

ALLSTATE CORP

Form 10-Q

November 02, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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  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  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

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

As of October 18, 2016, the registrant had 368,246,845 common shares, \$.01 par value, outstanding.

THE ALLSTATE CORPORATION  
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September 30, 2016

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS  
THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(\$ in millions, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenues				
Property-liability insurance premiums	\$7,869	\$7,650	\$23,406	\$22,625
Life and annuity premiums and contract charges	571	538	1,701	1,611
Net investment income	748	807	2,241	2,446
Realized capital gains and losses:				
Total other-than-temporary impairment (“OTTI”) losses	(73 )	(186 )	(241 )	(286 )
OTTI losses reclassified to (from) other comprehensive income	—	12	8	20
Net OTTI losses recognized in earnings	(73 )	(174 )	(233 )	(266 )
Sales and other realized capital gains and losses	106	207	141	546
Total realized capital gains and losses	33	33	(92 )	280
	9,221	9,028	27,256	26,962
Costs and expenses				
Property-liability insurance claims and claims expense	5,553	5,255	17,138	15,835
Life and annuity contract benefits	484	460	1,393	1,347
Interest credited to contractholder funds	183	194	558	578
Amortization of deferred policy acquisition costs	1,138	1,092	3,393	3,248
Operating costs and expenses	1,021	992	3,043	3,143
Restructuring and related charges	5	9	21	32
Interest expense	73	73	218	219
	8,457	8,075	25,764	24,402
Gain on disposition of operations	1	2	4	2
Income from operations before income tax expense	765	955	1,496	2,562
Income tax expense	245	305	459	880
Net income	520	650	1,037	1,682
Preferred stock dividends	29	29	87	87
Net income applicable to common shareholders	\$491	\$621	\$950	\$1,595
Earnings per common share:				
Net income applicable to common shareholders per common share - Basic	\$1.32	\$1.56	\$2.54	\$3.92
Weighted average common shares - Basic	371.5	397.0	374.4	406.5
Net income applicable to common shareholders per common share - Diluted	\$1.31	\$1.54	\$2.51	\$3.87
Weighted average common shares - Diluted	375.9	402.1	378.9	412.4
Cash dividends declared per common share	\$0.33	\$0.30	\$0.99	\$0.90

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Net income	\$520	\$650	\$1,037	\$1,682
Other comprehensive income (loss), after-tax				
Changes in:				
Unrealized net capital gains and losses	193	(540 )	1,197	(1,047 )
Unrealized foreign currency translation adjustments	(7 )	(14 )	12	(50 )
Unrecognized pension and other postretirement benefit cost	21	25	48	74
Other comprehensive income (loss), after-tax	207	(529 )	1,257	(1,023 )
Comprehensive income	\$727	\$121	\$2,294	\$659

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(\$ in millions, except par value data)	September 30, 2016	December 31, 2015
	(unaudited)	
Assets		
Investments		
Fixed income securities, at fair value (amortized cost \$57,775 and \$57,201)	\$ 60,306	\$ 57,948
Equity securities, at fair value (cost \$4,800 and \$4,806)	5,288	5,082
Mortgage loans	4,396	4,338
Limited partnership interests	5,588	4,874
Short-term, at fair value (amortized cost \$1,863 and \$2,122)	1,863	2,122
Other	3,663	3,394
Total investments	81,104	77,758
Cash	389	495
Premium installment receivables, net	5,799	5,544
Deferred policy acquisition costs	3,886	3,861
Reinsurance recoverables, net	8,922	8,518
Accrued investment income	567	569
Property and equipment, net	1,013	1,024
Goodwill	1,219	1,219
Other assets	2,169	2,010
Separate Accounts	3,469	3,658
Total assets	\$ 108,537	\$ 104,656
Liabilities		
Reserve for property-liability insurance claims and claims expense	\$ 25,450	\$ 23,869
Reserve for life-contingent contract benefits	12,228	12,247
Contractholder funds	20,583	21,295
Unearned premiums	12,772	12,202
Claim payments outstanding	934	842
Deferred income taxes	935	90
Other liabilities and accrued expenses	6,122	5,304
Long-term debt	5,110	5,124
Separate Accounts	3,469	3,658
Total liabilities	87,603	84,631
Commitments and Contingent Liabilities (Note 10)		
Shareholders' equity		
Preferred stock and additional capital paid-in, \$1 par value, 25 million shares authorized, 72.2 thousand shares issued and outstanding, and \$1,805 aggregate liquidation preference	1,746	1,746
Common stock, \$.01 par value, 2.0 billion shares authorized and 900 million issued, 368 million and 381 million shares outstanding	9	9
Additional capital paid-in	3,237	3,245
Retained income	39,990	39,413
Deferred ESOP expense	(13	) (13
Treasury stock, at cost (532 million and 519 million shares)	(24,537	) (23,620
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital gains and losses on fixed income securities with OTTI	56	56
Other unrealized net capital gains and losses	1,902	608
Unrealized adjustment to DAC, DSI and insurance reserves	(141	) (44
Total unrealized net capital gains and losses	1,817	620

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Unrealized foreign currency translation adjustments	(48	)	(60	)
Unrecognized pension and other postretirement benefit cost	(1,267	)	(1,315	)
Total accumulated other comprehensive income (loss)	502		(755	)
Total shareholders' equity	20,934		20,025	
Total liabilities and shareholders' equity	\$ 108,537		\$ 104,656	

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(\$ in millions)	Nine months ended	
	September 30, 2016	2015
	(unaudited)	
Preferred stock par value	\$—	\$—
Preferred stock additional capital paid-in	1,746	1,746
Common stock	9	9
Additional capital paid-in		
Balance, beginning of period	3,245	3,199
Forward contract on accelerated share repurchase agreement	(37	) —
Equity incentive plans activity	29	25
Balance, end of period	3,237	3,224
Retained income		
Balance, beginning of period	39,413	37,842
Net income	1,037	1,682
Dividends on common stock	(373	) (369
Dividends on preferred stock	(87	) (87
Balance, end of period	39,990	39,068
Deferred ESOP expense	(13	) (23
Treasury stock		
Balance, beginning of period	(23,620	) (21,030
Shares acquired	(1,094	) (2,230
Shares reissued under equity incentive plans, net	177	202
Balance, end of period	(24,537	) (23,058
Accumulated other comprehensive income		
Balance, beginning of period	(755	) 561
Change in unrealized net capital gains and losses	1,197	(1,047
Change in unrealized foreign currency translation adjustments	12	(50
Change in unrecognized pension and other postretirement benefit cost	48	74
Balance, end of period	502	(462
Total shareholders' equity	\$20,934	\$20,504

See notes to condensed consolidated financial statements.

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THE ALLSTATE CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ in millions)	Nine months ended September 30,	
	2016	2015
	(unaudited)	
Cash flows from operating activities		
Net income	\$1,037	\$1,682
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	285	275
Realized capital gains and losses	92	(280 )
Gain on disposition of operations	(4 )	(2 )
Interest credited to contractholder funds	558	578
Changes in:		
Policy benefits and other insurance reserves	978	500
Unearned premiums	540	762
Deferred policy acquisition costs	(159 )	(219 )
Premium installment receivables, net	(236 )	(290 )
Reinsurance recoverables, net	(420 )	(133 )
Income taxes	30	(60 )
Other operating assets and liabilities	41	(127 )
Net cash provided by operating activities	2,742	2,686
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	19,132	22,796
Equity securities	4,069	2,688
Limited partnership interests	634	795
Mortgage loans	—	6
Other investments	206	178
Investment collections		
Fixed income securities	3,430	3,248
Mortgage loans	403	305
Other investments	281	254
Investment purchases		
Fixed income securities	(22,282)	(22,928)
Equity securities	(4,113 )	(3,238 )
Limited partnership interests	(1,128 )	(930 )
Mortgage loans	(460 )	(524 )
Other investments	(674 )	(743 )
Change in short-term investments, net	94	(577 )
Change in other investments, net	(60 )	(16 )
Purchases of property and equipment, net	(190 )	(219 )
Net cash (used in) provided by investing activities	(658 )	1,095
Cash flows from financing activities		
Repayments of long-term debt	(16 )	(20 )
Contractholder fund deposits	785	784
Contractholder fund withdrawals	(1,537 )	(1,793 )
Dividends paid on common stock	(364 )	(365 )
Dividends paid on preferred stock	(87 )	(87 )
Treasury stock purchases	(1,154 )	(2,216 )

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Shares reissued under equity incentive plans, net	123	121
Excess tax benefits on share-based payment arrangements	25	44
Other	35	(1 )
Net cash used in financing activities	(2,190 )	(3,533 )
Net (decrease) increase in cash	(106 )	248
Cash at beginning of period	495	657
Cash at end of period	\$389	\$905

See notes to condensed consolidated financial statements.

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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”). These condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”).

The condensed consolidated financial statements and notes as of September 30, 2016 and for the three-month and nine-month periods ended September 30, 2016 and 2015 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, 2015. 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.

Adopted accounting standards

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

In June 2014, the Financial Accounting Standards Board (“FASB”) issued guidance which clarifies that a performance target that affects vesting and could be achieved after the requisite service period should be treated as a performance condition and not reflected in estimating the grant-date fair value of the award. Compensation costs should reflect the amount attributable to the periods for which the requisite service has been rendered. Total compensation expense recognized during and after the requisite service period (which may differ from the vesting period) should reflect the number of awards that are expected to vest and should be adjusted to reflect the number of awards that ultimately vest. The Company’s existing accounting policy for performance targets that affect the vesting of share-based payment awards is consistent with the new guidance and as such, the adoption as of January 1, 2016 had no impact on the Company’s results of operations or financial position.

Amendments to the Consolidation Analysis

In February 2015, the FASB issued guidance affecting the consolidation evaluation for limited partnerships and similar entities, fees paid to a decision maker or service provider, and variable interests in a variable interest entity held by related parties of the reporting enterprise. The adoption of this guidance as of January 1, 2016 did not have a material impact on the Company’s results of operations or financial position.

Pending accounting standards

Revenue from Contracts with Customers

In May 2014, the FASB issued guidance which revises the criteria for revenue recognition. Insurance contracts are excluded from the scope of the new guidance. Under the guidance, the transaction price is attributed to underlying performance obligations in the contract and revenue is recognized as the entity satisfies the performance obligations and transfers control of a good or service to the customer. Incremental costs of obtaining a contract may be capitalized to the extent the entity expects to recover those costs. The guidance is effective for reporting periods beginning after December 15, 2017 and is to be applied retrospectively. 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 or financial position.

Disclosures about Short-Duration Contracts

In May 2015, the FASB issued guidance requiring expanded disclosures for insurance entities that issue short-duration contracts. The expanded disclosures are designed to provide additional insight into an insurance entity’s significant

estimates made in measuring the liability for unpaid claims and claim adjustment expenses. The disclosures include information about incurred and paid claims development by accident year, on a net basis after reinsurance, for the number of years claims incurred typically remain outstanding, not to exceed ten years. Each period presented in the disclosure about claims development that precedes the current reporting period is considered required supplementary information. The expanded disclosures also include information about significant changes in methodologies and assumptions, a reconciliation of incurred and paid claims development to the carrying amount of the liability for unpaid claims and claim adjustment expenses, the total amount of incurred but not

reported liabilities plus expected development, the incidence of claims including the methodology used to determine the incidence of claims, and claim duration. The guidance is effective for annual periods beginning after December 15, 2015, and interim periods beginning after December 15, 2016, and is to be applied retrospectively. The new guidance affects disclosures only and will have no impact on the Company's results of operations or financial position.

#### Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued guidance requiring equity investments, including equity securities and limited partnership interests, that are not accounted for under the equity method of accounting or result in consolidation to be measured at fair value with changes in fair value recognized in net income. Equity investments without readily determinable fair values may be measured at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. When a qualitative assessment of equity investments without readily determinable fair values indicates that impairment exists, the carrying value is required to be adjusted to fair value, if lower. The guidance clarifies that an entity should evaluate the realizability of a deferred tax asset related to available-for-sale fixed income securities in combination with the entity's other deferred tax assets. The guidance also changes certain disclosure requirements. The guidance is effective for interim and annual periods beginning after December 15, 2017, and is to be applied through a cumulative-effect adjustment to beginning retained income as of the beginning of the period of adoption. The new guidance related to equity investments without readily determinable fair values is to be applied prospectively as of the date of adoption. The Company is in the process of evaluating the impact of adoption. The most significant impacts, using values as of September 30, 2016, are expected to be the change in accounting for equity securities where \$488 million of pre-tax unrealized net capital gains would be reclassified from accumulated other comprehensive income to retained income and cost method limited partnership interests (excluding limited partnership interests accounted for on a cost recovery basis) where the carrying value would increase by approximately \$191 million, pre-tax, with the adjustment recorded in retained income.

#### Accounting for Leases

In February 2016, the FASB issued guidance that revises the accounting for leases. Under the new guidance, lessees will be required to recognize a right-of-use asset and lease liability for all leases other than those that meet the definition of a short-term lease. The lease liability will be equal to the present value of lease payments. A right-of-use asset will be based on the lease liability adjusted for qualifying initial direct costs. The expense of operating leases under the new guidance will be recognized in the income statement on a straight-line basis after combining the lease expense components (interest expense on the lease liability and amortization of the right-of-use asset) over the term of the lease. For finance leases, the expense components will be computed separately thereby producing greater up-front expense as interest expense on the lease liability is higher in early years and the right-of-use asset is amortized on a straight-line basis. Lease classification will be based on criteria similar to those currently applied. The accounting model for lessors will be similar to the current model with modifications to reflect definition changes for components such as initial direct costs. Lessors will continue to classify leases as operating, direct financing, or sales-type. The guidance is effective for reporting periods beginning after December 15, 2018 using a modified retrospective approach applied at the beginning of the earliest period presented. 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 or financial position.

#### Employee Share-Based Payment Accounting

In March 2016, the FASB issued guidance to amend the accounting for share-based payments. Under the new guidance, reporting entities will be required to recognize all tax effects related to share-based payments at settlement (or expiration) through the income statement and will no longer be permitted to recognize excess tax benefits and tax deficiencies in additional paid in capital. The change will be applied on a modified retrospective basis, with a cumulative effect adjustment to beginning retained income. In addition, all tax-related cash flows resulting from share-based payments will be reported as operating activities on the statement of cash flows, with either prospective or retrospective transition permitted. The new guidance will permit employers to withhold shares upon settlement of an award to satisfy the employer's tax withholding requirement (up to the employee's maximum individual statutory tax rate) without causing liability classification of the award. The new guidance clarifies that all cash payments made to taxing authorities on an employee's behalf for withheld shares should be presented as financing activities on the

statement of cash flows. Also under the new guidance, reporting entities are permitted to make an accounting policy election to estimate forfeitures or recognize them when they occur. If elected, the change to recognize forfeitures when they occur must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained income. The new guidance is effective for reporting periods beginning after December 15, 2016. 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 or financial position.

#### Transition to Equity Method Accounting

In March 2016, the FASB issued guidance amending the accounting requirements for transitioning to the equity method of accounting ("EMA"), including a transition from the cost method. The guidance requires the cost of acquiring an additional interest in an investee to be added to the existing carrying value to establish the initial basis of the EMA investment. Under the new guidance, no retroactive adjustment is required when an investment initially qualifies for EMA treatment. The guidance is

effective for interim and annual periods beginning after December 15, 2016, and is to be applied prospectively. The guidance will principally affect the future accounting for investments that qualify for EMA after application of the cost method of accounting. 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 or financial position.

#### Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued guidance which revises the credit loss recognition criteria for certain financial assets measured at amortized cost. The new guidance replaces the existing incurred loss recognition model with an expected loss recognition model. The objective of the expected credit loss model is for the reporting entity to recognize its estimate of expected credit losses for affected financial assets in a valuation allowance deducted from the amortized cost basis of the related financial assets that results in presenting the net carrying value of the financial assets at the amount expected to be collected. The reporting entity must consider all available relevant information when estimating expected credit losses, including details about past events, current conditions, and reasonable and supportable forecasts over the contractual life of an asset. Financial assets may be evaluated individually or on a pooled basis when they share similar risk characteristics. The measurement of credit losses for available-for-sale debt securities measured at fair value is not affected except that credit losses recognized are limited to the amount by which fair value is below amortized cost and the carrying value adjustment is recognized through an allowance and not as a direct write-down. The guidance is effective for interim and annual periods beginning after December 15, 2019, and for most affected instruments must be adopted using a modified retrospective approach, with a cumulative effect adjustment recorded to beginning retained income. The Company is in the process of evaluating the impact of adoption.

#### 2. Earnings per Common Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding, including vested unissued 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 is presented in the following table.

(\$ in millions, except per share data)	Three months ended		Nine months ended	
	September 30, 2016	2015	September 30, 2016	2015
Numerator:				
Net income	\$520	\$650	\$1,037	\$1,682
Less: Preferred stock dividends	29	29	87	87
Net income applicable to common shareholders <sup>(1)</sup>	\$491	\$621	\$950	\$1,595
Denominator:				
Weighted average common shares outstanding	371.5	397.0	374.4	406.5
Effect of dilutive potential common shares:				
Stock options	3.2	3.6	3.3	4.2
Restricted stock units (non-participating) and performance stock awards	1.2	1.5	1.2	1.7
Weighted average common and dilutive potential common shares outstanding	375.9	402.1	378.9	412.4
Earnings per common share - Basic	\$1.32	\$1.56	\$2.54	\$3.92
Earnings per common share - Diluted	\$1.31	\$1.54	\$2.51	\$3.87

<sup>(1)</sup> Net income applicable to common shareholders is net income less preferred stock dividends.

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 3.6 million and 2.2 million Allstate common shares, with exercise prices ranging from \$58.14 to \$71.29 and \$52.22 to \$71.29, were outstanding for the three-month periods ended September 30, 2016 and 2015, respectively, but were not included in the computation of diluted earnings per common share in those periods. Options to purchase 4.7 million and 2.2 million Allstate common shares, with exercise prices ranging from \$57.29 to \$71.29 and \$57.98 to \$71.29, were outstanding for the nine-month periods ended September 30, 2016 and 2015, respectively, but were not included in the computation of diluted earnings per common share in those periods.

## 3. Supplemental Cash Flow Information

Non-cash investing activities include \$290 million and \$84 million related to mergers and exchanges completed with equity securities and modifications of certain mortgage loans and other investments for the nine months ended September 30, 2016 and 2015, respectively. Non-cash financing activities include \$40 million and \$74 million related to the issuance of Allstate common shares for vested equity awards for the nine months ended September 30, 2016 and 2015, respectively. Non-cash financing activities also include \$34 million related to debt acquired in conjunction with the purchase of an investment for the nine months ended September 30, 2016.

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 are as follows:

(\$ in millions)	Nine months ended September 30,	
	2016	2015
Net change in proceeds managed		
Net change in fixed income securities	\$(436)	\$—
Net change in short-term investments	181	(2 )
Operating cash flow used	(255 )	(2 )
Net change in cash	—	1
Net change in proceeds managed	\$(255)	\$(1 )

## Net change in liabilities

Liabilities for collateral, beginning of period	\$(840)	\$(782)
Liabilities for collateral, end of period	(1,095)	(783 )
Operating cash flow provided	\$255	\$1

## 4. 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		Fair value
		Gains	Losses	
September 30, 2016				
U.S. government and agencies	\$ 4,199	\$107	\$(2 )	\$4,304
Municipal	7,432	483	(13 )	7,902
Corporate	42,670	1,925	(121 )	44,474
Foreign government	1,060	59	—	1,119
Asset-backed securities ("ABS")	1,393	12	(15 )	1,390
Residential mortgage-backed securities ("RMBS")	696	90	(8 )	778
Commercial mortgage-backed securities ("CMBS")	304	20	(9 )	315
Redeemable preferred stock	21	3	—	24
Total fixed income securities	\$ 57,775	\$2,699	\$(168)	\$60,306
December 31, 2015				
U.S. government and agencies	\$ 3,836	\$90	\$(4 )	\$3,922
Municipal	7,032	389	(20 )	7,401
Corporate	41,674	1,032	(879 )	41,827
Foreign government	983	50	—	1,033

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ABS	2,359	11	(43 )	2,327
RMBS	857	100	(10 )	947
CMBS	438	32	(4 )	466
Redeemable preferred stock	22	3	—	25
Total fixed income securities	\$ 57,201	\$ 1,707	\$(960)	\$57,948

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Scheduled maturities

The scheduled maturities for fixed income securities are as follows as of September 30, 2016:

(\$ in millions)	Amortized Fair	
	cost	value
Due in one year or less	\$ 4,084	\$4,115
Due after one year through five years	29,357	30,222
Due after five years through ten years	16,576	17,315
Due after ten years	5,365	6,171
	55,382	57,823
ABS, RMBS and CMBS	2,393	2,483
Total	\$ 57,775	\$60,306

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 is as follows:

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Fixed income securities	\$508	\$546	\$1,546	\$1,681
Equity securities	31	23	103	77
Mortgage loans	56	53	162	165
Limited partnership interests	136	167	383	483
Short-term investments	4	4	11	8
Other	55	49	163	143
Investment income, before expense	790	842	2,368	2,557
Investment expense	(42 )	(35 )	(127 )	(111 )
Net investment income	\$748	\$807	\$2,241	\$2,446

Realized capital gains and losses

Realized capital gains and losses by asset type are as follows:

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Fixed income securities	\$(1 )	\$221	\$(48)	\$361
Equity securities	45	(150 )	(34 )	(24 )
Mortgage loans	—	1	1	2
Limited partnership interests	12	(55 )	25	(52 )
Derivatives	(15 )	24	(22 )	4
Other	(8 )	(8 )	(14 )	(11 )
Realized capital gains and losses	\$33	\$33	\$(92)	\$280

Realized capital gains and losses by transaction type are as follows:

(\$ in millions)	Three months ended	Nine months ended
	ended	September 30,

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	September 30,			
	2016	2015	2016	2015
Impairment write-downs	\$(63)	\$(47)	\$(185)	\$(77)
Change in intent write-downs	(10 )	(127 )	(48 )	(189 )
Net other-than-temporary impairment losses recognized in earnings	(73 )	(174 )	(233 )	(266 )
Sales and other	121	183	166	545
Valuation and settlements of derivative instruments	(15 )	24	(25 )	1
Realized capital gains and losses	\$33	\$33	\$(92 )	\$280

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Gross gains of \$150 million and \$357 million and gross losses of \$62 million and \$120 million were realized on sales of fixed income and equity securities during the three months ended September 30, 2016 and 2015, respectively. Gross gains of \$456 million and \$828 million and gross losses of \$347 million and \$241 million were realized on sales of fixed income and equity securities during the nine months ended September 30, 2016 and 2015, respectively. Other-than-temporary impairment losses by asset type are as follows:

(\$ in millions)	Three months ended September 30, 2016			Three months ended September 30, 2015		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	\$—	\$ —	\$—	\$(1 )	\$ —	\$(1 )
Corporate	(13 )	—	(13 )	(9 )	—	(9 )
ABS	—	—	—	(16 )	12	(4 )
RMBS	(1 )	—	(1 )	—	—	—
CMBS	(3 )	—	(3 )	(1 )	—	(1 )
Total fixed income securities	(17 )	—	(17 )	(27 )	12	(15 )
Equity securities	(27 )	—	(27 )	(151 )	—	(151 )
Limited partnership interests	(22 )	—	(22 )	(2 )	—	(2 )
Other	(7 )	—	(7 )	(6 )	—	(6 )
Other-than-temporary impairment losses	\$(73 )	\$ —	\$(73 )	\$(186 )	\$ 12	\$(174 )

(\$ in millions)	Nine months ended September 30, 2016			Nine months ended September 30, 2015		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	\$—	\$ —	\$—	\$(5 )	\$ 4	\$(1 )
Corporate	(30 )	7	(23 )	(19 )	4	(15 )
ABS	(6 )	—	(6 )	(20 )	13	(7 )
RMBS	(1 )	—	(1 )	1	(1 )	—
CMBS	(7 )	1	(6 )	(1 )	—	(1 )
Total fixed income securities	(44 )	8	(36 )	(44 )	20	(24 )
Equity securities	(155 )	—	(155 )	(226 )	—	(226 )
Limited partnership interests	(33 )	—	(33 )	(7 )	—	(7 )
Other	(9 )	—	(9 )	(9 )	—	(9 )
Other-than-temporary impairment losses	\$(241 )	\$ 8	\$(233 )	\$(286 )	\$ 20	\$(266 )

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 amounts exclude \$223 million and \$233 million as of September 30, 2016 and December 31, 2015, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

(\$ in millions)	September 30, 2016	December 31, 2015
Municipal	\$ (8 )	\$ (9 )
Corporate	(5 )	(7 )
ABS	(23 )	(23 )
RMBS	(93 )	(102 )
CMBS	(7 )	(6 )
Total	\$ (136 )	\$ (147 )



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		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Beginning balance	\$(331)	\$(372)	\$(392)	\$(380)
Additional credit loss for securities previously other-than-temporarily impaired	(3 )	(7 )	(14 )	(10 )
Additional credit loss for securities not previously other-than-temporarily impaired	(14 )	(8 )	(22 )	(14 )
Reduction in credit loss for securities disposed or collected	12	23	92	37
Change in credit loss due to accretion of increase in cash flows	—	—	—	3
Ending balance	\$(336)	\$(364)	\$(336)	\$(364)

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 of underlying collateral, 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 value	Gross unrealized Gains	Losses	Unrealized net gains (losses)
September 30, 2016				
Fixed income securities	\$60,306	\$2,699	\$(168)	\$ 2,531
Equity securities	5,288	592	(104)	488
Short-term investments	1,863	—	—	—
Derivative instruments <sup>(1)</sup>	4	4	(3)	1
Equity method (“EMA”) limited partnerships <sup>(2)</sup>				(5 )
Unrealized net capital gains and losses, pre-tax				3,015
Amounts recognized for:				
Insurance reserves <sup>(3)</sup>				—
DAC and DSI <sup>(4)</sup>				(216 )
Amounts recognized				(216 )
Deferred income taxes				(982 )
Unrealized net capital gains and losses, after-tax				\$ 1,817

<sup>(1)</sup> Included in the fair value of derivative instruments is \$(4) million classified as liabilities.

Unrealized net capital gains and losses for limited partnership interests represent the Company’s share of EMA

<sup>(2)</sup> limited partnerships’ other comprehensive income. Fair value and gross unrealized gains and losses are not applicable.

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,

<sup>(3)</sup> 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, if any, primarily relates to structured settlement annuities with life contingencies, in addition to annuity buy-outs and certain payout annuities with life contingencies.

<sup>(4)</sup> 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)	Fair value	Gross unrealized Gains	Losses	Unrealized net gains (losses)
December 31, 2015				
Fixed income securities	\$57,948	\$1,707	\$(960)	\$ 747
Equity securities	5,082	415	(139)	276
Short-term investments	2,122	—	—	—
Derivative instruments <sup>(1)</sup>	10	10	(4)	6
EMA limited partnerships				(4 )
Unrealized net capital gains and losses, pre-tax				1,025
Amounts recognized for:				
Insurance reserves				—
DAC and DSI				(67 )
Amounts recognized				(67 )
Deferred income taxes				(338 )
Unrealized net capital gains and losses, after-tax				\$ 620

<sup>(1)</sup> Included in the fair value of derivative instruments are \$6 million classified as assets and \$(4) million classified as liabilities.



## Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the nine months ended September 30, 2016 is as follows:  
(\$ in millions)

Fixed income securities	\$1,784
Equity securities	212
Derivative instruments	(5 )
EMA limited partnerships	(1 )
Total	1,990
Amounts recognized for:	
Insurance reserves	—
DAC and DSI	(149 )
Amounts recognized	(149 )
Deferred income taxes	(644 )
Increase in unrealized net capital gains and losses, after-tax	\$1,197

## 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.

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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 unrealized losses
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	
September 30, 2016							
Fixed income securities							
U.S. government and agencies	17	\$ 1,530	\$ (2 )	—	\$ —	\$ —	\$ (2 )
Municipal	302	785	(2 )	9	28	(11 )	(13 )
Corporate	226	3,733	(38 )	112	882	(83 )	(121 )
ABS	12	102	—	23	308	(15 )	(15 )
RMBS	61	30	(1 )	177	97	(7 )	(8 )
CMBS	17	93	(7 )	3	8	(2 )	(9 )
Total fixed income securities	635	6,273	(50 )	324	1,323	(118 )	(168 )
Equity securities	190	689	(82 )	42	121	(22 )	(104 )
Total fixed income and equity securities	825	\$6,962	\$ (132 )	366	\$1,444	\$ (140 )	\$ (272 )
Investment grade fixed income securities	525	\$5,095	\$ (17 )	220	\$808	\$ (61 )	\$ (78 )
Below investment grade fixed income securities	110	1,178	(33 )	104	515	(57 )	(90 )
Total fixed income securities	635	\$6,273	\$ (50 )	324	\$1,323	\$ (118 )	\$ (168 )

December 31, 2015

Fixed income securities							
U.S. government and agencies	53	\$ 1,874	\$ (4 )	—	\$ —	\$ —	\$ (4 )
Municipal	222	810	(6 )	9	36	(14 )	(20 )
Corporate	1,361	17,915	(696 )	111	1,024	(183 )	(879 )
Foreign government	9	44	—	—	—	—	—
ABS	133	1,733	(24 )	20	324	(19 )	(43 )
RMBS	88	69	—	176	125	(10 )	(10 )
CMBS	13	75	(2 )	1	2	(2 )	(4 )
Total fixed income securities	1,879	22,520	(732 )	317	1,511	(228 )	(960 )
Equity securities	265	1,397	(107 )	37	143	(32 )	(139 )
Total fixed income and equity securities	2,144	\$23,917	\$ (839 )	354	\$1,654	\$ (260 )	\$ (1,099 )
Investment grade fixed income securities	1,405	\$17,521	\$ (362 )	225	\$972	\$ (105 )	\$ (467 )
Below investment grade fixed income securities	474	4,999	(370 )	92	539	(123 )	(493 )
Total fixed income securities	1,879	\$22,520	\$ (732 )	317	\$1,511	\$ (228 )	\$ (960 )

As of September 30, 2016, \$161 million of the \$272 million 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 \$161 million, \$44 million are related to unrealized losses on investment grade fixed income securities and \$64 million are related to equity securities. Of the remaining \$53 million, \$23 million have been in an unrealized loss position for less than 12 months. 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 Standard and Poor's ("S&P"), a comparable rating from another nationally recognized rating agency, or a comparable internal rating if an externally provided rating is not available. Market prices for certain securities may have credit spreads which imply higher or lower credit quality than the current third party rating. Unrealized losses on investment grade securities are principally related to an increase in market yields which may include increased risk-free interest rates and/or wider credit spreads since the time of initial purchase.

As of September 30, 2016, the remaining \$111 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 \$34 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 \$111 million, \$37 million are related to below investment grade fixed income securities and \$40 million are related to equity securities. Of these amounts, \$20 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 September 30, 2016.

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 underlying credit quality of the primary obligor, obligation type and quality of the underlying assets. Unrealized losses on equity securities are primarily related to temporary equity market fluctuations of securities that are expected to recover.

As of September 30, 2016, 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 September 30, 2016, 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 September 30, 2016 and December 31, 2015, the carrying value of equity method limited partnerships totaled \$4.21 billion and \$3.72 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.

As of September 30, 2016 and December 31, 2015, the carrying value for cost method limited partnerships was \$1.38 billion and \$1.15 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.

#### 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 or present value of the loan's expected future repayment cash flows. 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 September 30, 2016.

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)	September 30, 2016			December 31, 2015		
	Fixed rate mortgage loans	Variable rate mortgage loans	Total	Fixed rate mortgage loans	Variable rate mortgage loans	Total
Below 1.0	\$61	\$ —	\$61	\$64	\$ —	\$64
1.0 - 1.25	321	—	321	382	—	382
1.26 - 1.50	1,198	—	1,198	1,219	—	1,219
Above 1.50	2,785	25	2,810	2,667	—	2,667
Total non-impaired mortgage loans	\$4,365	\$ 25	\$4,390	\$4,332	\$ —	\$4,332

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)	September 30, 2016	December 31, 2015
	Impaired mortgage loans with a valuation allowance	\$ 6
Impaired mortgage loans without a valuation allowance	—	—
Total impaired mortgage loans	\$ 6	\$ 6
Valuation allowance on impaired mortgage loans	\$ 3	\$ 3

The average balance of impaired loans was \$6 million and \$12 million for the nine months ended September 30, 2016 and 2015, respectively.

The rollforward of the valuation allowance on impaired mortgage loans is as follows:

(\$ in millions)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Beginning balance	\$ 3	\$ 7	\$ 3	\$ 8
Charge offs	—	—	—	(1 )
Ending balance	\$ 3	\$ 7	\$ 3	\$ 7

Payments on all mortgage loans were current as of September 30, 2016 and December 31, 2015.

## 5. 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 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.

The second situation where the Company classifies securities in Level 3 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.

Certain assets are not carried at fair value on a recurring basis, including investments such as mortgage loans, limited partnership interests, bank loans, agent 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 U.S. Treasury bills valued based on unadjusted quoted prices for identical assets in active markets that the Company can access and 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.

#### 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 - public:** 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 - privately placed:** 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 - collateralized debt obligations ("CDO") and ABS - consumer and other:** 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 - CDO and ABS - consumer and other are valued based on non-binding broker quotes whose inputs have been corroborated to be market observable.

• **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.

• **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.

• **Equity securities:** 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.

• **Short-term:** 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.



Other investments: 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.

Level 3 measurements

Fixed income securities:

Municipal: Comprise municipal bonds that are not rated by third party credit rating agencies. 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 included are municipal bonds valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and municipal bonds in default valued based on the present value of expected cash flows.

Corporate - public and Corporate - privately placed: Primarily valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable. 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 - CDO, ABS - consumer and other, 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.

Equity securities: 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.

Other investments: 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.

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.

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 connection with recognizing other-than-temporary impairments are generally valued using net asset values.



The following table summarizes the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2016.

(\$ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of September 30, 2016
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$ 3,440	\$ 864	\$ —		\$4,304
Municipal	—	7,742	160		7,902
Corporate - public	—	31,789	98		31,887
Corporate - privately placed	—	12,271	316		12,587
Foreign government	—	1,119	—		1,119
ABS - CDO	—	636	74		710
ABS - consumer and other	—	601	79		680
RMBS	—	777	1		778
CMBS	—	292	23		315
Redeemable preferred stock	—	24	—		24
Total fixed income securities	3,440	56,115	751		60,306
Equity securities	4,941	187	160		5,288
Short-term investments	343	1,520	—		1,863
Other investments: Free-standing derivatives	—	92	1	\$ (8 )	85
Separate account assets	3,469	—	—		3,469
Other assets	1	—	1		2
Total recurring basis assets	12,194	57,914	913	(8 )	71,013
Non-recurring basis <sup>(1)</sup>	—	—	25		25
Total assets at fair value	\$ 12,194	\$ 57,914	\$ 938	\$ (8 )	\$ 71,038
% of total assets at fair value	17.2	% 81.5	% 1.3	% —	% 100
<b>Liabilities</b>					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ —	\$ —	\$ (307 )		\$(307 )
Other liabilities: Free-standing derivatives	(1 )	(66 )	(4 )	\$ 22	(49 )
Total liabilities at fair value	\$ (1 )	\$(66 )	\$ (311 )	\$ 22	\$(356 )
% of total liabilities at fair value	0.3	% 18.5	% 87.4	% (6.2 )	% 100

(1) Includes \$16 million of limited partnership interests and \$9 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.



The following table summarizes the Company's assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2015.

(\$ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of December 31, 2015
<b>Assets</b>					
<b>Fixed income securities:</b>					
U.S. government and agencies	\$ 3,056	\$ 861	\$ 5		\$ 3,922
Municipal	—	7,240	161		7,401
Corporate - public	—	30,356	46		30,402
Corporate - privately placed	—	10,923	502		11,425
Foreign government	—	1,033	—		1,033
ABS - CDO	—	716	61		777
ABS - consumer and other	—	1,500	50		1,550
RMBS	—	946	1		947
CMBS	—	446	20		466
Redeemable preferred stock	—	25	—		25
Total fixed income securities	3,056	54,046	846		57,948
Equity securities	4,786	163	133		5,082
Short-term investments	615	1,507	—		2,122
Other investments: Free-standing derivatives	—	65	1	\$ (13 )	53
Separate account assets	3,658	—	—		3,658
Other assets	2	—	1		3
Total recurring basis assets	12,117	55,781	981	(13 )	68,866
Non-recurring basis <sup>(1)</sup>	—	—	55		55
Total assets at fair value	\$ 12,117	\$ 55,781	\$ 1,036	\$ (13 )	\$ 68,921
% of total assets at fair value	17.6	% 80.9	% 1.5	% —	% 100
<b>Liabilities</b>					
Contractholder funds: Derivatives embedded in life and annuity contracts	\$ —	\$ —	\$ (299 )		\$(299 )
Other liabilities: Free-standing derivatives	(1 )	(23 )	(8 )	\$ 7	(25 )
Total liabilities at fair value	\$ (1 )	\$ (23 )	\$ (307 )	\$ 7	\$(324 )
% of total liabilities at fair value	0.3	% 7.1	% 94.8	% (2.2 )	% 100

<sup>(1)</sup> Includes \$42 million of limited partnership interests and \$13 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table summarizes quantitative information about the significant unobservable inputs used in Level 3 fair value measurements.

(\$ in millions)	Fair value	Valuation technique	Unobservable input	Range	Weighted average
September 30, 2016					
Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(256)	Stochastic cash flow model	Projected option cost	1.0 - 2.2%	1.75%
December 31, 2015					
Derivatives embedded in life and annuity contracts – Equity-indexed and forward starting options	\$(247)	Stochastic cash flow model	Projected option cost	1.0 - 2.2%	1.76%

The embedded derivatives are equity-indexed and forward starting options in certain life and annuity products that provide customers with interest crediting rates based on the performance of the S&P 500. If the projected option cost increased (decreased), it would result in a higher (lower) liability fair value.

As of September 30, 2016 and December 31, 2015, Level 3 fair value measurements of fixed income securities total \$751 million and \$846 million, respectively, and include \$311 million and \$625 million, respectively, of securities valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and \$86 million and \$96 million, respectively, of municipal fixed income securities that are not rated by third party credit rating agencies. The Company does not

develop the unobservable inputs used in measuring fair value; therefore, these are not included in the table above. However, an increase (decrease) in credit spreads for fixed income securities valued based on non-binding broker quotes would result in a lower (higher) fair value, and an increase (decrease) in the credit rating of municipal bonds that are not rated by third party credit rating agencies would result in a higher (lower) fair value.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2016.

(\$ in millions)	Total gains (losses) included in:				
	Balance as of June 30, 2016	Net income	OCI <sup>(1)</sup>	Transfers into Level 3	Transfers out of Level 3
<b>Assets</b>					
<b>Fixed income securities:</b>					
Municipal	\$149	\$1	\$(1)	\$—	—
Corporate - public	74	—	—	—	(6)
Corporate - privately placed	585	—	2	—	(280)
ABS - CDO	33	—	3	—	—
ABS - consumer and other	45	—	—	—	—
RMBS	1	—	—	—	—
CMBS	20	—	—	—	—
Total fixed income securities	907	1	4	—	(286)
Equity securities	118	(1)	—	—	—
Free-standing derivatives, net	(7)	4	—	—	—
Other assets	1	—	—	—	—
Total recurring Level 3 assets	\$1,019	\$4	\$4	\$—	—\$(286)