,818	57,179	79,818
State and political subdivisions			5,170	2,910	5,170	2,910
Total non-investment grade securities	54,627	16,475	325,659	146,845	380,286	163,320
Total fixed maturity securities	$ 2,684,795	$ 127,440	$ 2,184,164	$ 444,703	$ 4,868,959	$ 572,143
Non-redeemable preferred stock	$ 8,320	$ 1,263	$ 68,037	$ 11,065	$ 76,357	$ 12,328
Other equity securities	5	15	7,950	394	7,955	409
Total equity securities	$ 8,325	$ 1,278	$ 75,987	$ 11,459	$ 84,312	$ 12,737
Total number of securities in an unrealized loss position	582		734		1,316	

13

As of June 30, 2010, the Company does not intend to sell these fixed maturity securities and does not believe it is more likely than not that it will be required to sell these fixed maturity securities before the recovery of the fair value up to the current amortized cost of the investment, which may be maturity. However, as facts and circumstances change, the Company may sell fixed maturity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality, asset-liability management and liquidity guidelines. As of June 30, 2010, the Company has the ability and intent to hold the equity securities until the recovery of the fair value up to the current cost of the investment. However, from time to time, if facts and circumstances change, the Company may sell equity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality and liquidity guidelines.

5. Derivative Instruments

The following table presents the notional amounts and fair value of derivative instruments as of June 30, 2010 and December 31, 2009 (dollars in thousands):

	June 30, 2010			December 31, 2009		
		Carrying Value/Fair Value			Carrying Value/Fair Value	
	Notional Amount	Assets	Liabilities	Notional Amount	Assets	Liabilities
Derivatives not designated as hedging instruments:						
Interest rate swaps(1)	$ 1,973,016	$ 59,861	$	$ 1,388,570	$ 17,962	$ 47,061
Financial futures(1)	305,125			200,436		
Foreign currency forwards(1)	40,500	2,939		40,500	2,200	
Consumer Price index (CPI) swaps(1)	137,800	1,848		124,034	1,631	
Credit default swaps(1)	317,500		3,166	367,500	2,363	249
Equity options(1)	6,710	1,654				
Embedded derivatives in:						
Modified coinsurance or funds withheld arrangements(2)			279,348			434,494
Indexed annuity products(3)		70,154	602,093		68,873	584,906
Variable annuity products(3)			157,511			23,748
Total non-hedging derivatives	2,780,651	136,456	1,042,118	2,121,040	93,029	1,090,458
Derivatives designated as hedging instruments:						
Interest rate swaps(1)	21,783		1,877	21,783		677
Foreign currency swaps(1)	397,580	2,499	1,538	226,715		9,008
Total hedging derivatives	419,363	2,499	3,415	248,498		9,685

Total derivatives	$ 3,200,014	$ 138,955	$ 1,045,533	$ 2,369,538	$ 93,029	$ 1,100,143

(1) Carried on the Company s condensed consolidated balance sheets in other invested assets or other liabilities, at fair value.

(2) Embedded liability is included on the condensed consolidated balance sheets with the host contract in funds withheld at interest, at fair value.

(3) Embedded liability is included on the condensed consolidated balance sheets with the host contract in interest-sensitive contract liabilities, at fair value. Embedded asset is included on the condensed consolidated balance sheets in reinsurance ceded receivables.

Accounting for Derivative Instruments and Hedging Activities

The Company does not enter into derivative instruments for speculative purposes. As of June 30, 2010 and December 31, 2009, the Company held interest rate swaps that were designated and qualified as fair value hedges of interest rate risk. As of June 30, 2010 and December 31, 2009, the Company held foreign currency swaps that were designated and qualified as fair value hedges of a portion of its net investment in its foreign operations. Gains of $50.0 million related to foreign currency swaps terminated in the second quarter of 2009 continue to be reflected in

AOCI. As of June 30, 2010 and December 31, 2009, the Company also had derivative instruments that were not designated as hedging instruments. See Note 2 Summary of Significant Accounting Policies of the Company s 2009 annual report on Form 10-K for a detailed discussion of the accounting treatment for derivative instruments, including embedded derivatives. Derivative instruments are carried at fair value and generally require an insignificant amount of cash at inception of the contracts.

Fair Value Hedges

The Company designates and accounts for certain interest rate swaps that convert fixed rate investments to floating rate investments as fair value hedges when they meet the requirements of the general accounting principles for *Derivatives and*

Table of Contents

Hedging. The gain or loss on the hedged item attributable to the hedged benchmark interest rate and the offsetting gain or loss on the related interest rate swaps for the three and six months ended June 30, 2010 and 2009 were (dollars in thousands):

Type of Fair Value Hedge	Derivative Gain (Loss) Location	Hedge Gain (Loss) Recognized	Hedged Item	Hedged Item Gain (Loss) Location	Hedged Item Gain (Loss) Recognized
For the three months ended June 30, 2010:					
Interest rate swaps	Investment related gains (losses), net	$ (877)	Fixed rate fixed maturity securities	Investment related gains (losses), net	$ 1,046
For the three months ended June 30, 2009:					
Interest rate swaps	Investment related gains (losses), net	$ 982	Fixed rate fixed maturity securities	Investment related gains (losses), net	$ (934)
For the six months ended June 30, 2010:					
Interest rate swaps	Investment related gains (losses), net	$ (1,200)	Fixed rate fixed maturity securities	Investment related gains (losses), net	$ 1,500
For the six months ended June 30, 2009:					
Interest rate swaps	Investment related gains (losses), net	$ 1,465	Fixed rate fixed maturity securities	Investment related gains (losses), net	$ (1,456)

The Company s investment related gains (losses), net representing the ineffective portion of all fair value hedges was immaterial for the three and six months ended June 30, 2010 and 2009.

All components of each derivative s gain or loss were included in the assessment of hedge effectiveness. There were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

Hedges of Net Investments in Foreign Operations

The Company uses foreign currency swaps to hedge a portion of its net investment in certain foreign operations against adverse movements in exchange rates. The following table illustrates the Company s net investments in foreign operations (NIFO) hedges for the three and six months ended June 30, 2010 and 2009 (dollars in thousands):

Type of NIFO Hedge	Derivative Gain (Loss) in OCI	Location of Gain (Loss) Reclassified From AOCI	Gain (Loss) Reclassified from AOCI into income	Income Statement Location of Gain (Loss)	Ineffective Gain (Loss) in Income
For the three months ended June 30, 2010:					
Foreign currency swaps	$ 16,846	None	$	Investment income	$
For the three months ended June 30, 2009:					
Foreign currency swaps	$ (6,491)	None	$	Investment income	$
For the six months ended June 30, 2010:					
Foreign currency swaps	$ 8,766	None	$	Investment income	$
For the six months ended June 30, 2009:					
Foreign currency swaps	$ 1,644	None	$	Investment income	$

Ineffectiveness on the foreign currency swaps is based upon the change in forward rates. There was no ineffectiveness recorded in the periods presented herein.

The Company s other comprehensive income for the three months ended June 30, 2010 and 2009, includes gains (losses) of $16.8 million and ($6.5) million, respectively, and $8.8 million and $1.6 million for the six months ended June 30, 2010 and 2009, respectively, related to foreign currency swaps used to hedge a portion of its net investment in its foreign operations. The cumulative foreign currency translation gain recorded in AOCI related to these hedges was $49.3 million and $40.5 million at June 30, 2010 and December 31, 2009, respectively. If a foreign operation was sold or substantially liquidated, the amounts in AOCI would be reclassified to the consolidated statements of income. A pro rata portion would be reclassified upon partial sale of a foreign operation.

Non-qualifying Derivatives and Derivatives for Purposes Other Than Hedging

The Company uses various other derivative instruments for risk management purposes that either do not qualify or have not been qualified for hedge accounting treatment, including derivatives used to economically hedge changes in the fair value of liabilities associated with the reinsurance of variable annuities with guaranteed living benefits. The gain or loss related to the change in fair value for these derivative instruments is recognized in investment related gains (losses), in the consolidated statements of income, except where otherwise noted. For the three months ended June 30, 2010 and 2009, the Company recognized investment related gains (losses) of $117.6 million and ($136.1) million, respectively, and $118.0 million and ($156.3) million for the six months ended June 30, 2010 and 2009, respectively, related to derivatives that do not qualify or have not been qualified for hedge accounting.

Interest Rate Swaps

Interest rate swaps are used by the Company primarily to reduce market risks from changes in interest rates and to alter interest rate exposure arising from mismatches between assets and liabilities (duration mismatches). With an interest rate swap, the Company agrees with another party to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts tied to an agreed-upon notional principal amount. These transactions are executed pursuant to master agreements that provide for a single net payment or individual gross payments at each due date.

Financial Futures

Exchange-traded equity futures are used primarily to economically hedge liabilities embedded in certain variable annuity products. With exchange-traded equity futures transactions, the Company agrees to purchase or sell a specified number of contracts, the value of which is determined by the relevant stock indices, and to post variation margin on a daily basis in an amount equal to the difference between the daily estimated fair values of those contracts. The Company enters into exchange-traded equity futures with regulated futures commission merchants that are members of the exchange.

Foreign Currency Swaps

Foreign currency swaps are used by the Company to reduce the risk from fluctuations in foreign currency exchange rates associated with its assets and liabilities denominated in foreign currencies. With a foreign currency swap transaction, the Company agrees with another party to exchange, at specified intervals, the difference between one currency and another at a forward exchange rate calculated by reference to an agreed upon principal amount. The principal amount of each currency is exchanged at the inception and termination of the currency swap by each party. The Company may also use foreign currency swaps to economically hedge the foreign currency risk associated with certain of its net investments in foreign operations.

Foreign Currency Forwards

Foreign currency forwards are used by the Company to reduce the risk from fluctuations in foreign currency exchange rates associated with its assets and liabilities denominated in foreign currencies. With a foreign currency forward transaction, the Company agrees with another party to deliver a specified amount of an identified currency at a specified future date. The price is agreed upon at the time of the contract and payment for such a contract is made in a different currency at the specified future date.

CPI Swaps

CPI swaps are used by the Company primarily to economically hedge liabilities embedded in certain insurance products where value is directly affected by changes in a designated benchmark consumer price index. With a CPI swap transaction, the Company agrees with another party to exchange the actual amount of inflation realized over a specified period of time for a fixed amount of inflation determined at inception. These transactions are executed pursuant to master agreements that provide for a single net payment or individual gross payments to be made by the counterparty at each due date. Most of these swaps will require a single payment to be made by one counterparty at the maturity date of the swap.

Credit Default Swaps

The Company invests in credit default swaps to diversify its credit risk exposure in certain portfolios. These credit default swaps are over-the-counter instruments in which the Company receives payments at specified intervals to insure credit risk on a portfolio of 125 U.S. investment-grade securities. Generally, if a credit event, as defined by the contract, occurs, the contract will require the swap to be settled gross by the delivery of par quantities or value of the referenced investment securities equal to the specified swap notional amount in exchange for the payment of cash amounts by the Company equal to the par value of the investment security surrendered.

Table of Contents

The Company also purchases credit default swaps to reduce its risk against a drop in bond prices due to credit concerns of certain bond issuers. If a credit event, as defined by the contract, occurs, the Company is able to put the bond back to the counterparty at par.

Equity Options

Equity index options are used by the Company primarily to hedge minimum guarantees embedded in certain variable annuity products. To hedge against adverse changes in equity indices volatility, the Company enters into contracts to sell the equity index options within a limited time at a contracted price. The contracts are net settled in cash based on differentials in the indices at the time of exercise and the strike price.

Embedded Derivatives

The Company has certain embedded derivatives which are required to be separated from their host contracts and reported as derivatives. Host contracts include reinsurance treaties structured on a modified coinsurance or funds withheld basis. Additionally, the Company reinsures equity-indexed annuity and variable annuity contracts with benefits that are considered embedded derivatives, including guaranteed minimum withdrawal benefits, guaranteed minimum accumulation benefits, and guaranteed minimum income benefits. The related gains (losses) for the three and six months ended June 30, 2010 and 2009 are reflected in the following table (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Embedded derivatives in modified coinsurance or funds withheld arrangements and variable annuity contracts included in investment related gains (losses)	$ (108,422)	$ 225,574	$ 21,383	$ 220,362
After the associated amortization of DAC and taxes, the related amounts included in net income	(7,172)	(5,517)	13,407	(32,596)
Amounts related to embedded derivatives in equity-indexed annuities included in benefits and expenses	(14,950)	(10,232)	(3,222)	11,465
After the associated amortization of DAC and taxes, the related amounts included in net income	(3,952)	(11,948)	(5,184)	(753)

Non-hedging Derivatives

A summary of the effect of non-hedging derivatives, including embedded derivatives, on the Company s income statement for the three and six months ended June 30, 2010 and 2009 is as follows (dollars in thousands):

		Gain (Loss) for the Three Months Ended June 30,	
Type of Non-hedging Derivative	Income Statement Location of Gain (Loss)	2010	2009
Interest rate swaps	Investment related gains (losses), net	$ 87,115	$ (99,017)
Financial futures	Investment related gains (losses), net	32,823	(48,059)
Foreign currency forwards	Investment related gains (losses), net	1,447	1,164
CPI swaps	Investment related gains (losses), net	108	544
Credit default swaps	Investment related gains (losses), net	(4,060)	9,288

Equity options	Investment related gains (losses), net	127	
Embedded derivatives in:			
Modified coinsurance or funds withheld arrangements	Investment related gains (losses), net	32,512	64,337
Indexed annuity products	Policy acquisition costs and other insurance expenses	2,596	161
Indexed annuity products	Interest credited	(17,546)	(10,393)
Variable annuity products	Investment related gains (losses), net	(140,934)	161,238
Total non-hedging derivatives		$ (5,812)	$ 79,263

17

Type of Non-hedging Derivative	Income Statement Location of Gain (Loss)	Gain (Loss) for the Six Months Ended June 30, 2010	2009
Interest rate swaps	Investment related gains (losses), net	$ 98,455	$ (137,881)
Financial futures	Investment related gains (losses), net	21,077	(25,748)
Foreign currency forwards	Investment related gains (losses), net	618	(878)
CPI swaps	Investment related gains (losses), net	1,032	854
Credit default swaps	Investment related gains (losses), net	(3,284)	7,377
Equity options	Investment related gains (losses), net	127	
Embedded derivatives in:			
Modified coinsurance or funds withheld arrangements	Investment related gains (losses), net	155,147	23,912
Indexed annuity products	Policy acquisition costs and other insurance expenses	1,161	(2,496)
Indexed annuity products	Interest credited	(4,383)	13,960
Variable annuity products	Investment related gains (losses), net	(133,763)	196,450
Total non-hedging derivatives		$ 136,187	$ 75,550

Credit Risk

The Company may be exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments. Generally, the current credit exposure of the Company s derivative contracts is limited to the fair value at the reporting date. The credit exposure of the Company s derivative transactions is represented by the fair value of contracts after consideration of any collateral received with a net positive fair value at the reporting date.

The Company manages its credit risk related to over-the-counter derivatives by entering into transactions with creditworthy counterparties, maintaining collateral arrangements and through the use of master agreements that provide for a single net payment to be made by one counterparty to another at each due date and upon termination. As exchange-traded futures are affected through regulated exchanges, and positions are marked to market on a daily basis, the Company has minimal exposure to credit-related losses in the event of nonperformance by counterparties to such derivative instruments.

The Company enters into various collateral arrangements, which require both the posting and accepting of collateral in connection with its derivative instruments. Collateral agreements contain attachment thresholds that vary depending on the posting party s financial strength ratings. Additionally, a decrease in the Company s financial strength rating to a specified level results in potential settlement of the derivative positions under the Company s agreements with its counterparties. As of June 30, 2010, the Company held cash collateral under its control of $56.9 million. This unrestricted cash collateral is included in cash and cash equivalents and the obligation to return it is included in other liabilities in the condensed consolidated balance sheets. No cash collateral was held as of December 31, 2009. As of

June 30, 2010 the Company had no cash collateral pledged to counterparties. As of December 31, 2009, the Company had pledged collateral to counterparties on swaps of $16.0 million. The receivable related to cash collateral is included in other assets, in the condensed consolidated balance sheets. From time to time, the Company has both accepted and posted collateral consisting of various securities. As of June 30, 2010, the Company posted a U.S. Treasury security as collateral to a counterparty with a book value and market value of $10.3 million and $10.8 million, respectively, which is included in other invested assets. There were no securities posted as collateral at December 31, 2009. There were no securities held as collateral as of June 30, 2010 and December 31, 2009. In addition, the Company has exchange-traded futures, which require the maintenance of a margin account, which is included in cash and cash equivalents. The Company s margin account totaled $27.3 million and $17.1 million as of June 30, 2010 and December 31, 2009, respectively.

6. Fair Value of Financial Instruments

Fair values of financial instruments have been determined by using available market information and the valuation techniques described below. Considerable judgment is often required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein may not necessarily be indicative of amounts that could be realized in a current market exchange. The following table presents the carrying amounts and estimated fair values of the Company s financial instruments at June 30, 2010 and December 31, 2009 (dollars in thousands). The use of different assumptions or valuation techniques may have a material effect on the estimated fair value amounts.

Table of Contents

	June 30, 2010		December 31, 2009	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Fixed maturity securities	$ 13,077,607	$ 13,077,607	$ 11,763,358	$ 11,763,358
Mortgage loans on real estate	838,827	895,020	791,668	792,331
Policy loans	1,173,016	1,173,016	1,136,564	1,136,564
Funds withheld at interest	5,257,929	5,546,802	4,895,356	5,201,569
Short-term investments	63,962	63,962	121,060	121,060
Other invested assets	637,827	633,368	516,086	509,618
Cash and cash equivalents	557,756	557,756	512,027	512,027
Accrued investment income	144,658	144,658	107,447	107,447
Reinsurance ceded receivables	100,744	81,279	106,396	173,309
Liabilities:				
Interest-sensitive contract liabilities	$ 5,802,045	$ 5,587,732	$ 5,929,134	$ 6,196,420
Long-term and short-term debt	1,216,230	1,204,150	1,216,052	1,180,712
Collateral finance facility	850,030	510,000	850,037	510,000
Company-obligated mandatorily redeemable preferred securities	159,316	231,845	159,217	205,655

Publicly traded fixed maturity securities are valued based upon quoted market prices or estimates from independent pricing services, independent broker quotes and pricing matrices. Private placement fixed maturity securities are valued based on the credit quality and duration of marketable securities deemed comparable by the Company s investment advisor, which may be of another issuer. The fair value of mortgage loans on real estate is estimated using discounted cash flows. Policy loans typically carry an interest rate that is adjusted annually based on a market index and therefore carrying value approximates fair value. The carrying value of funds withheld at interest approximates fair value except where the funds withheld are specifically identified in the agreement. When funds withheld are specifically identified in the agreement, the fair value is based on the fair value of the underlying assets which are held by the ceding company. The carrying values of cash and cash equivalents and short-term investments approximates fair values due to the short-term maturities of these instruments. Common and preferred equity investments and derivative financial instruments included in other invested assets are reflected at fair value on the condensed consolidated balance sheets based primarily on quoted market prices, while limited partnership interests are carried at cost. The fair value of limited partnerships is based on net asset values. The carrying value for accrued investment income approximates fair value.

The carrying and fair values of interest-sensitive contract liabilities reflected in the table above exclude contracts with significant mortality risk. The fair value of the Company s interest-sensitive contract liabilities and related reinsurance ceded receivables is based on the cash surrender value of the liabilities, adjusted for recapture fees. The fair value of the Company s long-term debt is estimated based on either quoted market prices or quoted market prices for the debt of corporations with similar credit quality. The fair values of the Company s collateral finance facility and company-obligated mandatorily redeemable preferred securities are estimated using discounted cash flows.

General accounting principles for *Fair Value Measurements and Disclosures* define fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In accordance with these principles, valuation techniques utilized by management for invested assets and embedded derivatives reported at fair value are generally categorized into three types:

Market Approach. Market approach valuation techniques use prices and other relevant information from market transactions involving identical or comparable assets or liabilities. Valuation techniques consistent with the market approach include comparables and matrix pricing. Comparables use market multiples, which might lie in ranges with a different multiple for each comparable. The selection of where within the range the appropriate multiple falls requires judgment, considering both quantitative and qualitative factors specific to the measurement. Matrix pricing is a mathematical technique used principally to value certain securities without relying exclusively on quoted prices for the specific securities but comparing the securities to benchmark or comparable securities.

Income Approach. Income approach valuation techniques convert future amounts, such as cash flows or earnings, to a single present amount, or a discounted amount. These techniques rely on current expectations of future amounts. Examples of income approach valuation techniques include present value techniques, option-pricing models and binomial or lattice models that incorporate present value techniques.

Cost Approach. Cost approach valuation techniques are based upon the amount that, at present, would be required to replace the service capacity of an asset, or the current replacement cost. That is, from the perspective of a market participant (seller), the price that would be received for the asset is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility.

The three approaches described above are consistent with generally accepted valuation techniques. While all three approaches are not applicable to all assets or liabilities reported at fair value, where appropriate and possible, one or more valuation techniques may be used. The selection of the valuation technique(s) to apply considers the definition of an exit price and the nature of the asset or liability being valued and significant expertise and judgment is required. The Company performs regular analysis and review of the various techniques utilized in determining fair value to ensure that the valuation approaches utilized are appropriate and consistently applied, and that the various assumptions are reasonable. The Company also utilizes information from third parties, such as pricing services and brokers, to assist in determining fair values for certain assets and liabilities; however, management is ultimately responsible for all fair values presented in the Company s financial statements. The Company performs analysis and review of the information and prices received from third parties to ensure that the prices represent a reasonable estimate of the fair value. This process involves quantitative and qualitative analysis and is overseen by the Company s investment and accounting personnel. Examples of procedures performed include, but are not limited to, initial and ongoing review of third party pricing services and techniques, review of pricing trends and monitoring of recent trade information. In addition, the Company utilizes both internal and external cash flow models to analyze the reasonableness of fair values utilizing credit spread and other market assumptions, where appropriate. As a result of the analysis, if the Company determines there is a more appropriate fair value based upon the available market data, the price received from the third party is adjusted accordingly.

For invested assets reported at fair value, when available, fair values are based on quoted prices in active markets that are regularly and readily obtainable. Generally, these are very liquid investments and the valuation does not require management judgment. When quoted prices in active markets are not available, fair value is based on the market valuation techniques described above, primarily a combination of the market approach, including matrix pricing and the income approach. The assumptions and inputs used by management in applying these techniques include, but are not limited to: interest rates, credit standing of the issuer or counterparty, industry sector of the issuer, coupon rate, call provisions, sinking fund requirements, maturity, estimated duration and assumptions regarding liquidity and future cash flows.

The significant inputs to the market standard valuation techniques for certain types of securities with reasonable levels of price transparency are inputs that are observable in the market or can be derived principally from or corroborated by observable market data. Such observable inputs include benchmarking prices for similar assets in active, liquid markets, quoted prices in markets that are not active and observable yields and spreads in the market.

When observable inputs are not available, the market standard valuation techniques for determining the estimated fair value of certain types of securities that trade infrequently, and therefore have little or no price transparency, rely on inputs that are significant to the estimated fair value that are not observable in the market or cannot be derived principally from or corroborated by observable market data. These unobservable inputs can be based in large part on management judgment or estimation, and cannot be supported by reference to market activity. Even though unobservable, these inputs are based on assumptions deemed appropriate given the circumstances and are believed to be consistent with what other market participants would use when pricing such securities.

The use of different techniques, assumptions and inputs may have a material effect on the estimated fair values of the Company s securities holdings.

For embedded derivative liabilities associated with the underlying products in reinsurance treaties, primarily equity-indexed and variable annuity treaties, the Company utilizes a market standard technique, which includes an estimate of future equity option purchases and an adjustment for the Company s own credit risk that takes into consideration the Company s financial strength rating, also commonly referred to as a claims paying rating. The capital market inputs to the model, such as equity indexes, equity volatility, interest rates and the Company s credit adjustment, are generally observable. However, the valuation models also use inputs requiring certain actuarial assumptions such as future interest margins, policyholder behavior, including future equity participation rates, and explicit risk margins related to non-capital market inputs, that are generally not observable and may require use of significant management judgment. Changes in interest rates, equity indices, equity volatility, the Company s own credit risk, and actuarial assumptions regarding policyholder behavior may result in significant fluctuations in the value of embedded derivatives liabilities associated with equity-indexed annuity reinsurance treaties.

The fair value of embedded derivatives associated with funds withheld reinsurance treaties is determined based upon a total return swap technique with reference to the fair value of the investments held by the ceding company that support the Company s funds withheld at interest asset. The fair value of the underlying assets is generally based on market observable inputs using market standard valuation techniques. However, the valuation also requires certain significant inputs based on

Table of Contents

actuarial assumptions about policyholder behavior, which are generally not observable.