

REINSURANCE GROUP OF AMERICA INC  
Form 10-Q  
August 07, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

X

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

OR

..

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  
(State or other jurisdiction  
of incorporation or organization)

43-1627032  
(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  No

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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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  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 July 31, 2012, 73,713,241 shares of the registrant's common stock were outstanding.

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**REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES**

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**Table of Contents****REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

|   | June 30,<br>2012                          | December 31,<br>2011 |
|---|---|----------------------|
|   | (Dollars in thousands, except share data) |                      |
| <b>Assets</b>   |   |                      |
| Fixed maturity securities:  |   |                      |
| Available-for-sale at fair value (amortized cost of \$14,957,165 and \$14,182,880 at June 30, 2012 and December 31, 2011, respectively)   | \$ 17,244,192                             | \$ 16,200,950        |
| Mortgage loans on real estate (net of allowances of \$11,011 and \$11,793 at June 30, 2012 and December 31, 2011, respectively)           | 1,157,049                                 | 991,731              |
| Policy loans  | 1,250,238                                 | 1,260,400            |
| Funds withheld at interest  | 5,457,888                                 | 5,410,424            |
| Short-term investments  | 49,981                                    | 88,566               |
| Investment receivable   | 5,406,898                                 | -                    |
| Other invested assets   | 940,605                                   | 1,012,541            |
| <b>Total investments</b>  | <b>31,506,851</b>                         | <b>24,964,612</b>    |
| Cash and cash equivalents   | 957,341                                   | 962,870              |
| Accrued investment income   | 182,586                                   | 144,334              |
| Premiums receivable and other reinsurance balances  | 1,104,176                                 | 1,059,572            |
| Reinsurance ceded receivables   | 626,734                                   | 626,194              |
| Deferred policy acquisition costs   | 3,605,008                                 | 3,543,925            |
| Other assets  | 361,627                                   | 332,466              |
| <b>Total assets</b>   | <b>\$ 38,344,323</b>                      | <b>\$ 31,633,973</b> |
| <b>Liabilities and Stockholders' Equity</b>   |   |                      |
| Future policy benefits  | \$ 10,725,096                             | \$ 9,903,886         |
| Interest-sensitive contract liabilities   | 13,352,601                                | 8,394,468            |
| Other policy claims and benefits  | 3,026,467                                 | 2,841,373            |
| Other reinsurance balances  | 249,336                                   | 118,219              |
| Deferred income taxes   | 1,785,614                                 | 1,679,834            |
| Other liabilities   | 890,687                                   | 810,775              |
| Long-term debt  | 1,414,969                                 | 1,414,688            |
| Collateral finance facility   | 651,936                                   | 652,032              |
| <b>Total liabilities</b>  | <b>32,096,706</b>                         | <b>25,815,275</b>    |
| Commitments and contingent liabilities (See Note 8)   |   |                      |
| <b>Stockholders' Equity:</b>  |   |                      |
| 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: 79,137,758 at June 30, 2012 and December 31, 2011) | 791                                       | 791                  |
| Additional paid-in-capital  | 1,740,415                                 | 1,727,774            |
| Retained earnings   | 3,033,505                                 | 2,818,429            |
| Treasury stock, at cost; 5,415,403 and 5,770,024 shares at June 30, 2012 and December 31, 2011, respectively                              | (326,292)                                 | (346,449)            |
| Accumulated other comprehensive income  | 1,799,198                                 | 1,618,153            |
| <b>Total stockholders' equity</b>   | <b>6,247,617</b>                          | <b>5,818,698</b>     |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$ 38,344,323</b>                      | <b>\$ 31,633,973</b> |

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

**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, |              |
|--|---|--------------|---------------------------|--------------|
|  | 2012  | 2011         | 2012                      | 2011         |
|  | (Dollars in thousands, except per share data) |              |                           |              |
| <b>Revenues:</b>   |   |              |                           |              |
| Net premiums   | \$ 1,950,661                                  | \$ 1,788,676 | \$ 3,814,143              | \$ 3,524,806 |
| Investment income, net of related expenses   | 328,334                                       | 337,436      | 669,274                   | 708,476      |
| Investment related gains (losses), net:  |   |              |                           |              |
| Other-than-temporary impairments on fixed maturity securities  | (1,959)                                       | (5,582)      | (9,566)                   | (7,138)      |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | 162   | 292          | (7,059)                   | 292          |
| Other investment related gains (losses), net   | 25,598  | 32,678       | 83,946                    | 157,854      |
| Total investment related gains (losses), net   | 23,801  | 27,388       | 67,321                    | 151,008      |
| Other revenues   | 72,957  | 50,477       | 117,990                   | 102,122      |
| Total revenues   | 2,375,753                                     | 2,203,977    | 4,668,728                 | 4,486,412    |
| <b>Benefits and Expenses:</b>  |   |              |                           |              |
| Claims and other policy benefits   | 1,625,446                                     | 1,520,013    | 3,205,595                 | 2,989,462    |
| Interest credited  | 66,697  | 96,196       | 154,739                   | 202,259      |
| Policy acquisition costs and other insurance expenses  | 335,939                                       | 274,519      | 643,573                   | 620,766      |
| Other operating expenses   | 105,541                                       | 97,161       | 215,639                   | 203,311      |
| Interest expense   | 23,360  | 25,818       | 46,682                    | 50,387       |
| Collateral finance facility expense  | 2,878   | 3,101        | 5,845                     | 6,303        |
| Total benefits and expenses  | 2,159,861                                     | 2,016,808    | 4,272,073                 | 4,072,488    |
| <b>Income before income taxes</b>  | 215,892                                       | 187,169      | 396,655                   | 413,924      |
| Provision for income taxes   | 74,781  | 63,225       | 132,226                   | 141,060      |
| <b>Net income</b>  | \$ 141,111                                    | \$ 123,944   | \$ 264,429                | \$ 272,864   |
| <b>Earnings per share:</b>   |   |              |                           |              |
| Basic earnings per share   | \$ 1.91                                       | \$ 1.68      | \$ 3.59                   | \$ 3.71      |
| Diluted earnings per share   | \$ 1.91                                       | \$ 1.66      | \$ 3.57                   | \$ 3.68      |
| <b>Dividends declared per share</b>  | \$ 0.18                                       | \$ 0.12      | \$ 0.36                   | \$ 0.24      |

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

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**REINSURANCE GROUP OF AMERICA, INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)

(Unaudited)

|   | Three months ended June 30, |                   | Six months ended June 30, |                   |
|---|-----------------------------|-------------------|---------------------------|-------------------|
|   | 2012                        | 2011              | 2012                      | 2011              |
| <b>Comprehensive income:</b>  |                             |                   |                           |                   |
| Net income  | \$ 141,111                  | \$ 123,944        | \$ 264,429                | \$ 272,864        |
| <b>Other comprehensive income, net of income tax:</b>                         |                             |                   |                           |                   |
| Change in foreign currency translation adjustments                            | (16,865)                    | 11,487            | 7,215                     | 35,894            |
| Change in net unrealized gain on investments                                  | 203,156                     | 151,582           | 167,741                   | 115,764           |
| Change in other-than-temporary impairment losses on fixed maturity securities | (106)                       | (190)             | 4,588                     | (190)             |
| Changes in pension and other postretirement plan adjustments                  | 1,211                       | 358               | 1,501                     | 572               |
| Total other comprehensive income  | 187,396                     | 163,237           | 181,045                   | 152,040           |
| <b>Total comprehensive income, net of income tax</b>                          | <b>\$ 328,507</b>           | <b>\$ 287,181</b> | <b>\$ 445,474</b>         | <b>\$ 424,904</b> |

See accompanying notes to condensed consolidated financial statements.

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

|  | Six months ended June 30, |             |
|--|---------------------------|-------------|
|  | 2012                      | 2011        |
|  | (Dollars in thousands)    |             |
| <b>Cash Flows from Operating Activities:</b>   |                           |             |
| Net income   | \$ 264,429                | \$ 272,864  |
| Adjustments to reconcile net income to net cash provided by operating activities:        |                           |             |
| Change in operating assets and liabilities:  |                           |             |
| Accrued investment income  | (38,182)                  | (31,378)    |
| Premiums receivable and other reinsurance balances                                       | (47,370)                  | 66,922      |
| Deferred policy acquisition costs  | (63,690)                  | 61,339      |
| Reinsurance ceded receivable balances  | (540)                     | (11,307)    |
| Future policy benefits, other policy claims and benefits, and other reinsurance balances | 755,790                   | 332,611     |
| Deferred income taxes  | (5,469)                   | (42,189)    |
| Other assets and other liabilities, net  | 62,682                    | 41,262      |
| Amortization of net investment premiums, discounts and other                             | (69,347)                  | (67,755)    |
| Investment related gains, net  | (67,321)                  | (151,008)   |
| Excess tax benefits from share-based payment arrangement                                 | 24                        | (2,690)     |
| Other, net   | 27,251                    | 69,143      |
| Net cash provided by operating activities  | 818,257                   | 537,814     |
| <b>Cash Flows from Investing Activities:</b>   |                           |             |
| Sales of fixed maturity securities available-for-sale                                    | 1,759,932                 | 1,791,826   |
| Maturities of fixed maturity securities available-for-sale                               | 104,008                   | 164,043     |
| Purchases of fixed maturity securities available-for-sale                                | (2,518,580)               | (2,341,291) |
| Cash invested in mortgage loans  | (225,005)                 | (44,679)    |
| Cash invested in policy loans  | (1,589)                   | (8,928)     |
| Cash invested in funds withheld at interest  | (60,145)                  | (10,563)    |
| Principal payments on mortgage loans on real estate                                      | 46,313                    | 19,283      |
| Principal payments on policy loans   | 11,752                    | 7,683       |
| Change in short-term investments and other invested assets                               | 98,530                    | (74,600)    |
| Net cash used in investing activities  | (784,784)                 | (497,226)   |
| <b>Cash Flows from Financing Activities:</b>   |                           |             |
| Dividends to stockholders  | (26,524)                  | (17,703)    |
| Repurchase of collateral finance facility securities                                     | --                        | (7,586)     |
| Net proceeds from long-term debt issuance  | --                        | 394,410     |
| Proceeds from redemption and remarketing of trust preferred securities                   | --                        | 154,588     |
| Maturity of trust preferred securities   | --                        | (159,455)   |
| Purchases of treasury stock  | (6,924)                   | (340,220)   |
| Excess tax benefits from share-based payment arrangement                                 | (24)                      | 2,690       |
| Exercise of stock options, net   | (651)                     | 15,605      |
| Change in cash collateral for derivative positions                                       | (15,096)                  | 8,010       |
| Deposits on universal life and other investment type policies and contracts              | 79,134                    | 288,424     |
| Withdrawals on universal life and other investment type policies and contracts           | (70,753)                  | (147,774)   |
| Net cash (used in) provided by financing activities                                      | (40,838)                  | 190,989     |



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|  |            |            |
|--|------------|------------|
| Effect of exchange rate changes on cash        | 1,836      | 15,735     |
| Change in cash and cash equivalents            | (5,529)    | 247,312    |
| Cash and cash equivalents, beginning of period | 962,870    | 463,661    |
| Cash and cash equivalents, end of period       | \$ 957,341 | \$ 710,973 |
| <b>Supplementary information:</b>              |            |            |
| Cash paid for interest                         | \$ 49,094  | \$ 47,054  |
| Cash paid for income taxes, net of refunds     | \$ 40,735  | \$ 105,107 |

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

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. Results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. There were no subsequent events, other than as disclosed in Note 13 Subsequent Event, 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 include the accounts of RGA and its subsidiaries, all intercompany accounts and transactions have been eliminated. They should be read in conjunction with the Company s 2011 Annual Report on Form 10-K ( 2011 Annual Report ) filed with the Securities and Exchange Commission ( SEC ) on February 29, 2012 and the consolidated financial statements and notes thereto included in the Company s 2012 Current Report on Form 8-K ( DAC Current Report ) filed with the SEC on July 13, 2012.

In October 2010, the Financial Accounting Standards Board ( FASB ) amended the general accounting principles for *Financial Services Insurance* as it relates to accounting for costs associated with acquiring or renewing insurance contracts. This amendment clarified that only those costs that result directly from and are essential to the contract transaction and that would not have been incurred had the contract transaction not occurred can be capitalized. It also defined acquisitions costs as costs that are related directly to the successful acquisitions of new or renewal insurance contracts.

The Company filed the DAC Current Report in response to its adoption of the amendment described above on January 1, 2012 on a retrospective basis. The DAC Current Report reflects the impact of the adoption of this amendment on the Company s previously filed financial statements and other disclosures included in the 2011 Annual Report, including that (i) only cost related directly to the successful acquisition of new or renewal contracts can be capitalized as deferred acquisition costs and (ii) all other acquisition-related costs must be expensed as incurred. In connection therewith, the Company adjusted the presentation of certain prior-period information to conform to the new accounting principles. The Company believes retrospective adoption provides the most comparable and useful financial information for financial statement users. Likewise, the financial statements and notes thereto presented in this Quarterly Report on Form 10-Q have been adjusted to reflect the retrospective adoption of these accounting principles.

The following tables present the effects of the retrospective adoption of the new accounting principles to the Company s previously reported condensed consolidated statement of income and condensed consolidated statement of cash flows for the three and six months ended June 30, 2011 (in thousands, except share amounts):

|   | As Reported | Three months ended June 30, 2011 |    | As Amended |
|---|-------------|----------------------------------|----|------------|
|   |             | Adjustments                      |    |            |
| <b>Benefits and Expenses:</b>                         |             |                                  |    |            |
| Policy acquisition costs and other insurance expenses | \$ 261,282  | \$ 13,237                        | \$ | 274,519    |
| Income before income taxes                            | 200,406     | (13,237)                         |    | 187,169    |
| Provision for income taxes                            | 67,518      | (4,293)                          |    | 63,225     |
| Net income  | \$ 132,888  | \$ (8,944)                       | \$ | 123,944    |

**Earnings per share:**

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|                            |    |      |    |        |    |      |
|----------------------------|----|------|----|--------|----|------|
| Basic earnings per share   | \$ | 1.80 | \$ | (0.12) | \$ | 1.68 |
| Diluted earnings per share | \$ | 1.78 | \$ | (0.12) | \$ | 1.66 |

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|   | Six months ended June 30, 2011 |             |            |
|---|--------------------------------|-------------|------------|
|   | As Reported                    | Adjustments | As Amended |
| <b>Benefits and Expenses:</b>                         |                                |             |            |
| Policy acquisition costs and other insurance expenses | \$ 592,435                     | \$ 28,331   | \$ 620,766 |
| Income before income taxes                            | 442,255                        | (28,331)    | 413,924    |
| Provision for income taxes                            | 148,551                        | (7,491)     | 141,060    |
| Net income  | \$ 293,704                     | \$ (20,840) | \$ 272,864 |

**Earnings per share:**

|                            |         |           |         |
|----------------------------|---------|-----------|---------|
| Basic earnings per share   | \$ 3.99 | \$ (0.28) | \$ 3.71 |
| Diluted earnings per share | \$ 3.96 | \$ (0.28) | \$ 3.68 |

|  | Six months ended June 30, 2011 |             |            |
|--|--------------------------------|-------------|------------|
|  | As Reported                    | Adjustments | As Amended |
| <b>Cash Flows from Operating Activities:</b> |                                |             |            |
| Net Income                                   | \$ 293,704                     | \$ (20,840) | \$ 272,864 |
| Change in operating assets and liabilities   |                                |             |            |
| Deferred policy acquisition costs            | 33,008                         | 28,331      | 61,339     |
| Deferred income taxes                        | (34,698)                       | (7,491)     | (42,189)   |

**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<br>June 30, |            | Six months ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2012                           | 2011       | 2012                         | 2011       |
| <b>Earnings:</b>  |                                |            |                              |            |
| Net income (numerator for basic and diluted calculations)               | \$ 141,111                     | \$ 123,944 | \$ 264,429                   | \$ 272,864 |
| <b>Shares:</b>  |                                |            |                              |            |
| Weighted average outstanding shares (denominator for basic calculation) | 73,718                         | 73,971     | 73,646                       | 73,593     |
| Equivalent shares from outstanding stock options <sup>(1)</sup>         | 336                            | 559        | 402                          | 591        |
| Denominator for diluted calculation                                     | 74,054                         | 74,530     | 74,048                       | 74,184     |
| <b>Earnings per share:</b>  |                                |            |                              |            |
| Basic   | \$ 1.91                        | \$ 1.68    | \$ 3.59                      | \$ 3.71    |
| Diluted   | \$ 1.91                        | \$ 1.66    | \$ 3.57                      | \$ 3.68    |

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

The calculation of common equivalent shares does not include the impact of options 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, 2012, approximately 1.8 million stock options and approximately 0.7 million performance contingent shares were excluded from the calculation. For the three months ended June 30, 2011, no stock options and approximately 0.8 million performance contingent shares were excluded from the calculation.

**Table of Contents****3. Accumulated Other Comprehensive Income**

The balance of and changes in each component of accumulated other comprehensive income ( AOCI ) for the six months ended June 30, 2012 and 2011 are as follows (dollars in thousands):

|                                       | Accumulated Other Comprehensive Income (Loss), Net of Income Tax |   |   |    | Total     |
|---------------------------------------|--|---|---|----|-----------|
|                                       | Accumulated<br>Currency<br>Translation<br>Adjustments            | Unrealized<br>Appreciation<br>of Securities | Pension and<br>Postretirement<br>Benefits |    |           |
| Balance, December 31, 2011            | \$ 229,795   | \$ 1,419,318                                | \$ (30,960)                               | \$ | 1,618,153 |
| Change in component during the period | 7,215  | 172,329                                     | 1,501                                     |    | 181,045   |
| Balance, June 30, 2012                | \$ 237,010   | \$ 1,591,647                                | \$ (29,459)                               | \$ | 1,799,198 |

|                                       | Accumulated Other Comprehensive Income (Loss), Net of Income Tax |   |   |    | Total     |
|---------------------------------------|--|---|---|----|-----------|
|                                       | Accumulated<br>Currency<br>Translation<br>Adjustments            | Unrealized<br>Appreciation<br>of Securities | Pension and<br>Postretirement<br>Benefits |    |           |
| Balance, December 31, 2010            | \$ 255,295   | \$ 651,449                                  | \$ (14,560)                               | \$ | 892,184   |
| Change in component during the period | 35,894   | 115,574                                     | 572                                       |    | 152,040   |
| Balance, June 30, 2011                | \$ 291,189   | \$ 767,023                                  | \$ (13,988)                               | \$ | 1,044,224 |

**4. Investments**

The Company had total cash and invested assets of \$32.5 billion and \$25.9 billion at June 30, 2012 and December 31, 2011, respectively, as illustrated below (dollars in thousands):

|   | June 30, 2012 | December 31, 2011 |
|---|---------------|-------------------|
| Fixed maturity securities, available-for-sale | \$ 17,244,192 | \$ 16,200,950     |
| Mortgage loans on real estate                 | 1,157,049     | 991,731           |
| Policy loans                                  | 1,250,238     | 1,260,400         |
| Funds withheld at interest                    | 5,457,888     | 5,410,424         |
| Short-term investments                        | 49,981        | 88,566            |
| Investment receivable                         | 5,406,898     | --                |
| Other invested assets                         | 940,605       | 1,012,541         |
| Cash and cash equivalents                     | 957,341       | 962,870           |
| Total cash and invested assets                | \$ 32,464,192 | \$ 25,927,482     |

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 securities 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 portfolios, when consolidated, ranges between eight and ten years.

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The Company participates in a securities borrowing program whereby securities, which are not reflected on the Company's condensed consolidated balance sheets, are borrowed from a third party. The Company is required to maintain a minimum of 100% of the market value of the borrowed securities as collateral. The Company had borrowed securities with an amortized cost and an estimated fair value of \$237.5 million and \$150.0 million as of June 30, 2012 and December 31, 2011, respectively. The borrowed securities are used to provide collateral under an affiliated reinsurance transaction.

**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<br>June 30, |            | Six months ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2012                           | 2011       | 2012                         | 2011       |
| Fixed maturity securities available-for-sale | \$ 193,388                     | \$ 191,030 | \$ 384,806                   | \$ 375,591 |
| Mortgage loans on real estate                | 16,000                         | 13,593     | 30,966                       | 27,328     |
| Policy loans                                 | 16,334                         | 16,724     | 33,117                       | 33,095     |
| Funds withheld at interest                   | 62,992                         | 111,700    | 178,006                      | 264,760    |
| Short-term investments                       | 781                            | 883        | 1,769                        | 1,808      |
| Investment receivable                        | 36,752                         | -          | 36,752                       | -          |
| Other invested assets                        | 11,356                         | 10,512     | 22,679                       | 20,210     |
| Investment revenue                           | 337,603                        | 344,442    | 688,095                      | 722,792    |
| Investment expense                           | (9,269)                        | (7,006)    | (18,821)                     | (14,316)   |
| Investment income, net of related expenses   | \$ 328,334                     | \$ 337,436 | \$ 669,274                   | \$ 708,476 |

*Investment Related Gains (Losses), Net*

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

|   | Three months ended<br>June 30, |            | Six months ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2012                           | 2011       | 2012                         | 2011       |
| Fixed maturity and equity securities available for sale:                              |                                |            |                              |            |
| Other-than-temporary impairment losses on fixed maturities                            | \$ (1,959)                     | \$ (5,582) | \$ (9,566)                   | \$ (7,138) |
| Portion of loss recognized in accumulated other comprehensive income (before taxes)   | 162                            | 292        | (7,059)                      | 292        |
| Net other-than-temporary impairment losses on fixed maturities recognized in earnings | (1,797)                        | (5,290)    | (16,625)                     | (6,846)    |
| Impairment losses on equity securities  | (2,186)                        | (3,680)    | (3,025)                      | (3,680)    |
| Gain on investment activity   | 26,593                         | 28,208     | 48,905                       | 57,584     |
| Loss on investment activity   | (8,918)                        | (6,653)    | (16,422)                     | (13,567)   |
| Other impairment losses and change in mortgage loan provision                         | 1,762                          | (3,186)    | (4,081)                      | (2,610)    |
| Derivatives and other, net  | 8,347                          | 17,989     | 58,569                       | 120,127    |
| Total investment related gains (losses), net  | \$ 23,801                      | \$ 27,388  | \$ 67,321                    | \$ 151,008 |

The net other-than-temporary impairment losses on fixed maturity securities recognized in earnings of \$16.6 million and \$6.8 million in the first six months of 2012 and 2011, respectively, are primarily due to a decline in value of structured securities with exposure to commercial mortgages and general credit deterioration in select corporate and foreign securities. The decreases in derivatives and other for the three and six months ended June 30, 2012 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, 2012 and 2011, the Company sold fixed maturity and equity securities with fair values of \$153.5 million and \$135.0 million at losses of \$8.9 million and \$6.7 million, respectively. During the six months ended June 30, 2012 and 2011, the Company sold fixed maturity and equity securities with fair values of \$401.6 million and \$331.6 million at losses of \$16.4 million and \$13.6 million, respectively. The Company generally does not engage in short-term buying and selling of securities.

*Other-Than-Temporary Impairments*

As discussed in Note 2 Summary of Significant Accounting Policies of the DAC Current Report, a portion of certain other-than-temporary impairment ( OTTI ) losses on fixed maturity securities are recognized in AOCI. For these securities the net amount recognized in earnings ( credit loss impairments ) represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in AOCI. The following table sets forth the amount of pre-tax credit loss impairments on fixed maturity securities held by the Company as of the dates indicated, for which a portion of the OTTI loss was recognized in AOCI, and the corresponding changes in such amounts (dollars in thousands):



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|   | Three months ended June 30, |           |
|---|-----------------------------|-----------|
|   | 2012                        | 2011      |
| Balance, beginning of period  | \$ 62,236                   | \$ 47,949 |
| Initial impairments - credit loss OTTI recognized on securities not previously impaired                               | 60                          | 1,473     |
| Additional impairments - credit loss OTTI recognized on securities previously impaired                                | 161                         | 3,780     |
| Credit loss OTTI previously recognized on securities impaired to fair value during the period                         | (8,288)                     | --        |
| Credit loss OTTI previously recognized on securities which matured, paid down, prepaid or were sold during the period | (8,266)                     | (718)     |
| Balance, end of period  | \$ 45,903                   | \$ 52,484 |

|   | Six months ended June 30, |           |
|---|---------------------------|-----------|
|   | 2012                      | 2011      |
| Balance, beginning of period  | \$ 63,947                 | \$ 47,291 |
| Initial impairments - credit loss OTTI recognized on securities not previously impaired                               | 1,962                     | 1,473     |
| Additional impairments - credit loss OTTI recognized on securities previously impaired                                | 8,881                     | 4,438     |
| Credit loss OTTI previously recognized on securities impaired to fair value during the period                         | (19,669)                  | --        |
| Credit loss OTTI previously recognized on securities which matured, paid down, prepaid or were sold during the period | (9,218)                   | (718)     |
| Balance, end of period  | \$ 45,903                 | \$ 52,484 |

*Fixed Maturity and Equity Securities Available-for-Sale*

The following tables provide information relating to investments in fixed maturity and equity securities by sector as of June 30, 2012 and December 31, 2011 (dollars in thousands):

| <b>June 30, 2012:</b>  | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair<br>Value | % of<br>Total | Other-than-<br>temporary<br>impairments<br>in AOCI |
|--|-------------------|---------------------|----------------------|----------------------------|---------------|--|
| <b>Available-for-sale:</b>   |                   |                     |                      |                            |               |  |
| Corporate securities   | \$ 7,675,473      | \$ 792,051          | \$ 65,615            | \$ 8,401,909               | 48.7 %        | \$ --  |
| Canadian and Canadian provincial governments   | 2,579,161         | 1,350,301           | 88                   | 3,929,374                  | 22.8          | --   |
| Residential mortgage-backed securities   | 1,007,793         | 78,727              | 7,958                | 1,078,562                  | 6.3           | (520)  |
| Asset-backed securities  | 469,616           | 12,746              | 41,311               | 441,051                    | 2.6           | (3,521)  |
| Commercial mortgage-backed securities  | 1,308,668         | 107,284             | 67,905               | 1,348,047                  | 7.8           | (6,119)  |
| U.S. government and agencies   | 218,164           | 31,761              | 11                   | 249,914                    | 1.4           | --   |
| State and political subdivisions   | 204,108           | 34,066              | 8,398                | 229,776                    | 1.3           | --   |
| Other foreign government, supranational and foreign government-sponsored enterprises | 1,494,182         | 73,916              | 2,539                | 1,565,559                  | 9.1           | --   |
| Total fixed maturity securities  | \$ 14,957,165     | \$ 2,480,852        | \$ 193,825           | \$ 17,244,192              | 100.0 %       | \$ (10,160)  |
| Non-redeemable preferred stock   | \$ 73,265         | \$ 5,170            | \$ 2,465             | \$ 75,970                  | 95.9 %        |  |
| Other equity securities  | 2,235             | 1,001               | 9                    | 3,227                      | 4.1           |  |
| Total equity securities  | \$ 75,500         | \$ 6,171            | \$ 2,474             | \$ 79,197                  | 100.0 %       |  |

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| <b>December 31, 2011:</b>  | Amortized<br>Cost    | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair<br>Value | % of<br>Total  | Other-than-<br>temporary<br>impairments<br>in AOCI |
|--|----------------------|---------------------|----------------------|----------------------------|----------------|--|
| <b>Available-for-sale:</b>   |                      |                     |                      |                            |                |  |
| Corporate securities   | \$ 6,931,958         | \$ 654,519          | \$ 125,371           | \$ 7,461,106               | 46.0 %         | \$ --  |
| Canadian and Canadian provincial governments   | 2,507,802            | 1,362,160           | 29                   | 3,869,933                  | 23.9           | --   |
| Residential mortgage-backed securities   | 1,167,265            | 76,393              | 16,424               | 1,227,234                  | 7.6            | (1,042)  |
| Asset-backed securities  | 443,974              | 11,692              | 53,675               | 401,991                    | 2.5            | (5,256)  |
| Commercial mortgage-backed securities  | 1,233,958            | 87,750              | 79,489               | 1,242,219                  | 7.7            | (12,225)   |
| U.S. government and agencies   | 341,087              | 32,976              | 61                   | 374,002                    | 2.3            | --   |
| State and political subdivisions   | 184,308              | 24,419              | 3,341                | 205,386                    | 1.3            | --   |
| Other foreign government, supranational and foreign government-sponsored enterprises | 1,372,528            | 50,127              | 3,576                | 1,419,079                  | 8.7            | --   |
| <b>Total fixed maturity securities</b>   | <b>\$ 14,182,880</b> | <b>\$ 2,300,036</b> | <b>\$ 281,966</b>    | <b>\$ 16,200,950</b>       | <b>100.0 %</b> | <b>\$ (18,523)</b>                                 |
| <b>Non-redeemable preferred stock</b>  | <b>\$ 82,488</b>     | <b>\$ 4,677</b>     | <b>\$ 8,982</b>      | <b>\$ 78,183</b>           | <b>68.6 %</b>  |  |
| <b>Other equity securities</b>   | <b>35,352</b>        | <b>1,903</b>        | <b>1,538</b>         | <b>35,717</b>              | <b>31.4</b>    |  |
| <b>Total equity securities</b>   | <b>\$ 117,840</b>    | <b>\$ 6,580</b>     | <b>\$ 10,520</b>     | <b>\$ 113,900</b>          | <b>100.0 %</b> |  |

The Company enters into various collateral arrangements that require both the pledging and acceptance of fixed maturity securities as collateral, which are excluded from the tables above. The Company pledged fixed maturity securities as collateral to derivative and reinsurance counterparties with an amortized cost of \$23.3 million and \$29.0 million, and an estimated fair value of \$26.4 million and \$32.6 million, as of June 30, 2012 and December 31, 2011 respectively, which are included in other invested assets in the condensed consolidated balance sheets.

The Company received fixed maturity securities as collateral from derivative and reinsurance counterparties with an estimated fair value of \$31.4 million and \$1.0 million, as of June 30, 2012 and December 31, 2011, respectively. Subject to certain constraints, the Company is permitted by contract to sell or re-pledge this collateral; however, as of June 30, 2012 and December 31, 2011, none of the collateral had been sold or re-pledged.

As of June 30, 2012, the Company held securities with a fair value of \$1,185.1 million that were issued by the Canadian province of Ontario and \$1,129.0 million that were issued by an entity that is guaranteed by the Canadian province of Quebec, both of which exceeded 10% of total stockholders' equity. As of December 31, 2011, the Company held securities with a fair value of \$1,171.2 million that were issued by the Canadian province of Ontario and \$1,107.7 million that were issued by an entity that is guaranteed by the Canadian province of Quebec, both of which exceeded 10% of total stockholders' equity.

The amortized cost and estimated fair value of fixed maturity securities available-for-sale at June 30, 2012 are shown by contractual maturity in the table below. Actual maturities can differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. At June 30, 2012, the contractual maturities of investments in fixed maturity securities were as follows (dollars in thousands):

|                                       | Amortized<br>Cost    | Fair<br>Value        |
|---------------------------------------|----------------------|----------------------|
| <b>Available-for-sale:</b>            |                      |                      |
| Due in one year or less               | \$ 153,228           | \$ 155,606           |
| Due after one year through five years | 2,734,890            | 2,866,290            |
| Due after five year through ten years | 4,269,704            | 4,695,994            |
| Due after ten years                   | 5,013,266            | 6,658,641            |
| Asset and mortgage-backed securities  | 2,786,077            | 2,867,661            |
| <b>Total</b>                          | <b>\$ 14,957,165</b> | <b>\$ 17,244,192</b> |



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The tables below show the major industry types of the Company's corporate fixed maturity holdings as of June 30, 2012 and December 31, 2011 (dollars in thousands):

**June 30, 2012:**

|              | Amortized Cost      | Estimated<br>Fair Value | % of Total    |
|--------------|---------------------|-------------------------|---------------|
| Finance      | \$ 2,618,913        | \$ 2,762,847            | 32.9%         |
| Industrial   | 3,834,519           | 4,257,907               | 50.7          |
| Utility      | 1,213,333           | 1,372,024               | 16.3          |
| Other        | 8,708               | 9,131                   | 0.1           |
| <b>Total</b> | <b>\$ 7,675,473</b> | <b>\$ 8,401,909</b>     | <b>100.0%</b> |

**December 31, 2011:**

|              | Amortized Cost      | Estimated<br>Fair Value | % of Total    |
|--------------|---------------------|-------------------------|---------------|
| Finance      | \$ 2,411,175        | \$ 2,442,149            | 32.7%         |
| Industrial   | 3,402,099           | 3,760,187               | 50.4          |
| Utility      | 1,115,384           | 1,255,090               | 16.9          |
| Other        | 3,300               | 3,680                   | -             |
| <b>Total</b> | <b>\$ 6,931,958</b> | <b>\$ 7,461,106</b>     | <b>100.0%</b> |

The creditworthiness of Greece, Ireland, Italy, Portugal and Spain, commonly referred to as Europe's peripheral region, is under ongoing stress and uncertainty due to high debt levels and economic weakness. The Company did not have exposure to sovereign fixed maturity securities, which includes global government agencies, from Europe's peripheral region as of June 30, 2012 and December 31, 2011. In addition, the Company did not purchase or sell credit protection, through credit default swaps, referenced to sovereign entities of Europe's peripheral region. The tables below show the Company's exposure to sovereign fixed maturity securities originated in countries other than Europe's peripheral region, included in Other foreign government, supranational and foreign government-sponsored enterprises, as of June 30, 2012 and December 31, 2011 (dollars in thousands):

**June 30, 2012:**

|                | Amortized Cost      | Estimated<br>Fair Value | % of Total     |
|----------------|---------------------|-------------------------|----------------|
| Australia      | \$ 475,097          | \$ 490,913              | 37.2%          |
| Japan          | 214,420             | 220,390                 | 16.7           |
| United Kingdom | 124,547             | 136,672                 | 10.3           |
| South Africa   | 66,353              | 68,691                  | 5.2            |
| New Zealand    | 52,684              | 53,231                  | 4.0            |
| Cayman Islands | 48,133              | 53,013                  | 4.0            |
| Germany        | 40,406              | 42,863                  | 3.2            |
| Other          | 236,277             | 256,300                 | 19.4           |
| <b>Total</b>   | <b>\$ 1,257,917</b> | <b>\$ 1,322,073</b>     | <b>100.0 %</b> |

**December 31, 2011:**

|                | Amortized Cost | Estimated<br>Fair Value | % of Total |
|----------------|----------------|-------------------------|------------|
| Australia      | \$ 437,713     | \$ 446,694              | 39.1%      |
| Japan          | 214,994        | 219,276                 | 19.2       |
| United Kingdom | 118,618        | 130,106                 | 11.4       |
| Germany        | 72,926         | 75,741                  | 6.6        |
| New Zealand    | 51,547         | 51,544                  | 4.5        |

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|              |                     |                     |               |
|--------------|---------------------|---------------------|---------------|
| South Africa | 37,624              | 38,528              | 3.4           |
| South Korea  | 30,592              | 32,025              | 2.8           |
| Other        | 139,927             | 148,792             | 13.0          |
| <b>Total</b> | <b>\$ 1,103,941</b> | <b>\$ 1,142,706</b> | <b>100.0%</b> |

The tables below show the Company's exposure to non-sovereign fixed maturity and equity securities, based on the security's country of issuance, from Europe's peripheral region as of June 30, 2012 and December 31, 2011 (dollars in thousands):

**Table of Contents****June 30, 2012:**

|                                | Amortized Cost | Estimated Fair Value | % of Total |
|--------------------------------|----------------|----------------------|------------|
| <b>Financial institutions:</b> |                |                      |            |
| Ireland                        | \$ 3,477       | \$ 3,864             | 6.1%       |
| Spain                          | 23,486         | 20,865               | 32.9       |
| Total financial institutions   | 26,963         | 24,729               | 39.0       |
| <b>Other:</b>                  |                |                      |            |
| Ireland                        | 12,476         | 13,042               | 20.6       |
| Italy                          | 3,544          | 3,438                | 5.4        |
| Spain                          | 24,420         | 22,148               | 35.0       |
| Total other                    | 40,440         | 38,628               | 61.0       |
| Total                          | \$ 67,403      | \$ 63,357            | 100.0%     |

**December 31, 2011:**

|                                | Amortized Cost | Estimated Fair Value | % of Total |
|--------------------------------|----------------|----------------------|------------|
| <b>Financial institutions:</b> |                |                      |            |
| Ireland                        | \$ 4,084       | \$ 4,397             | 5.9%       |
| Spain                          | 25,565         | 20,378               | 27.6       |
| Total financial institutions   | 29,649         | 24,775               | 33.5       |
| <b>Other:</b>                  |                |                      |            |
| Ireland                        | 12,474         | 13,149               | 17.8       |
| Italy                          | 2,898          | 2,808                | 3.8        |
| Spain                          | 34,459         | 33,137               | 44.9       |
| Total other                    | 49,831         | 49,094               | 66.5       |
| Total                          | \$ 79,480      | \$ 73,869            | 100.0%     |

*Unrealized Losses for Fixed Maturity and Equity Securities Available-for-Sale*

The following table presents the total gross unrealized losses for the 752 and 940 fixed maturity and equity securities as of June 30, 2012 and December 31, 2011, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (dollars in thousands):

|                                       | June 30, 2012     |            | December 31, 2011 |            |
|---------------------------------------|-------------------|------------|-------------------|------------|
|                                       | Gross             |            | Gross             |            |
|                                       | Unrealized Losses | % of Total | Unrealized Losses | % of Total |
| Less than 20%                         | \$ 77,198         | 39.3%      | \$ 131,155        | 44.8%      |
| 20% or more for less than six months  | 6,739             | 3.4        | 51,503            | 17.6       |
| 20% or more for six months or greater | 112,362           | 57.3       | 109,828           | 37.6       |
| Total                                 | \$ 196,299        | 100.0%     | \$ 292,486        | 100.0%     |

As of June 30, 2012 and December 31, 2011, respectively, 58.4% and 65.3% of these gross unrealized losses were associated with investment grade securities. The unrealized losses on these securities decreased primarily due to a decline in interest rates since December 31, 2011.

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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 Company believes that due to fluctuating market conditions and an extended period of economic uncertainty, the extent and duration of a decline in value have become less indicative of when there has been credit deterioration with respect to a fixed maturity security since it may not have an impact on the ability of the issuer to service all scheduled payments and the Company's evaluation of the recoverability of all contractual cash flows or the ability to recover an amount at least equal to amortized cost. In the Company's impairment review process, the duration and severity of an unrealized loss position for equity securities are given greater weight and consideration given the lack of contractual cash flows or deferability features.

The following tables present the estimated fair values and gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, for 752 and 940 fixed maturity and equity securities that have estimated fair values below amortized cost as of June 30, 2012 and December 31, 2011, 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.

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|  | Less than 12 months |                  | 12 months or greater |                   | Total               |                   |
|--|---------------------|------------------|----------------------|-------------------|---------------------|-------------------|
|  | Estimated           | Gross            | Estimated            | Gross             | Estimated           | Gross             |
|  |                     | Unrealized       |                      | Unrealized        |                     | Unrealized        |
|  | Fair Value          | Losses           | Fair Value           | Losses            | Fair Value          | Losses            |
| <b>June 30, 2012:</b>  |                     |                  |                      |                   |                     |                   |
| <b>Investment grade securities:</b>  |                     |                  |                      |                   |                     |                   |
| Corporate securities   | \$ 397,287          | \$ 12,765        | \$ 299,074           | \$ 41,570         | \$ 696,361          | \$ 54,335         |
| Canadian and Canadian provincial governments   | 10,573              | 88               | --                   | --                | 10,573              | 88                |
| Residential mortgage-backed securities   | 36,106              | 425              | 54,545               | 6,573             | 90,651              | 6,998             |
| Asset-backed securities  | 59,722              | 938              | 101,011              | 24,734            | 160,733             | 25,672            |
| Commercial mortgage-backed securities  | 129,450             | 2,590            | 73,130               | 12,757            | 202,580             | 15,347            |
| U.S. government and agencies   | 4,004               | 11               | --                   | --                | 4,004               | 11                |
| State and political subdivisions   | 24,191              | 2,532            | 18,688               | 5,866             | 42,879              | 8,398             |
| Other foreign government, supranational and foreign government-sponsored enterprises | 79,976              | 465              | 33,620               | 1,449             | 113,596             | 1,914             |
| <b>Total investment grade securities</b>   | <b>741,309</b>      | <b>19,814</b>    | <b>580,068</b>       | <b>92,949</b>     | <b>1,321,377</b>    | <b>112,763</b>    |
| <b>Non-investment grade securities:</b>  |                     |                  |                      |                   |                     |                   |
| Corporate securities   | 135,253             | 4,001            | 49,063               | 7,279             | 184,316             | 11,280            |
| Residential mortgage-backed securities   | 2,025               | 178              | 9,858                | 782               | 11,883              | 960               |
| Asset-backed securities  | 7                   | 18               | 19,374               | 15,621            | 19,381              | 15,639            |
| Commercial mortgage-backed securities  | 12,483              | 1,218            | 73,062               | 51,340            | 85,545              | 52,558            |
| Other foreign government, supranational and foreign government-sponsored enterprises | 11,779              | 625              | --                   | --                | 11,779              | 625               |
| <b>Total non-investment grade securities</b>   | <b>161,547</b>      | <b>6,040</b>     | <b>151,357</b>       | <b>75,022</b>     | <b>312,904</b>      | <b>81,062</b>     |
| <b>Total fixed maturity securities</b>   | <b>\$ 902,856</b>   | <b>\$ 25,854</b> | <b>\$ 731,425</b>    | <b>\$ 167,971</b> | <b>\$ 1,634,281</b> | <b>\$ 193,825</b> |
| Non-redeemable preferred stock   | \$ 1,743            | \$ 245           | \$ 17,280            | \$ 2,220          | \$ 19,023           | \$ 2,465          |
| Other equity securities  | --                  | --               | 309                  | 9                 | 309                 | 9                 |
| <b>Total equity securities</b>   | <b>\$ 1,743</b>     | <b>\$ 245</b>    | <b>\$ 17,589</b>     | <b>\$ 2,229</b>   | <b>\$ 19,332</b>    | <b>\$ 2,474</b>   |
| <b>December 31, 2011:</b>  |                     |                  |                      |                   |                     |                   |
| <b>Investment grade securities:</b>  |                     |                  |                      |                   |                     |                   |
| Corporate securities   | \$ 790,758          | \$ 40,180        | \$ 286,244           | \$ 63,117         | \$ 1,077,002        | \$ 103,297        |
| Canadian and Canadian provincial governments   | 3,094               | 29               | --                   | --                | 3,094               | 29                |
| Residential mortgage-backed securities   | 128,622             | 3,549            | 58,388               | 10,382            | 187,010             | 13,931            |
| Asset-backed securities  | 101,263             | 3,592            | 93,910               | 29,036            | 195,173             | 32,628            |
| Commercial mortgage-backed securities  | 109,455             | 3,538            | 58,979               | 22,001            | 168,434             | 25,539            |
| U.S. government and agencies   | 1,764               | 61               | --                   | --                | 1,764               | 61                |
| State and political subdivisions   | 21,045              | 1,845            | 12,273               | 1,268             | 33,318              | 3,113             |
| Other foreign government, supranational and foreign government-sponsored enterprises | 148,416             | 1,085            | 16,588               | 2,491             | 165,004             | 3,576             |
| <b>Total investment grade securities</b>   | <b>1,304,417</b>    | <b>53,879</b>    | <b>526,382</b>       | <b>128,295</b>    | <b>1,830,799</b>    | <b>182,174</b>    |
| <b>Non-investment grade securities:</b>  |                     |                  |                      |                   |                     |                   |
| Corporate securities   | 212,795             | 10,852           | 47,310               | 11,222            | 260,105             | 22,074            |
| Residential mortgage-backed securities   | 23,199              | 712              | 10,459               | 1,781             | 33,658              | 2,493             |



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|  |                  |                 |                  |                 |                  |                  |
|--|------------------|-----------------|------------------|-----------------|------------------|------------------|
| Asset-backed securities                      | 2,363            | 940             | 21,275           | 20,107          | 23,638           | 21,047           |
| Commercial mortgage-backed securities        | 34,918           | 7,220           | 62,357           | 46,730          | 97,275           | 53,950           |
| State and political subdivisions             | 4,000            | 228             | --               | --              | 4,000            | 228              |
| <b>Total non-investment grade securities</b> | <b>277,275</b>   | <b>19,952</b>   | <b>141,401</b>   | <b>79,840</b>   | <b>418,676</b>   | <b>99,792</b>    |
| Total fixed maturity securities              | \$ 1,581,692     | \$ 73,831       | \$ 667,783       | \$ 208,135      | \$ 2,249,475     | \$ 281,966       |
| Non-redeemable preferred stock               | \$ 19,516        | \$ 4,478        | \$ 15,694        | \$ 4,504        | \$ 35,210        | \$ 8,982         |
| Other equity securities                      | 1,662            | 602             | 5,905            | 936             | 7,567            | 1,538            |
| <b>Total equity securities</b>               | <b>\$ 21,178</b> | <b>\$ 5,080</b> | <b>\$ 21,599</b> | <b>\$ 5,440</b> | <b>\$ 42,777</b> | <b>\$ 10,520</b> |

As of June 30, 2012, 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, unforeseen facts and circumstances may cause the Company to sell fixed maturity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality, asset-liability management and liquidity guidelines.

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As of June 30, 2012, 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, unforeseen facts and circumstances may cause the Company to sell equity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality and liquidity guidelines.

Unrealized losses on non-investment grade securities are principally related to asset-backed securities, residential mortgage-backed securities and commercial mortgage-backed securities and were the result of wider credit spreads resulting from higher risk premiums since the time of initial purchase, largely due to macroeconomic conditions and credit market deterioration, including the impact of lower real estate valuations. As of June 30, 2012 and December 31, 2011, approximately \$67.7 million and \$68.6 million, respectively, of gross unrealized losses greater than 12 months was associated with non-investment grade asset and mortgage-backed securities. This class of securities was evaluated based on actual and projected collateral losses relative to the securities positions in the respective securitization trusts and security specific expectations of cash flows. 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, and (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.

*Mortgage Loans on Real Estate*

Mortgage loans represented approximately 3.6% and 3.8% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively. The Company makes mortgage loans on income producing properties, such as apartments, retail and office buildings, light warehouses and light industrial facilities. Loan-to-value ratios at the time of loan approval are 75% or less.

Information regarding the Company's credit quality indicators for its recorded investment in mortgage loans, gross of valuation allowances, as of June 30, 2012 and December 31, 2011 is as follows (dollars in thousands):

| Internal credit risk grade: | June 30, 2012 | December 31, 2011 |
|-----------------------------|---------------|-------------------|
| High investment grade       | \$ 306,845    | \$ 252,333        |
| Investment grade            | 656,968       | 526,608           |
| Average                     | 92,668        | 105,177           |
| Watch list                  | 95,727        | 91,037            |
| In or near default          | 15,852        | 28,369            |
| Total                       | \$ 1,168,060  | \$ 1,003,524      |

The age analysis of the Company's past due recorded investment in mortgage loans, gross of valuation allowances, as of June 30, 2012 and December 31, 2011 is as follows (dollars in thousands):

|                      | June 30, 2012 | December 31, 2011 |
|----------------------|---------------|-------------------|
| 31-60 days past due  | \$ 18,211     | \$ 21,800         |
| 61-90 days past due  | 3,610         | --                |
| Greater than 90 days | 14,367        | 20,316            |
| Total past due       | 36,188        | 42,116            |
| Current              | 1,131,872     | 961,408           |
| Total                | \$ 1,168,060  | \$ 1,003,524      |

The following table presents the recorded investment in mortgage loans, by method of evaluation of credit loss, and the related valuation allowances, by type of credit loss, at (dollars in thousands):

| June 30, 2012 | December 31, 2011 |
|---------------|-------------------|
|---------------|-------------------|

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|   |              |            |
|---|--------------|------------|
| Mortgage loans:                               |              |            |
| Evaluated individually for credit losses      | \$ 47,808    | \$ 60,904  |
| Evaluated collectively for credit losses      | 1,120,252    | 942,620    |
| Mortgage loans, gross of valuation allowances | 1,168,060    | 1,003,524  |
| Valuation allowances:                         |              |            |
| Specific for credit losses                    | 6,959        | 8,188      |
| Non-specifically identified credit losses     | 4,052        | 3,605      |
| Total valuation allowances                    | 11,011       | 11,793     |
| Mortgage loans, net of valuation allowances   | \$ 1,157,049 | \$ 991,731 |

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Information regarding the Company's loan valuation allowances for mortgage loans for the three months ended June 30, 2012 and 2011 is as follows (dollars in thousands):

|                              | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|------------------------------|-----------------------------|----------|---------------------------|----------|
|                              | 2012                        | 2011     | 2012                      | 2011     |
| Balance, beginning of period | \$ 14,650                   | \$ 5,664 | \$ 11,793                 | \$ 6,239 |
| Charge-offs                  | (1,876)                     | (1,157)  | (4,069)                   | (1,157)  |
| Provision (release)          | (1,763)                     | 3,185    | 3,287                     | 2,610    |
| Balance, end of period       | \$ 11,011                   | \$ 7,692 | \$ 11,011                 | \$ 7,692 |

Information regarding the portion of the Company's mortgage loans that were impaired as of June 30, 2012 and December 31, 2011 is as follows (dollars in thousands):

|  | Unpaid            |           | Recorded Investment | Related Allowance | Carrying Value |
|--|-------------------|-----------|---------------------|-------------------|----------------|
|  | Principal Balance |           |                     |                   |                |
| <b>June 30, 2012:</b>  |                   |           |                     |                   |                |
| Impaired mortgage loans with no valuation allowance recorded | \$ 10,066         | \$ 9,523  | \$ --               | \$ 9,523          |                |
| Impaired mortgage loans with valuation allowance recorded    | 38,424            | 38,285    | 6,959               | 31,326            |                |
| Total impaired mortgage loans                                | \$ 48,490         | \$ 47,808 | \$ 6,959            | \$ 40,849         |                |
| <b>December 31, 2011:</b>                                    |                   |           |                     |                   |                |
| Impaired mortgage loans with no valuation allowance recorded | \$ 32,088         | \$ 31,496 | \$ --               | \$ 31,496         |                |
| Impaired mortgage loans with valuation allowance recorded    | 29,724            | 29,408    | 8,188               | 21,220            |                |
| Total impaired mortgage loans                                | \$ 61,812         | \$ 60,904 | \$ 8,188            | \$ 52,716         |                |

The Company's average investment in impaired mortgage loans and the related interest income are reflected in the table below for the periods indicated (dollars in thousands):

|  | Three Months Ended                |                 |                                   |                 |
|--|-----------------------------------|-----------------|-----------------------------------|-----------------|
|  | June 30, 2012                     |                 | June 30, 2011                     |                 |
|  | Average Investment <sup>(1)</sup> | Interest Income | Average Investment <sup>(1)</sup> | Interest Income |
| Impaired mortgage loans with no valuation allowance recorded | \$ 10,585                         | \$ 28           | \$ 12,720                         | \$ 51           |
| Impaired mortgage loans with valuation allowance recorded    | 41,747                            | 410             | 23,908                            | 209             |
| Total  | \$ 52,332                         | \$ 438          | \$ 36,628                         | \$ 260          |

|  | Six Months Ended                  |                 |                                   |                 |
|--|-----------------------------------|-----------------|-----------------------------------|-----------------|
|  | June 30, 2012                     |                 | June 30, 2011                     |                 |
|  | Average Investment <sup>(1)</sup> | Interest Income | Average Investment <sup>(1)</sup> | Interest Income |
| Impaired mortgage loans with no valuation allowance recorded | \$ 17,555                         | \$ 197          | \$ 14,114                         | \$ 93           |

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|   |                  |               |                  |               |
|---|------------------|---------------|------------------|---------------|
| Impaired mortgage loans with valuation allowance recorded | 37,634           | 718           | 22,187           | 453           |
| <b>Total</b>  | <b>\$ 55,189</b> | <b>\$ 915</b> | <b>\$ 36,301</b> | <b>\$ 546</b> |

(1) Average recorded investment represents the average loan balances as of the beginning of period and all subsequent quarterly end of period balances. The Company did not acquire any impaired mortgage loans during the six months ended June 30, 2012 and 2011. The Company had \$14.4 million and \$20.3 million of mortgage loans, gross of valuation allowances, that were on nonaccrual status at June 30, 2012 and December 31, 2011, respectively.

### *Investment Receivable*

During the second quarter of 2012, the Company added a large fixed deferred annuity reinsurance transaction in its U.S. Asset Intensive sub-segment. This transaction increased the Company's invested asset base by approximately \$5.4 billion which is reflected on the condensed consolidated balance sheet as an investment receivable. The transaction is considered a non-cash transaction in the condensed consolidated statement of cash flows. Investment receivable represented approximately 16.7% of the Company's cash and invested assets as of June 30, 2012 which represents cash, cash equivalents and invested assets, valued as of the effective date of the transaction, and the related accrued investment income expected to be received. The Company recorded these assets as a receivable since they were not received until July 31, 2012 and August 3, 2012, see Note 13 Subsequent Event for more information.

**Table of Contents***Other Invested Assets*

Other invested assets include equity securities, limited partnership interests, structured loans and derivative contracts. Other invested assets represented approximately 2.9% and 3.9% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively. Carrying values of these assets as of June 30, 2012 and December 31, 2011 are as follows (dollars in thousands):

|   | June 30, 2012 |                | December 31, 2011 |                  |
|---|---------------|----------------|-------------------|------------------|
| Equity securities                       | \$            | 79,197         | \$                | 113,900          |
| Limited partnerships and joint ventures |               | 300,385        |                   | 251,315          |
| Structured loans                        |               | 238,367        |                   | 281,022          |
| Derivatives                             |               | 250,460        |                   | 257,050          |
| Other                                   |               | 72,196         |                   | 109,254          |
| <b>Total other invested assets</b>      | <b>\$</b>     | <b>940,605</b> | <b>\$</b>         | <b>1,012,541</b> |

**5. Derivative Instruments**

The following table presents the notional amounts and fair value of derivative instruments as of June 30, 2012 and December 31, 2011 (dollars in thousands):

|  | Notional Amount     | June 30, 2012                    |                     | Notional Amount     | December 31, 2011                |                     |  |
|--|---------------------|----------------------------------|---------------------|---------------------|----------------------------------|---------------------|--|
|  |                     | Carrying Value/Fair Value Assets | Liabilities         |                     | Carrying Value/Fair Value Assets | Liabilities         |  |
| <b>Derivatives not designated as hedging instruments:</b>          |                     |                                  |                     |                     |                                  |                     |  |
| Interest rate swaps <sup>(1)</sup>                                 | \$ 2,875,588        | \$ 344,157                       | \$ 188,142          | \$ 2,748,317        | \$ 184,842                       | \$ 18,702           |  |
| Financial futures <sup>(1)</sup>                                   | 245,481             | --                               | --                  | 277,814             | --                               | --                  |  |
| Foreign currency forwards <sup>(1)</sup>                           | 44,400              | 3,275                            | --                  | 24,400              | 4,560                            | --                  |  |
| Consumer price index swaps <sup>(1)</sup>                          | 101,455             | 388                              | --                  | 101,069             | 766                              | --                  |  |
| Credit default swaps <sup>(1)</sup>                                | 644,500             | 990                              | 7,812               | 649,500             | 1,313                            | 10,949              |  |
| Equity options <sup>(1)</sup>                                      | 710,461             | 94,300                           | --                  | 510,073             | 90,106                           | --                  |  |
| Synthetic guaranteed investment contracts (GICs <sup>(1)</sup> )   | 1,003,914           | --                               | --                  | --                  | --                               | --                  |  |
| Embedded derivatives in:   |                     |                                  |                     |                     |                                  |                     |  |
| Modified coinsurance or funds withheld arrangements <sup>(2)</sup> | --                  | --                               | 375,337             | --                  | --                               | 361,456             |  |
| Indexed annuity products <sup>(3)</sup>                            | --                  | 4,416                            | 733,655             | --                  | 4,945                            | 751,523             |  |
| Variable annuity products <sup>(3)</sup>                           | --                  | --                               | 205,272             | --                  | --                               | 276,718             |  |
| <b>Total non-hedging derivatives</b>                               | <b>5,625,799</b>    | <b>447,526</b>                   | <b>1,510,218</b>    | <b>4,311,173</b>    | <b>286,532</b>                   | <b>1,419,348</b>    |  |
| <b>Derivatives designated as hedging instruments:</b>              |                     |                                  |                     |                     |                                  |                     |  |
| Interest rate swaps <sup>(1)</sup>                                 | 56,465              | 1,044                            | 325                 | 56,250              | 133                              | 960                 |  |
| Foreign currency swaps <sup>(1)</sup>                              | 646,653             | 236                              | 23,390              | 621,578             | 286                              | 23,996              |  |
| <b>Total hedging derivatives</b>                                   | <b>703,118</b>      | <b>1,280</b>                     | <b>23,715</b>       | <b>677,828</b>      | <b>419</b>                       | <b>24,956</b>       |  |
| <b>Total derivatives</b>   | <b>\$ 6,328,917</b> | <b>\$ 448,806</b>                | <b>\$ 1,533,933</b> | <b>\$ 4,989,001</b> | <b>\$ 286,951</b>                | <b>\$ 1,444,304</b> |  |

- (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 discussed below under **Non-qualifying Derivatives and Derivatives for Purposes Other Than Hedging**, the Company uses various 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. As of June 30, 2012 and December 31, 2011, the Company held interest rate swaps that were designated and qualified as cash flow hedges of interest rate risk. As of June 30, 2012 and December 31, 2011, 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. As of June 30, 2012 and December 31, 2011, 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 DAC Current Report 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.

**Table of Contents****Fair Value Hedges**

During the fourth quarter of 2011 the Company removed the fair value hedge designation for its interest rate swaps. However, prior to the fourth quarter of 2011 the Company designated and accounted 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 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, 2011 were (dollars in thousands):

| Type of Fair Value Hedge                         | Hedged Item                 | Gains (Losses) Recognized for Derivatives | Gains (Losses) Recognized for Hedged Items | Ineffectiveness Recognized in Investment Related Gains (Losses) |
|--|-----------------------------|---|--|---|
| <b>For the three months ended June 30, 2011:</b> |                             |   |  |   |
| Interest rate swaps                              | Fixed rate fixed maturities | \$ (489)                                  | \$ 694                                     | \$ 205  |
| <b>For the six months ended June 30, 2011:</b>   |                             |   |  |   |
| Interest rate swaps                              | Fixed rate fixed maturities | \$ (266)                                  | \$ 596                                     | \$ 330  |

A regression analysis was used, both at the inception of the hedge and on an ongoing basis, to determine whether each derivative used in a hedge transaction is highly effective in offsetting changes in the hedged item. All components of each derivative's gain or loss were included in the assessment of hedge effectiveness.

**Cash Flow Hedges**

The Company designates and accounts for certain interest rate swaps, in which the cash flows are denominated in different currencies, commonly referred to as cross-currency swaps, as cash flow hedges when they meet the requirements of the general accounting principles for *Derivatives and Hedging*.

The following table presents the components of AOCI, before income tax, and the condensed consolidated income statement classification where the gain or loss is recognized related to cash flow hedges for the three months ended June 30, 2012 (dollars in thousands):

|   | Three months ended<br>June 30, 2012 | Six months ended<br>June 30, 2012 |
|---|-------------------------------------|-----------------------------------|
| Accumulated other comprehensive income (loss), balance beginning of period                                | \$ (862)                            | \$ (828)                          |
| Gains (losses) deferred in other comprehensive income (loss) on the effective portion of cash flow hedges | 464                                 | 787                               |
| Amounts reclassified to investment related gains (losses), net  | --                                  | --                                |
| Amounts reclassified to investment income   | (321)                               | (678)                             |
| Accumulated other comprehensive income (loss), balance end of period                                      | \$ (719)                            | \$ (719)                          |

As of June 30, 2012, the before-tax deferred net gains on derivative instruments recorded in AOCI that are expected to be reclassified to earnings during the next twelve months are \$0.9 million. This expectation is based on the anticipated interest payments on hedged investments in fixed maturity securities that will occur over the next twelve months, at which time the Company will recognize the deferred net gains (losses) as an adjustment to investment income over the term of the investment cash flows. There were no hedged forecasted transactions, other than the receipt or payment of variable interest payments on existing financial instruments, for the three and six months ended June 30, 2012. The Company had no derivative instruments that were designated and qualified as cash flow hedges for the three and six months ended June 30, 2011.

The following table presents the effects of derivatives in cash flow hedging relationships on the condensed consolidated statements of income and AOCI for the three and six months ended June 30, 2012 (dollars in thousands):





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| Derivatives in Cash Flow<br><br>Hedging Relationships | Amount of<br>Gains   |   | Amount and Location of Gains (Losses)<br>Recognized in Income (Loss) on Derivatives<br>(Ineffective Portion and<br>Amounts Excluded<br>from Effectiveness Testing) |  |
|---|--|---|--|--|
|   | (Losses) Deferred in<br>AOCI on Derivatives<br><br>(Effective Portion) | Amount and Location of Gains (Losses)<br>Reclassified from AOCI into Income (Loss)<br><br>(Effective Portion) | Investment Related<br>Gains<br>(Losses)<br><br>Investment Income   | Investment Related<br>Gains<br>(Losses)<br><br>Investment Income |
| <b>For the three months ended June 30, 2012:</b>      |  |   |  |  |
| Interest rate swaps                                   | \$ 464   | \$ --   | \$ 321   | \$ 27  |
| <b>For the six months ended June 30, 2012:</b>        |  |   |  |  |
| Interest rate swaps                                   | \$ 787   | \$ --   | \$ 678   | \$ 3   |

**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, 2012 and 2011 (dollars in thousands):

| Type of NIFO Hedge <sup>(1)(2)</sup> | Derivative Gains (Losses) Deferred in AOCI |            |                                  |             |
|--------------------------------------|--|------------|----------------------------------|-------------|
|                                      | For the three months ended<br>2012         | 2011       | For the six months ended<br>2012 | 2011        |
| Foreign currency swaps               | \$ 6,642                                   | \$ (9,916) | \$ (4,003)                       | \$ (25,020) |

(1) There were no sales or substantial liquidations of net investments in foreign operations that would have required the reclassification of gains or losses from accumulated other comprehensive income (loss) into investment income during the periods presented.

(2) There was no ineffectiveness recognized for the Company's hedges of net investments in foreign operations.

The cumulative foreign currency translation gain (loss) recorded in AOCI related to these hedges was \$0.1 million and \$4.1 million at June 30, 2012 and December 31, 2011, respectively. If a foreign operation was sold or substantially liquidated, the amounts in AOCI would be reclassified to the condensed 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 condensed consolidated statements of income, except where otherwise noted. For the three months ended June 30, 2012 and 2011, the Company recognized investment related gains (losses) of \$82.1 million and \$28.5 million, respectively, and \$(11.3) million and \$2.6 million for the six months ended June 30, 2012 and 2011, respectively, related to derivatives (not including embedded 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 two rates, which can be either fixed-rate or 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.

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### *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 buys put options. The contracts are net settled in cash based on differentials in the indices at the time of exercise and the strike price.

### *Consumer Price Index Swaps*

Consumer price index ( 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.

### *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.

### *Credit Default Swaps*

The Company sells protection under single name credit default swaps and credit default swap index tranches to diversify its credit risk exposure in certain portfolios and, in combination with purchasing securities, to replicate characteristics of similar investments based on the credit quality and term of the credit default swap. Credit default triggers for indexed reference entities and single name reference entities are defined in the contracts. The Company's maximum exposure to credit loss equals the notional value for credit default swaps. In the event of default for credit default swaps, the Company is typically required to pay the protection holder the full notional value less a recovery rate determined at auction.

The Company's maximum amount at risk on credit default swaps, assuming the value of the underlying referenced securities is zero, was \$619.0 million and \$614.0 million at June 30, 2012 and December 31, 2011, respectively.

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.

### *Synthetic GICs*

The Company sells fee-based synthetic GICs which include investment-only, stable value contracts, to retirement plans. The assets are owned by the trustees of such plans, who invest the assets under the terms of investment guidelines agreed to with the Company. The contracts contain a guarantee of a minimum rate of return on participant balances supported by the underlying assets, and a guarantee of liquidity to meet certain participant-initiated plan cash flow requirements. These contracts are accounted for as derivatives, recorded at fair value and classified as interest rate derivatives.

### *Embedded Derivatives*

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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 ( modco ) or funds withheld basis. Changes in fair values of embedded derivatives on modco or funds withheld treaties are net of an increase (decrease) in investment related gains, net of \$6.3 million and \$(0.4) million for the three months and \$(57.2) million and \$(24.3) million for the six months ended June 30, 2012 and 2011, respectively, associated with the Company's own credit risk. Changes in fair values of embedded derivatives on variable annuity contracts are net of an increase in investment related gains (losses), net of \$14.6 million and \$51.6 million for the three and six months ended June 30, 2012, respectively,

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associated with the Company's own credit risk. 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) and the effect on net income after amortization of deferred acquisition costs ( DAC ) and income taxes for the three months ended June 30, 2012 and 2011 are reflected in the following table (dollars in thousands):

|   | Three months ended<br>June 30, |           | Six months ended<br>June 30, |            |
|---|--------------------------------|-----------|------------------------------|------------|
|   | 2012                           | 2011      | 2012                         | 2011       |
| Embedded derivatives in modco or funds withheld arrangements included in investment related gains     | \$ (4,453)                     | \$ 10,525 | \$ (13,881)                  | \$ 101,060 |
| After the associated amortization of DAC and taxes, the related amounts included in net income        | (2,598)                        | 3,788     | (665)                        | 22,971     |
| Embedded derivatives in variable annuity contracts included in investment related gains               | (74,929)                       | (25,860)  | 71,446                       | 6,794      |
| After the associated amortization of DAC and taxes, the related amounts included in net income        | (16,175)                       | (7,414)   | (1,093)                      | 1,387      |
| Amounts related to embedded derivatives in equity-indexed annuities included in benefits and expenses | 27,138                         | (32,077)  | 7,399                        | (73,348)   |
| After the associated amortization of DAC and taxes, the related amounts included in net income        | 15,378                         | (13,192)  | 29,248                       | (49,842)   |

*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, 2012 and 2011 is as follows (dollars in thousands):

| Type of Non-hedging Derivative                      | Income Statement Location of Gain (Loss)              | Gain (Loss) for the Three Months Ended<br>June 30, |             |
|---|---|--|-------------|
|   |   | 2012   | 2011        |
| Interest rate swaps                                 | Investment related gains (losses), net                | \$ 73,342  | \$ 25,343   |
| Financial futures                                   | Investment related gains (losses), net                | 11,074   | (2,873)     |
| Foreign currency forwards                           | Investment related gains (losses), net                | 516  | 595         |
| CPI swaps   | Investment related gains (losses), net                | (1,431)  | 503         |
| Credit default swaps                                | Investment related gains (losses), net                | (4,795)  | 988         |
| Equity options                                      | Investment related gains (losses), net                | 3,367  | 3,919       |
| Embedded derivatives in:                            |   |  |             |
| Modified coinsurance or funds withheld arrangements | Investment related gains (losses), net                | (4,453)  | 10,525      |
| Indexed annuity products                            | Policy acquisition costs and other insurance expenses | 859  | 4,026       |
| Indexed annuity products                            | Interest credited                                     | 26,279   | (36,101)    |
| Variable annuity products                           | Investment related gains (losses), net                | (74,929)   | (25,860)    |
| Total non-hedging derivatives                       |   | \$ 29,829  | \$ (18,935) |

| Type of Non-hedging Derivative | Income Statement Location of Gain (Loss) | Gain<br>(Loss) for the Six Months Ended<br>June 30, |           |
|--------------------------------|--|---|-----------|
|                                |  | 2012  | 2011      |
| Interest rate swaps            | Investment related gains (losses), net   | \$ 25,990   | \$ 14,613 |
| Financial futures              | Investment related gains (losses), net   | (6,335)   | (14,296)  |
| Foreign currency forwards      | Investment related gains (losses), net   | (1,093)   | (260)     |
| CPI swaps                      | Investment related gains (losses), net   | (2,233)   | 1,315     |
| Credit default swaps           | Investment related gains (losses), net   | 7,019   | 1,880     |
| Equity options                 | Investment related gains (losses), net   | (34,616)  | (650)     |
| Embedded derivatives in:       |  |   |           |

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|   |   |           |           |
|---|---|-----------|-----------|
| Modified coinsurance or funds withheld arrangements | Investment related gains (losses), net                | (13,881)  | 101,060   |
| Indexed annuity products                            | Policy acquisition costs and other insurance expenses | (139)     | 12,119    |
| Indexed annuity products                            | Interest credited                                     | 7,538     | (85,466)  |
| Variable annuity products                           | Investment related gains (losses), net                | 71,446    | 6,794     |
| Total non-hedging derivatives                       |   | \$ 53,696 | \$ 37,109 |

### **Credit Risk**

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.

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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 may vary depending on the posting party's ratings. Additionally, a decline in the Company's or the counterparty's credit ratings to specified levels could result in potential settlement of the derivative positions under the Company's agreements with its counterparties. The Company also has exchange-traded futures, which require the maintenance of a margin account.

The Company's credit exposure related to derivative contracts is generally limited to the fair value at the reporting date plus or minus any collateral posted or held by the Company. Information regarding the Company's credit exposure related to its over-the-counter derivative contracts and margin account for exchange-traded futures at June 30, 2012 and December 31, 2011 are reflected in the following table (dollars in thousands):

|   | June 30, 2012      | December 31, 2011 |
|---|--------------------|-------------------|
| Estimated fair value of derivatives in net asset position           | \$ 224,721         | \$ 227,399        |
| Securities pledged to counterparties as collateral <sup>(1)</sup>   | 22,654             | 27,052            |
| Cash pledged from counterparties as collateral <sup>(2)</sup>       | (226,384)          | (241,480)         |
| Securities pledged from counterparties as collateral <sup>(3)</sup> | (31,404)           | (997)             |
| <b>Net credit exposure</b>  | <b>\$ (10,413)</b> | <b>\$ 11,974</b>  |
| <br>  |                    |                   |
| Margin account related to exchange-traded futures <sup>(2)</sup>    | \$ 9,564           | \$ 18,153         |

(1) Consists of U.S. Treasury securities, included in other invested assets.

(2) Included in cash and cash equivalents.

(3) Consists of U.S. Treasury securities.

**6. Fair Value of Assets and Liabilities***Fair Value Measurement*

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. These principles also establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value and describes three levels of inputs that may be used to measure fair value:

**Level 1** Quoted prices in active markets for identical assets or liabilities. The Company's Level 1 assets and liabilities include investment securities that are traded in exchange markets.

**Level 2** Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or market standard valuation techniques and assumptions with significant inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. 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. The Company's Level 2 assets and liabilities include investment securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose values are determined using market standard valuation techniques. This category primarily includes corporate securities, Canadian and Canadian provincial government securities, and residential and commercial mortgage-backed securities, among others. Level 2 valuations are generally obtained from third party pricing services for identical or comparable assets or liabilities or through the use of valuation methodologies using observable market inputs. Prices from services are validated through analytical reviews and assessment of current market activity.



Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the related assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using market standard valuation techniques described above. When observable inputs are not available, the market standard techniques for determining the estimated fair value of certain securities that trade infrequently, and therefore have little transparency, rely on inputs that are significant to the estimated fair value and 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, management believes these inputs are based on assumptions deemed appropriate given the circumstances and consistent with what other market participants would use when pricing similar assets and liabilities. For the Company's invested assets, this category generally includes corporate securities (primarily private placements), asset-backed securities (including those with exposure to subprime mortgages), and to a lesser extent, certain residential and commercial mortgage-backed securities, among others.

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Prices are determined using valuation methodologies such as discounted cash flow models and other similar techniques. Non-binding broker quotes, which are utilized when pricing service information is not available, are reviewed for reasonableness based on the Company's understanding of the market, and are generally considered Level 3. Under certain circumstances, based on its observations of transactions in active markets, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company would apply internally developed valuation techniques to the related assets or liabilities. Additionally, the Company's embedded derivatives, all of which are associated with reinsurance treaties, are classified in Level 3 since their values include significant unobservable inputs.

When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest priority level input that is significant to the fair value measurement in its entirety. For example, a Level 3 fair value measurement may include inputs that are observable (Levels 1 and 2) and unobservable (Level 3). Therefore, gains and losses for such assets and liabilities categorized within Level 3 may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3).

*Assets and Liabilities by Hierarchy Level*

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011 are summarized below (dollars in thousands):

| June 30, 2012:  | Total                | Fair Value Measurements Using: |                      |                   |
|---|----------------------|--------------------------------|----------------------|-------------------|
|   |                      | Level 1                        | Level 2              | Level 3           |
| <b>Assets:</b>  |                      |                                |                      |                   |
| Fixed maturity securities available-for-sale:                                       |                      |                                |                      |                   |
| Corporate securities  | \$ 8,401,909         | \$ 69,954                      | \$ 7,337,941         | \$ 994,014        |
| Canadian and Canadian provincial governments  | 3,929,374            | --                             | 3,929,374            | --                |
| Residential mortgage-backed securities  | 1,078,562            | --                             | 1,028,971            | 49,591            |
| Asset-backed securities   | 441,051              | --                             | 312,693              | 128,358           |
| Commercial mortgage-backed securities   | 1,348,047            | --                             | 1,232,314            | 115,733           |
| U.S. government and agencies securities   | 249,914              | 182,787                        | 67,127               | --                |
| State and political subdivision securities  | 229,776              | --                             | 215,290              | 14,486            |
| Other foreign government supranational and foreign government-sponsored enterprises | 1,565,559            | 222,591                        | 1,342,968            | --                |
| <b>Total fixed maturity securities available-for-sale</b>                           | <b>17,244,192</b>    | <b>475,332</b>                 | <b>15,466,678</b>    | <b>1,302,182</b>  |
| Funds withheld at interest embedded derivatives                                     | (375,337)            | --                             | --                   | (375,337)         |
| Cash equivalents  | 378,595              | 378,595                        | --                   | --                |
| Short-term investments  | 3,704                | 110                            | 3,594                | --                |
| <b>Other invested assets:</b>   |                      |                                |                      |                   |
| Non-redeemable preferred stock  | 75,970               | 62,131                         | 13,839               | --                |
| Other equity securities   | 3,227                | --                             | --                   | 3,227             |
| <b>Derivatives:</b>   |                      |                                |                      |                   |
| Interest rate swaps   | 156,866              | --                             | 156,866              | --                |
| Foreign currency forwards   | 3,275                | --                             | 3,275                | --                |
| CPI swaps   | 388                  | --                             | 388                  | --                |
| Credit default swaps  | (4,369)              | --                             | (4,369)              | --                |
| Equity options  | 94,300               | --                             | 94,300               | --                |
| Collateral  | 26,448               | 20,813                         | 5,635                | --                |
| Other   | 10,595               | 10,595                         | --                   | --                |
| <b>Total other invested assets</b>  | <b>366,700</b>       | <b>93,539</b>                  | <b>269,934</b>       | <b>3,227</b>      |
| Reinsurance ceded receivable embedded derivatives                                   | 4,416                | --                             | --                   | 4,416             |
| <b>Total</b>  | <b>\$ 17,622,270</b> | <b>\$ 947,576</b>              | <b>\$ 15,740,206</b> | <b>\$ 934,488</b> |
| <b>Liabilities:</b>   |                      |                                |                      |                   |
| Interest sensitive contract liabilities embedded derivatives                        | \$ 938,927           | \$ --                          | \$ --                | \$ 938,927        |
| <b>Other liabilities:</b>   |                      |                                |                      |                   |
| <b>Derivatives:</b>   |                      |                                |                      |                   |

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|                         |            |       |           |            |
|-------------------------|------------|-------|-----------|------------|
| Interest rate swaps     | 132        | --    | 132       | --         |
| Credit default swaps    | 2,453      | --    | 2,453     | --         |
| Foreign currency swaps  | 23,154     | --    | 23,154    | --         |
| Total other liabilities | 25,739     | --    | 25,739    | --         |
| Total                   | \$ 964,666 | \$ -- | \$ 25,739 | \$ 938,927 |

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|  | Total                | Fair Value Measurements Using: |                      |                     |
|--|----------------------|--------------------------------|----------------------|---------------------|
|  |                      | Level 1                        | Level 2              | Level 3             |
| <b>Assets:</b>   |                      |                                |                      |                     |
| Fixed maturity securities available-for-sale:  |                      |                                |                      |                     |
| Corporate securities   | \$ 7,461,106         | \$ 76,097                      | \$ 6,410,840         | \$ 974,169          |
| Canadian and Canadian provincial governments   | 3,869,933            | --                             | 3,869,933            | --                  |
| Residential mortgage-backed securities   | 1,227,234            | --                             | 1,145,579            | 81,655              |
| Asset-backed securities  | 401,991              | --                             | 208,499              | 193,492             |
| Commercial mortgage-backed securities  | 1,242,219            | --                             | 1,126,243            | 115,976             |
| U.S. government and agencies securities  | 374,002              | 300,514                        | 73,488               | --                  |
| State and political subdivision securities   | 205,386              | 12,894                         | 182,119              | 10,373              |
| Other foreign government, supranational and foreign government-sponsored enterprises | 1,419,079            | 223,440                        | 1,195,639            | --                  |
| <b>Total fixed maturity securities available-for-sale</b>                            | <b>16,200,950</b>    | <b>612,945</b>                 | <b>14,212,340</b>    | <b>1,375,665</b>    |
| Funds withheld at interest embedded derivatives                                      | (361,456)            | --                             | --                   | (361,456)           |
| Cash equivalents   | 504,522              | 504,522                        | --                   | --                  |
| Short-term investments   | 46,671               | 37,155                         | 9,516                | --                  |
| <b>Other invested assets:</b>  |                      |                                |                      |                     |
| Non-redeemable preferred stock   | 78,183               | 58,906                         | 19,277               | --                  |
| Other equity securities  | 35,717               | 5,308                          | 18,920               | 11,489              |
| <b>Derivatives:</b>  |                      |                                |                      |                     |
| Interest rate swaps  | 168,484              | --                             | 168,484              | --                  |
| Foreign currency forwards  | 4,560                | --                             | 4,560                | --                  |
| CPI swaps  | 766                  | --                             | 766                  | --                  |
| Credit default swaps   | (4,003)              | --                             | (4,003)              | --                  |
| Equity options   | 87,243               | --                             | 87,243               | --                  |
| Collateral   | 32,622               | 27,052                         | 5,570                | --                  |
| Other  | 59,373               | 59,373                         | --                   | --                  |
| <b>Total other invested assets</b>   | <b>462,945</b>       | <b>150,639</b>                 | <b>300,817</b>       | <b>11,489</b>       |
| Reinsurance ceded receivable embedded derivatives                                    | 4,945                | --                             | --                   | 4,945               |
| <b>Total</b>   | <b>\$ 16,858,577</b> | <b>\$ 1,305,261</b>            | <b>\$ 14,522,673</b> | <b>\$ 1,030,643</b> |
| <b>Liabilities:</b>  |                      |                                |                      |                     |
| Interest sensitive contract liabilities embedded derivatives                         | \$ 1,028,241         | \$ --                          | \$ --                | \$ 1,028,241        |
| <b>Other liabilities:</b>  |                      |                                |                      |                     |
| <b>Derivatives:</b>  |                      |                                |                      |                     |
| Interest rate swaps  | 3,171                | --                             | 3,171                | --                  |
| Credit default swaps   | 5,633                | --                             | 5,633                | --                  |
| Equity options   | (2,864)              | --                             | (2,864)              | --                  |
| Foreign currency swaps   | 23,710               | --                             | 23,710               | --                  |
| <b>Total other liabilities</b>   | <b>29,650</b>        | <b>--</b>                      | <b>29,650</b>        | <b>--</b>           |
| <b>Total</b>   | <b>\$ 1,057,891</b>  | <b>\$ --</b>                   | <b>\$ 29,650</b>     | <b>\$ 1,028,241</b> |

The Company may utilize information from third parties, such as pricing services and brokers, to assist in determining the fair value for certain assets and liabilities; however, management is ultimately responsible for all fair values presented in the Company's financial statements. This includes responsibility for monitoring the fair value process, ensuring objective and reliable valuation practices and pricing of financial instruments, and approving changes to valuation methodologies and pricing sources. 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 initial and ongoing 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 performs ongoing 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 and to monitor controls around pricing, which includes 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, review of pricing trends, comparing a sample of executed prices of securities sold to the fair value estimates, comparing fair value estimates to management's knowledge

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of the current market, and ongoing confirmation that third party pricing services use, wherever possible, market-based parameters for valuation. 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. The Company also determines if the inputs used in estimated fair values received from pricing services are observable by assessing whether these inputs can be corroborated by observable market data.

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The fair value of embedded derivative liabilities, including those calculated by third parties, are monitored through the use of attribution reports to quantify the effect of underlying sources of fair value change, including capital market inputs based on policyholder account values, interest rates and short-term and long-term implied volatilities, from period to period. Actuarial assumptions are based on experience studies performed internally in combination with available industry information and are reviewed on a periodic basis, at least annually.

For assets and liabilities reported at fair value, the Company utilizes when available, fair values 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 market valuation techniques, matrix pricing and the income approach. 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 the quarters ended June 30, 2012 and 2011, the application of market standard valuation techniques applied to similar assets and liabilities has been consistent.

The methods and assumptions the Company uses to estimate the fair value of assets and liabilities measured at fair value on a recurring bases are summarized below.

*Fixed Maturity Securities* The fair values of the Company's public fixed maturity securities are generally based on prices obtained from independent pricing services. Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. The Company generally receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. To validate reasonability, prices are periodically reviewed as explained above. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on observable pricing for similar assets and/or other market observable inputs. If the pricing information received from third party pricing services is not reflective of market activity or other inputs observable in the market, the Company may challenge the price through a formal process with the pricing service.

If the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity, non-binding broker quotes are used, if available. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may override the information from the pricing service or broker with an internally developed valuation; however, this occurs infrequently. Internally developed valuations or non-binding broker quotes are also used to determine fair value in circumstances where vendor pricing is not available. These estimates may use significant unobservable inputs, which reflect the Company's assumptions about the inputs market participants would use in pricing the asset. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. Pricing service overrides, internally developed valuations and non-binding broker quotes are generally based on significant unobservable inputs and are often reflected as Level 3 in the valuation hierarchy.

The inputs used in the valuation of corporate and government securities include, but are not limited to standard market observable inputs which are derived from, or corroborated by, market observable data including market yield curve, duration, call provisions, observable prices and spreads for similar publicly traded or privately traded issues that incorporate the credit quality and industry sector of the issuer. For structured securities, valuation is based primarily on matrix pricing or other similar techniques using standard market inputs including spreads for actively traded securities, spreads off benchmark yields, expected prepayment speeds and volumes, current and forecasted loss severity, rating, weighted average coupon, weighted average maturity, average delinquency rates, geographic region, debt-service coverage ratios and issuance-specific information including, but not limited to: collateral type, payment terms of the underlying assets, payment priority within the tranche, structure of the security, deal performance and vintage of loans.

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 fair values of private placement securities are primarily determined using a discounted cash flow model. In certain cases these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Generally, these securities have been reflected within Level 2. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the security. To the extent management determines that such unobservable inputs are not significant to the price of a security, a Level 2 classification is made. Otherwise, a Level 3 classification is used.



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*Embedded Derivatives* 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. The variable annuity embedded derivative calculations are performed by third parties based on methodology and input assumptions provided by the Company. To validate the reasonability of the resulting fair value, the Company's internal actuaries perform reviews and analytical procedures on the results. The capital market inputs to the model, such as equity indexes, short-term equity volatility and interest rates, are generally observable. Long-term volatility inputs are a significant unobservable input. 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.

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 with an adjustment for the Company's own credit risk. The fair value of the underlying assets is generally based on market observable inputs using industry standard valuation techniques. However, the valuation also requires certain significant inputs based on actuarial assumptions, which are generally not observable and accordingly, the valuation is considered Level 3 in the fair value hierarchy.

*Company's Own Credit Risk* The Company uses a structural default risk model to estimate its own credit risk. The input assumptions are a combination of externally derived and published values (default threshold and uncertainty), market inputs (interest rate, Company equity price per share, Company debt per share, Company equity price volatility) and insurance industry data (Loss Given Default), adjusted for market recoverability.

*Cash Equivalents and Short-Term Investments* Cash equivalents and short-term investments include money market instruments, commercial paper and other highly liquid debt instruments. Money market instruments are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The fair value of certain other short-term investments, such as floating rate notes and bonds with original maturities less than twelve months, are based upon other market observable data and are typically classified as Level 2. Various time deposits carried as cash equivalents or short-term investments are not measured at estimated fair value and therefore are excluded from the tables presented.

*Equity Securities* Equity securities consist principally of preferred stock of publicly and privately traded companies. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for most privately traded equity securities are determined using valuation models that require a substantial level of judgment. In determining the fair value of certain privately traded equity securities the models may also use unobservable inputs, which reflect the Company's assumptions about the inputs market participants would use in pricing. The estimated fair value of certain private equity securities are based on net asset value calculations using fund statements. Most privately traded equity securities are classified within Level 3 because the fund statements are considered a significant unobservable input. The fair values of preferred equity securities are based on prices obtained from independent pricing services and these securities are generally classified within Level 2 in the fair value hierarchy.

*Derivative Assets and Derivative Liabilities* Valuation is based on unadjusted quoted prices in active markets that are readily and regularly available. Level 2 measurement includes all types of derivative instruments utilized by the Company. These derivatives are principally valued using an income approach. Valuations of interest rate contracts, non-option-based, are based on present value techniques, which utilize significant inputs that may include the swap yield curve, LIBOR basis curves, and repurchase rates. Valuations of foreign currency contracts, non-option-based, are based on present value techniques, which utilize significant inputs that may include the swap yield curve, LIBOR basis curves, currency spot rates, and cross currency basis curves. Valuations of credit contracts, non-option-based, are based on present value techniques, which utilize significant inputs that may include the swap yield curve, credit curves, and recovery rates. Valuations of equity market contracts, non-option-based, are based on present value techniques, which utilize significant inputs that may include the swap yield curve, spot equity index levels, and dividend yield curves. Valuations of equity market contracts, option-based, are based on option pricing models, which utilize significant inputs that may include the swap yield curve, spot equity index levels, dividend yield curves, and equity volatility. The Company does not currently have derivatives included in Level 3 measurement.



**Table of Contents***Level 3 Measurements and Transfers*

As of June 30, 2012 and December 31, 2011, respectively, the Company classified approximately 7.6% and 8.5% of its fixed maturity securities in the Level 3 category. These securities primarily consist of private placement corporate securities with inactive trading markets. Additionally, the Company has included asset-backed securities with sub-prime exposure and mortgage-backed securities with below investment grade ratings in the Level 3 category due to market uncertainty associated with these securities and the Company's utilization of information from third parties for the valuation of these securities.

The significant unobservable inputs used in the fair value measurement of the Company's corporate, sovereign, government-backed and other political subdivision securities are probability of default, liquidity premium, subordination premium and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumptions used for the liquidity premium, subordination premium and loss severity.

The significant unobservable inputs used in the fair value measurement of the Company's asset and mortgage-backed securities are prepayment rates, probability of default, liquidity premium and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the liquidity premium and loss severity and a directionally opposite change in the assumption used for prepayment rates.

The actuarial assumptions used in the fair value of embedded derivatives which include assumptions related to lapses, withdrawals, and mortality, are based on experience studies performed by the Company in combination with available industry information and are reviewed on a periodic basis, at least annually. The significant unobservable inputs used in the fair value measurement of embedded derivatives are assumptions associated with policyholder experience and selected capital market assumptions for equity indexed and variable annuities. The selected capital market assumptions, which include long-term implied volatilities, are based on observable historical information. Changes in interest rates, equity indices, equity volatility, the Company's own credit risk, and actuarial assumptions regarding policyholder experience may result in significant fluctuations in the value of embedded derivatives.

Fair value measurements associated with funds withheld reinsurance treaties are generally not materially sensitive to changes in unobservable inputs associated with policyholder experience. The primary drivers of change in these fair values are related to movements of credit spreads, which are generally observable. Increases (decreases) in market credit spreads tend to decrease (increase) the fair value of embedded derivatives. Increases (decreases) in the own credit assumption tend to decrease (increase) the magnitude of the fair value of embedded derivatives.

Fair value measurements associated with variable annuity treaties are sensitive to both capital markets inputs and policyholder experience inputs. Increases (decreases) in lapse rates tend to decrease (increase) the value of the embedded derivatives associated with variable annuity treaties. Increases (decreases) in the long-term volatility assumption tend to increase (decrease) the fair value of embedded derivatives. Increases (decreases) in the own credit assumption tend to decrease (increase) the magnitude of the fair value of embedded derivatives.

The following table presents quantitative information about significant unobservable inputs used in Level 3 fair value measurements that are developed by the Company as of June 30, 2012 (dollars in thousands):

**June 30, 2012:**

|  | Fair Value | Valuation Technique(s)       | Unobservable Input        | Range (Weighted Average) |
|--|------------|------------------------------|---------------------------|--------------------------|
| <b>Assets:</b>                                     |            |                              |                           |                          |
| State and political subdivision securities         | \$ 14,486  | Market comparable securities | Liquidity premium         | 1%                       |
| Corporate securities                               | 11,614     | Market comparable securities | Liquidity premium         | 1-2% (2%)                |
| Private equity securities                          | 516        | Net asset value              | Fund financial statements | Not Applicable           |
| Funds withheld at interest- embedded derivatives   | (375,337)  | Total return swap            | Mortality                 | 0-100% (1%)              |
|  |            |                              | Lapse                     | 0-35% (4%)               |
|  |            |                              | Withdrawal                | 0-5% (4%)                |
|  |            |                              | Own Credit                | 0-1% (0%)                |
|  |            |                              | Crediting rate            | 2-4% (3%)                |
| Reinsurance ceded receivable- embedded derivatives | 4,416      | Discounted cash flow         | Mortality                 | 0-100% (8%)              |
|  |            |                              | Lapse                     | 14-16% (15%)             |



**Table of Contents****Liabilities:**

## Interest sensitive contract liabilities- embedded

|                                |         |                      |                          |             |
|--------------------------------|---------|----------------------|--------------------------|-------------|
| derivatives- indexed annuities | 733,655 | Discounted cash flow | Mortality                | 0-100% (1%) |
|                                |         |                      | Lapse                    | 0-35% (4%)  |
|                                |         |                      | Withdrawal               | 0-5% (4%)   |
|                                |         |                      | Option budget projection | 2-4% (3%)   |

## Interest sensitive contract liabilities- embedded

|                                 |         |                      |                      |             |
|---------------------------------|---------|----------------------|----------------------|-------------|
| derivatives- variable annuities | 205,272 | Discounted cash flow | Mortality            | 0-100% (1%) |
|                                 |         |                      | Lapse                | 0-25% (5%)  |
|                                 |         |                      | Withdrawal           | 0-7% (4%)   |
|                                 |         |                      | Own Credit           | 0-1% (1%)   |
|                                 |         |                      | Long-term volatility | 0-27% (16%) |

The Company recognizes transfers of financial instruments into and out of levels within the fair value hierarchy at the beginning of the quarter in which the actual event or change in circumstances that caused the transfer occurs. Financial instruments transferred into Level 3 are due to a lack of observable market transactions and price information. Financial instruments are transferred out of Level 3 when circumstances change such that significant inputs can be corroborated with market observable data. This may be due to a significant increase in market activity for the financial instrument, a specific event, one or more significant input(s) becoming observable. Transfers out of Level 3 were primarily the result of the Company using observable pricing information or a third party pricing quotation that appropriately reflects the fair value of those financial instruments, without the need for adjustment based on the Company's own assumptions regarding the characteristics of a specific financial instrument or the current liquidity in the market. In addition, certain transfers out of Level 3 were also due to increased observations of market transactions and price information for those financial instruments.

Transfers from Level 1 to Level 2 are due to the lack of observable market data when pricing these securities, while transfers from Level 2 to Level 1 are due to an increase in the availability of market observable data in an active market. The following tables present the transfers between Level 1 and Level 2 during the three and six months ended June 30, 2012 and 2011 (dollars in thousands):

|  | Three months ended June 30,                |   |  |   |
|--|--|---|--|---|
|  | 2012                                       |   | 2011                                       |   |
|  | Transfers from<br>Level 1<br>to<br>Level 2 | Transfers from<br>Level 2 to<br>Level 1 | Transfers from<br>Level 1<br>to<br>Level 2 | Transfers from<br>Level 2 to<br>Level 1 |
| <b>Fixed maturity securities - available-for-sale:</b>                               |  |   |  |   |
| Corporate securities   | \$ 2,996                                   | \$ --                                   | \$ --                                      | \$ --                                   |
| U.S. government and agencies securities  | --   | 11,152                                  | 23,065                                     | --                                      |
| State and political subdivision securities   | 12,794                                     | --                                      | --   | --                                      |
| Other foreign government, supranational and foreign government-sponsored enterprises | 1,059                                      | --                                      | 371  | --                                      |
| <b>Total fixed maturity securities</b>   | <b>16,849</b>                              | <b>11,152</b>                           | <b>23,436</b>                              | <b>--</b>                               |
| Other equity securities  | --   | --                                      | 2,290                                      | --                                      |
| <b>Total</b>   | <b>\$ 16,849</b>                           | <b>\$ 11,152</b>                        | <b>\$ 25,726</b>                           | <b>\$ --</b>                            |

|  | Six months ended June 30,                  |   |  |   |
|--|--|---|--|---|
|  | 2012                                       |   | 2011                                       |   |
|  | Transfers from<br>Level 1<br>to<br>Level 2 | Transfers from<br>Level 2 to<br>Level 1 | Transfers from<br>Level 1<br>to<br>Level 2 | Transfers from<br>Level 2 to<br>Level 1 |
| <b>Fixed maturity securities - available-for-sale:</b> |  |   |  |   |
| Corporate securities                                   | \$ 2,996                                   | \$ 4                                    | \$ --                                      | \$ --                                   |
| U.S. government and agencies securities                | --   | 11,152                                  | 23,065                                     | --                                      |
| State and political subdivision securities             | 12,794                                     | --                                      | --   | --                                      |

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|  |           |           |           |       |
|--|-----------|-----------|-----------|-------|
| Other foreign government, supranational and foreign government-sponsored enterprises | 1,059     | --        | 371       | --    |
| Total fixed maturity securities  | 16,849    | 11,156    | 23,436    | --    |
| Other equity securities  | --        | --        | 2,290     | --    |
| Total  | \$ 16,849 | \$ 11,156 | \$ 25,726 | \$ -- |

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The tables below provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and six months ended June 30, 2012, as well as the portion of gains or losses included in income for the three and six months ended June 30, 2012 attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2012 (dollars in thousands):

**For the three months ended June 30, 2012:**

|   | Fixed maturity securities - available-for-sale |  |                         |                                       |  |
|---|--|--|-------------------------|---------------------------------------|--|
|   | Corporate securities                           | Residential mortgage-backed securities | Asset-backed securities | Commercial mortgage-backed securities | State and political subdivision securities |
| Fair value, beginning of period                       | \$ 977,671                                     | \$ 54,435                              | \$ 146,362              | \$ 118,678                            | \$ 5,239                                   |
| Total gains/losses (realized/unrealized)              |  |  |                         |                                       |  |
| Included in earnings, net:                            |  |  |                         |                                       |  |
| Investment income, net of related expenses            | 77   | 188                                    | 195                     | 545                                   | 9  |
| Investment related gains (losses), net                | (696)  | (315)                                  | 164                     | 393                                   | (4)  |
| Claims & other policy benefits                        | --   | --                                     | --                      | --                                    | --   |
| Interest credited                                     | --   | --                                     | --                      | --                                    | --   |
| Policy acquisition costs and other insurance expenses | --   | --                                     | --                      | --                                    | --   |
| Included in other comprehensive income                | 10,341   | (172)                                  | 1,782                   | (2,273)                               | 827  |
| Purchases <sup>(1)</sup>                              | 68,275   | 337                                    | 2,012                   | --                                    | --   |
| Sales <sup>(1)</sup>                                  | (17,876)                                       | (8,219)                                | (7,902)                 | (1,552)                               | --   |
| Settlements <sup>(1)</sup>                            | (32,497)                                       | (1,902)                                | (3,238)                 | (58)                                  | (23)                                       |
| Transfers into Level 3                                | --   | 7,176                                  | --                      | --                                    | 8,438                                      |
| Transfers out of Level 3                              | (11,281)                                       | (1,937)                                | (11,017)                | --                                    | --   |
| Fair value, end of period                             | \$ 994,014                                     | \$ 49,591                              | \$ 128,358              | \$ 115,733                            | \$ 14,486                                  |

Unrealized gains and losses recorded in earnings for the

period relating to those Level 3 assets and liabilities that

were still held at the end of the period

| Included in earnings, net:                            |       |        |        |        |      |
|---|-------|--------|--------|--------|------|
| Investment income, net of related expenses            | \$ 84 | \$ 148 | \$ 151 | \$ 545 | \$ 9 |
| Investment related gains (losses), net                | (380) | (161)  | --     | --     | --   |
| Claims & other policy benefits                        | --    | --     | --     | --     | --   |
| Interest credited                                     | --    | --     | --     | --     | --   |
| Policy acquisition costs and other insurance expenses | --    | --     | --     | --     | --   |

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**For the three months ended June 30, 2012 (continued):**

|   | Funds withheld<br>at interest-<br>embedded<br>derivative | Other invested<br>assets- other<br>equity securities | Reinsurance<br>ceded receivable-<br>embedded<br>derivative | Interest sensitive<br>contract<br>liabilities<br>embedded<br>derivative |
|---|--|--|--|---|
| Fair value, beginning of period                       | \$ (370,884)   | \$ 11,827  | \$ 3,514   | \$ (903,282)  |
| Total gains/losses (realized/unrealized)              |  |  |  |   |
| Included in earnings, net:                            |  |  |  |   |
| Investment income, net of related expenses            | --   | --   | --   | --  |
| Investment related gains (losses), net                | (4,453)  | 1,098  | --   | (74,929)  |
| Claims & other policy benefits                        | --   | --   | --   | (1,721)   |
| Interest credited                                     | --   | --   | --   | 27,825  |
| Policy acquisition costs and other insurance expenses | --   | --   | 1,003  | --  |
| Included in other comprehensive income                | --   | 505  | --   | --  |
| Purchases <sup>(1)</sup>                              | --   | 108  | --   | (16,107)  |
| Sales <sup>(1)</sup>                                  | --   | (3,788)  | --   | --  |
| Settlements <sup>(1)</sup>                            | --   | --   | (101)  | 29,287  |
| Transfers into Level 3                                | --   | --   | --   | --  |
| Transfers out of Level 3                              | --   | (6,523)  | --   | --  |
| Fair value, end of period                             | \$ (375,337)   | \$ 3,227   | \$ 4,416   | \$ (938,927)  |

Unrealized gains and losses recorded in earnings for the period

relating to those Level 3 assets and liabilities that were still held at

the end of the period

| Included in earnings, net:                            |         |       |       |          |
|---|---------|-------|-------|----------|
| Investment income, net of related expenses            | \$ --   | \$ -- | \$ -- | \$ --    |
| Investment related gains (losses), net                | (4,452) | (183) | --    | (76,737) |
| Claims & other policy benefits                        | --      | --    | --    | (1,959)  |
| Interest credited                                     | --      | --    | --    | (1,288)  |
| Policy acquisition costs and other insurance expenses | --      | --    | 1,143 | --       |

(1) The amount reported within purchases, sales and settlements is the purchase price (for purchases) and the sales/settlement proceeds (for sales and settlements) based upon the actual date purchased or sold/settled. Items purchased and sold/settled in the same period are excluded from the rollforward. The Company had no issuances during the period.

**For the six months ended June 30, 2012:**

|   | Fixed maturity securities - available-for-sale |  |                         |                                       |  |
|---|--|--|-------------------------|---------------------------------------|--|
|   | Corporate securities                           | Residential mortgage-backed securities | Asset-backed securities | Commercial mortgage-backed securities | State and political subdivision securities |
| Fair value, beginning of period                       | \$ 974,169                                     | \$ 81,655                              | \$ 193,492              | \$ 115,976                            | \$ 10,373                                  |
| Total gains/losses (realized/unrealized)              |  |  |                         |                                       |  |
| Included in earnings, net:                            |  |  |                         |                                       |  |
| Investment income, net of related expenses            | 107  | 298                                    | 444                     | 1,133                                 | 4  |
| Investment related gains (losses), net                | (1,280)  | (36)                                   | (506)                   | (11,682)                              | (8)  |
| Claims & other policy benefits                        | --   | --                                     | --                      | --                                    | --   |
| Interest credited                                     | --   | --                                     | --                      | --                                    | --   |
| Policy acquisition costs and other insurance expenses | --   | --                                     | --                      | --                                    | --   |
| Included in other comprehensive income                | 9,659  | 1,408                                  | 8,477                   | 11,248                                | 1,233                                      |
| Purchases <sup>(1)</sup>                              | 89,435   | 582                                    | 2,012                   | --                                    | --   |

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|                            |          |          |          |          |         |
|----------------------------|----------|----------|----------|----------|---------|
| Sales <sup>(1)</sup>       | (27,285) | (16,224) | (7,902)  | (1,552)  | --      |
| Settlements <sup>(1)</sup> | (53,371) | (3,702)  | (7,103)  | (58)     | (46)    |
| Transfers into Level 3     | 17,445   | 7,176    | 1,080    | 10,846   | 8,438   |
| Transfers out of Level 3   | (14,865) | (21,566) | (61,636) | (10,178) | (5,508) |

|                           |            |           |            |            |           |
|---------------------------|------------|-----------|------------|------------|-----------|
| Fair value, end of period | \$ 994,014 | \$ 49,591 | \$ 128,358 | \$ 115,733 | \$ 14,486 |
|---------------------------|------------|-----------|------------|------------|-----------|

Unrealized gains and losses recorded in earnings for the period relating to

those Level 3 assets and liabilities that were still held at the end of the

|   |         |        |        |          |      |
|---|---------|--------|--------|----------|------|
| period  |         |        |        |          |      |
| Included in earnings, net:                            |         |        |        |          |      |
| Investment income, net of related expenses            | \$ 114  | \$ 255 | \$ 400 | \$ 1,133 | \$ 4 |
| Investment related gains (losses), net                | (1,106) | (269)  | (607)  | (12,075) | --   |
| Claims & other policy benefits                        | --      | --     | --     | --       | --   |
| Interest credited                                     | --      | --     | --     | --       | --   |
| Policy acquisition costs and other insurance expenses | --      | --     | --     | --       | --   |

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| For the six months ended June 30, 2012 (continued):   | Funds withheld                           |  | Reinsurance<br>ceded receivable- | Interest sensitive<br>contract liabilities |
|---|--|--|----------------------------------|--|
|   | at interest -<br>embedded<br>derivatives | Other invested<br>assets- other<br>equity securities |                                  |  |
| Fair value, beginning of period                       | \$ (361,456)                             | \$ 11,489  | \$ 4,945                         | \$ (1,028,241)                             |
| Total gains/losses (realized/unrealized)              |  |  |                                  |  |
| Included in earnings, net:                            |  |  |                                  |  |
| Investment income, net of related expenses            | --                                       | --   | --                               | --   |
| Investment related gains (losses), net                | (13,881)                                 | 1,098  | --                               | 71,446                                     |
| Claims & other policy benefits                        | --                                       | --   | --                               | 557  |
| Interest credited                                     | --                                       | --   | --                               | 6,632                                      |
| Policy acquisition costs and other insurance expenses | --                                       | --   | (325)                            | --   |
| Included in other comprehensive income                | --                                       | 843  | --                               | --   |
| Purchases <sup>(1)</sup>                              | --                                       | 108  | --                               | (39,697)                                   |
| Sales <sup>(1)</sup>                                  | --                                       | (3,788)  | --                               | --   |
| Settlements <sup>(1)</sup>                            | --                                       | --   | (204)                            | 50,376                                     |
| Transfers into Level 3                                | --                                       | --   | --                               | --   |
| Transfers out of Level 3                              | --                                       | (6,523)  | --                               | --   |
| Fair value, end of period                             | \$ (375,337)                             | \$ 3,227   | \$ 4,416                         | \$ (938,927)                               |

Unrealized gains and losses recorded in earnings for the period relating to those Level 3 assets and liabilities that were still held at the end of the period

| Included in earnings, net:                            |          |       |       |          |
|---|----------|-------|-------|----------|
| Investment income, net of related expenses            | \$ --    | \$ -- | \$ -- | \$ --    |
| Investment related gains (losses), net                | (13,881) | (183) | --    | 67,887   |
| Claims & other policy benefits                        | --       | --    | --    | 79       |
| Interest credited                                     | --       | --    | --    | (43,395) |
| Policy acquisition costs and other insurance expenses | --       | --    | (46)  | --       |

(1) The amount reported within purchases, sales and settlements is the purchase price (for purchases) and the sales/settlement proceeds (for sales and settlements) based upon the actual date purchased or sold/settled. Items purchased and sold/settled in the same period are excluded from the rollforward. The Company had no issuances during the period.

The tables below provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and six months ended June 30, 2011, as well as the portion of gains or losses included in income for the three months ended June 30, 2011 attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2011 (dollars in thousands):

| For the three months ended June 30, 2011:             | Fixed maturity securities - available-for-sale |  |                         |                                       |
|---|--|--|-------------------------|---------------------------------------|
|   | Corporate securities                           | Residential mortgage-backed securities | Asset-backed securities | Commercial mortgage-backed securities |
| Fair value, beginning of period                       | \$ 940,470                                     | \$ 138,568                             | \$ 202,246              | \$ 203,394                            |
| Total gains/losses (realized/unrealized)              |  |  |                         |                                       |
| Included in earnings, net:                            |  |  |                         |                                       |
| Investment income, net of related expenses            | 75   | 233                                    | 322                     | 611                                   |
| Investment related gains (losses), net                | 321  | (45)                                   | (3,671)                 | (2,242)                               |
| Claims & other policy benefits                        | --   | --                                     | --                      | --                                    |
| Interest credited                                     | --   | --                                     | --                      | --                                    |
| Policy acquisition costs and other insurance expenses | --   | --                                     | --                      | --                                    |
| Included in other comprehensive income                | 9,228  | (2,910)                                | 3,182                   | (5,825)                               |
| Purchases <sup>(1)</sup>                              | 97,606   | 5,329                                  | 25,007                  | 5,069                                 |
| Sales <sup>(1)</sup>                                  | (19,563)                                       | (6,635)                                | (3,998)                 | --                                    |
| Settlements <sup>(1)</sup>                            | (25,050)                                       | (4,205)                                | (8,693)                 | (3,080)                               |



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|                           |            |            |            |            |
|---------------------------|------------|------------|------------|------------|
| Transfers into Level 3    | 26,268     | --         | 10,175     | 11,665     |
| Transfers out of Level 3  | (51,795)   | (26,905)   | (35,797)   | (58,827)   |
| Fair value, end of period | \$ 977,560 | \$ 103,430 | \$ 188,773 | \$ 150,765 |

**Table of Contents****For the three months ended June 30, 2011 (continued):**

|   | Fixed maturity securities - available-for-sale |  |                         |                                       |
|---|--|--|-------------------------|---------------------------------------|
|   | Corporate securities                           | Residential mortgage-backed securities | Asset-backed securities | Commercial mortgage-backed securities |
| Unrealized gains and losses recorded in earnings for the period relating to those |  |  |                         |                                       |
| Level 3 assets and liabilities that were still held at the end of the period      |  |  |                         |                                       |
| Included in earnings, net:  |  |  |                         |                                       |
| Investment income, net of related expenses  | \$ 56  | \$ 216                                 | \$ 331                  | \$ 601                                |
| Investment related gains (losses), net  | --   | (44)                                   | (2,998)                 | (2,254)                               |
| Claims & other policy benefits  | --   | --                                     | --                      | --                                    |
| Interest credited   | --   | --                                     | --                      | --                                    |
| Policy acquisition costs and other insurance expenses                             | --   | --                                     | --                      | --                                    |

**For the three months ended June 30, 2011 (continued):**

|   | Fixed maturity securities - available-for-sale |  |  |
|---|--|--|--|
|   | State and political subdivision securities     | Other foreign government, supranational and foreign government-sponsored enterprises | Funds withheld at interest-embedded derivative |
| Fair value, beginning of period                       | \$ 45,081                                      | \$ 6,495   | \$ (183,685)                                   |
| Total gains/losses (realized/unrealized)              |  |  |  |
| Included in earnings, net:                            |  |  |  |
| Investment income, net of related expenses            | 2  | --   | --   |
| Investment related gains (losses), net                | (3)  | --   | 10,525   |
| Claims & other policy benefits                        | --   | --   | --   |
| Interest credited                                     | --   | --   | --   |
| Policy acquisition costs and other insurance expenses | --   | --   | --   |
| Included in other comprehensive income                | 939  | 110  | --   |
| Purchases <sup>(1)</sup>                              | --   | --   | --   |
| Sales <sup>(1)</sup>                                  | --   | --   | --   |
| Settlements <sup>(1)</sup>                            | (22)   | --   | --   |
| Transfers into Level 3                                | 14,260   | --   | --   |
| Transfers out of Level 3                              | (37,325)                                       | (2,531)  | --   |
| Fair value, end of period                             | \$ 22,932                                      | \$ 4,074   | \$ (173,160)                                   |

Unrealized gains and losses recorded in earnings for the period relating to those Level

3 assets and liabilities that were still held at the end of the period

|   |      |       |        |
|---|------|-------|--------|
| Included in earnings, net:                            |      |       |        |
| Investment income, net of related expenses            | \$ 2 | \$ -- | \$ --  |
| Investment related gains (losses), net                | --   | --    | 10,525 |
| Claims & other policy benefits                        | --   | --    | --     |
| Interest credited                                     | --   | --    | --     |
| Policy acquisition costs and other insurance expenses | --   | --    | --     |

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| <b>For the three months ended June 30, 2011 (continued):</b> | Other invested<br>assets- non-<br>redeemable<br>preferred stock | Other invested<br>assets- other<br>equity securities | Reinsurance<br>ceded receivable-<br>embedded<br>derivative | Interest sensitive<br>contract liabilities<br>embedded<br>derivative |
|--|---|--|--|--|
| Fair value, beginning of period                              | \$ 420  | \$ 14,134  | \$ 82,482  | \$ (739,017)   |
| Total gains/losses (realized/unrealized)                     |   |  |  |  |
| Included in earnings, net:                                   |   |  |  |  |
| Investment income, net of related expenses                   | --  | --   | --   | --   |
| Investment related gains (losses), net                       | --  | 3,504  | --   | (25,860)   |
| Claims & other policy benefits                               | --  | --   | --   | (603)  |
| Interest credited  | --  | --   | --   | (36,267)   |
| Policy acquisition costs and other insurance expenses        | --  | --   | 4,473  | --   |
| Included in other comprehensive income                       | --  | (2,704)  | --   | --   |
| Purchases <sup>(1)</sup>                                     | --  | --   | 1,831  | (21,302)   |
| Sales <sup>(1)</sup>   | (420)   | (3,933)  | --   | --   |
| Settlements <sup>(1)</sup>                                   | --  | --   | (2,757)  | 18,878   |
| Transfers into Level 3                                       | --  | --   | --   | --   |
| Transfers out of Level 3                                     | --  | --   | --   | --   |
| Fair value, end of period                                    | \$ --   | \$ 11,001  | \$ 86,029  | \$ (804,171)   |

Unrealized gains and losses recorded in earnings for the period relating to those Level 3 assets and liabilities that were still held at the end of the period

| Included in earnings, net:                            |       |       |        |          |
|---|-------|-------|--------|----------|
| Investment income, net of related expenses            | \$ -- | \$ -- | \$ --  | \$ --    |
| Investment related gains (losses), net                | --    | --    | --     | (25,861) |
| Claims & other policy benefits                        | --    | --    | --     | (1,370)  |
| Interest credited                                     | --    | --    | --     | (55,145) |
| Policy acquisition costs and other insurance expenses | --    | --    | 10,645 | --       |

(1) The amount reported within purchases, sales and settlements is the purchase price (for purchases) and the sales/settlement proceeds (for sales and settlements) based upon the actual date purchased or sold/settled. Items purchased and sold/settled in the same period are excluded from the rollforward. The Company had no issuances during the period.

| <b>For the six months ended June 30, 2011:</b>        | Fixed maturity securities - available-for-sale |  |                            |   |
|---|--|--|----------------------------|---|
|   | Corporate<br>securities                        | Residential<br>mortgage-<br>backed<br>securities | Asset-backed<br>securities | Commercial<br>mortgage-<br>backed<br>securities |
| Fair value, beginning of period                       | \$ 872,179                                     | \$ 183,291                                       | \$ 228,558                 | \$ 147,556                                      |
| Total gains/losses (realized/unrealized)              |  |  |                            |   |
| Included in earnings, net:                            |  |  |                            |   |
| Investment income, net of related expenses            | 162  | 493  | 904                        | 1,169   |
| Investment related gains (losses), net                | 741  | (401)  | (2,827)                    | (2,732)   |
| Claims & other policy benefits                        | --   | --   | --                         | --  |
| Interest credited                                     | --   | --   | --                         | --  |
| Policy acquisition costs and other insurance expenses | --   | --   | --                         | --  |
| Included in other comprehensive income                | 9,450  | 4,484  | 7,413                      | 27,316  |
| Purchases <sup>(1)</sup>                              | 197,807  | 5,782  | 29,880                     | 7,683   |
| Sales <sup>(1)</sup>                                  | (21,071)                                       | (20,701)   | (22,298)                   | --  |
| Settlements <sup>(1)</sup>                            | (75,730)                                       | (12,365)   | (16,841)                   | (3,410)   |
| Transfers into Level 3                                | 60,679   | 5,001  | 21,501                     | 66,854  |
| Transfers out of Level 3                              | (66,657)                                       | (62,154)   | (57,517)                   | (93,671)  |
| Fair value, end of period                             | \$ 977,560                                     | \$ 103,430                                       | \$ 188,773                 | \$ 150,765                                      |

Unrealized gains and losses recorded in earnings for the period relating to those Level 3 assets and liabilities that were still held at the end of the period

| Included in earnings, net:                 |        |        |        |          |
|--|--------|--------|--------|----------|
| Investment income, net of related expenses | \$ 130 | \$ 474 | \$ 838 | \$ 1,155 |

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|   |       |      |         |         |
|---|-------|------|---------|---------|
| Investment related gains (losses), net                | (514) | (44) | (3,551) | (2,743) |
| Claims & other policy benefits                        | --    | --   | --      | --      |
| Interest credited                                     | --    | --   | --      | --      |
| Policy acquisition costs and other insurance expenses | --    | --   | --      | --      |

**Table of Contents****For the six months ended June 30, 2011 (continued):**

|   | Fixed maturity securities -<br>available-for-sale   |   |  |
|---|---|---|--|
|   | State<br>and political<br>subdivision<br>securities | Other foreign<br>government<br>securities | Funds withheld<br>at interest-<br>embedded<br>derivative |
| Fair value, beginning of period                       | \$ 6,983  | \$ 6,736                                  | \$ (274,220)   |
| Total gains/losses (realized/unrealized)              |   |   |  |
| Included in earnings, net:                            |   |   |  |
| Investment income, net of related expenses            | 370   | 1   | --   |
| Investment related gains (losses), net                | (8)   | --  | 101,060  |
| Claims & other policy benefits                        | --  | --  | --   |
| Interest credited                                     | --  | --  | --   |
| Policy acquisition costs and other insurance expenses | --  | --  | --   |
| Included in other comprehensive income                | 3,615   | 8   | --   |
| Purchases <sup>(1)</sup>                              | 871   | --  | --   |
| Sales <sup>(1)</sup>                                  | --  | (161)                                     | --   |
| Settlements <sup>(1)</sup>                            | (43)  | --  | --   |
| Transfers into Level 3                                | 48,469  | 21  | --   |
| Transfers out of Level 3                              | (37,325)  | (2,531)                                   | --   |
| Fair value, end of period                             | \$ 22,932   | \$ 4,074                                  | \$ (173,160)   |

Unrealized gains and losses recorded in earnings for the period relating to those Level 3 assets and liabilities that were still held at the end of the period

|   |        |         |         |
|---|--------|---------|---------|
| Included in earnings, net:                            |        |         |         |
| Investment income, net of related expenses            | \$ 370 | \$ (36) | \$ --   |
| Investment related gains (losses), net                | --     | --      | 101,060 |
| Claims & other policy benefits                        | --     | --      | --      |
| Interest credited                                     | --     | --      | --      |
| Policy acquisition costs and other insurance expenses | --     | --      | --      |

**For the six months ended June 30, 2011 (continued):**

|   | Other invested<br>assets- non-<br>redeemable<br>preferred stock | Other invested<br>assets- other<br>equity securities | Reinsurance<br>ceded receivable-<br>embedded<br>derivative | Interest sensitive<br>contract liabilities<br>embedded<br>derivative |
|---|---|--|--|--|
|   | Fair value, beginning of period                                 | \$ 420   | \$ 16,416  | \$ 75,431  |
| Total gains/losses (realized/unrealized)              |   |  |  |  |
| Included in earnings, net:                            |   |  |  |  |
| Investment income, net of related expenses            | --  | --   | --   | --   |
| Investment related gains (losses), net                | --  | 3,504  | --   | 6,794  |
| Claims & other policy benefits                        | --  | --   | --   | 317  |
| Interest credited                                     | --  | --   | --   | (86,116)   |
| Policy acquisition costs and other insurance expenses | --  | --   | 12,312   | --   |
| Included in other comprehensive income                | --  | (4,987)  | --   | --   |
| Purchases <sup>(1)</sup>                              | --  | --   | 4,264  | (41,220)   |
| Sales <sup>(1)</sup>                                  | (420)   | (3,932)  | --   | --   |
| Settlements <sup>(1)</sup>                            | --  | --   | (5,978)  | 37,539   |
| Transfers into Level 3                                | --  | --   | --   | --   |
| Transfers out of Level 3                              | --  | --   | --   | --   |
| Fair value, end of period                             | \$ --   | \$ 11,001  | \$ 86,029  | \$ (804,171)   |

Unrealized gains and losses recorded in earnings for the period relating to those Level 3 assets and liabilities that were still held at the end of the period

Included in earnings, net:

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|   |    |    |    |    |    |        |    |           |
|---|----|----|----|----|----|--------|----|-----------|
| Investment income, net of related expenses            | \$ | -- | \$ | -- | \$ | --     | \$ | --        |
| Investment related gains (losses), net                |    | -- |    | -- |    | --     |    | 6,794     |
| Claims & other policy benefits                        |    | -- |    | -- |    | --     |    | (16)      |
| Interest credited                                     |    | -- |    | -- |    | --     |    | (123,655) |
| Policy acquisition costs and other insurance expenses |    | -- |    | -- |    | 18,485 |    | --        |

- (1) The amount reported within purchases, sales and settlements is the purchase price (for purchases) and the sales/settlement proceeds (for sales and settlements) based upon the actual date purchased or sold/settled. Items purchased and sold/settled in the same period are excluded from the rollforward. The Company had no issuances during the period.

**Table of Contents***Nonrecurring Fair Value Measurements*

Certain assets and liabilities are measured at fair value on a nonrecurring basis. Nonrecurring fair value adjustments on impaired commercial mortgage loans resulted in \$1.0 million and \$(2.7) million of net gains (losses) being recorded for the three and six months ended June 30, 2012, respectively. The carrying value of these impaired mortgage loans as of June 30, 2012 was \$23.4 million. Nonrecurring fair value adjustments on impaired commercial mortgage loans resulted in \$(0.7) million and \$0.4 million of net gains (losses) being recorded for the three and six months ended June 30, 2011, respectively. The carrying value of the 2011 impaired mortgage loans as of June 30, 2011 was \$15.3 million, based on the fair value of the underlying real estate collateral. Subsequent improvements in estimated fair value on previously impaired loans recorded through a reduction in the previously established valuation allowance are reported as gains. Nonrecurring fair value adjustments on mortgage loans are based on the fair value of underlying collateral or discounted cash flows and were classified as Level 3 in the fair value hierarchy.

*Fair Value of Financial Instruments*

The Company is required by general accounting principles for *Fair Value Measurements and Disclosures* to disclose the fair value of certain financial instruments including those that are not carried at fair value. The following table presents the carrying amounts and estimated fair values of the Company's financial instruments, which were not measured at fair value on a recurring basis, at June 30, 2012 and December 31, 2011 (dollars in thousands):

| June 30, 2012  | Carrying Value | Estimated Fair Value | Fair Value Measurement Using: |           |               |
|--|----------------|----------------------|-------------------------------|-----------|---------------|
|  |                |                      | Level 1                       | Level 2   | Level 3       |
| <b>Assets:</b>   |                |                      |                               |           |               |
| Mortgage loans on real estate                          | \$ 1,157,049   | \$ 1,254,696         | \$ --                         | \$ --     | \$ 1,254,696  |
| Policy loans   | 1,250,238      | 1,250,238            | --                            | 1,250,238 | --            |
| Funds withheld at interest <sup>(1)</sup>              | 5,457,888      | 6,229,065            | --                            | --        | 6,229,065     |
| Cash and cash equivalents <sup>(2)</sup>               | 578,746        | 578,746              | 578,746                       | --        | --            |
| Short-term investments <sup>(2)</sup>                  | 46,277         | 46,277               | 46,277                        | --        | --            |
| Investment receivable                                  | 5,406,898      | 5,457,290            | 753,221                       | 3,172,107 | 1,531,962     |
| Other invested assets <sup>(2)</sup>                   | 497,238        | 508,730              | --                            | 18,900    | 489,830       |
| Accrued investment income                              | 182,586        | 182,586              | --                            | 182,586   | --            |
| <b>Liabilities:</b>                                    |                |                      |                               |           |               |
| Interest-sensitive contract liabilities <sup>(1)</sup> | \$ 11,486,794  | \$ 11,553,027        | \$ --                         | \$ --     | \$ 11,553,027 |
| Long-term debt   | 1,414,969      | 1,481,569            | --                            | --        | 1,481,569     |
| Collateral finance facility                            | 651,936        | 423,475              | --                            | --        | 423,475       |

| December 31, 2011:                                     | Carrying Value | Estimated Fair Value |
|--|----------------|----------------------|
|  |                |                      |
| <b>Assets:</b>   |                |                      |
| Mortgage loans on real estate                          | \$ 991,731     | \$ 1,081,924         |
| Policy loans   | 1,260,400      | 1,260,400            |
| Funds withheld at interest <sup>(1)</sup>              | 5,410,424      | 6,041,984            |
| Cash and cash equivalents <sup>(2)</sup>               | 458,348        | 458,348              |
| Short-term investments <sup>(2)</sup>                  | 41,895         | 41,895               |
| Other invested assets <sup>(2)</sup>                   | 500,681        | 503,293              |
| Accrued investment income                              | 144,334        | 144,334              |
| <b>Liabilities:</b>                                    |                |                      |
| Interest-sensitive contract liabilities <sup>(1)</sup> | \$ 6,203,001   | \$ 6,307,779         |
| Long-term debt   | 1,414,688      | 1,462,329            |
| Collateral finance facility                            | 652,032        | 390,900              |

(1) Carrying values presented herein differ from those presented in the condensed consolidated balance sheets because certain items within the respective financial statement caption are embedded derivatives and are measured at fair value on a recurring basis.

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(2) Carrying values presented herein differ from those presented in the condensed consolidated balance sheets because certain items within the respective financial statement caption are measured at fair value on a recurring basis.

*Mortgage Loans on Real Estate* The fair value of mortgage loans on real estate is estimated by discounting cash flows, both principal and interest, using current interest rates for mortgage loans with similar credit ratings and similar remaining maturities. As such, inputs include current treasury yields and spreads, which are based on the credit rating and average life of the loan, corresponding to the market spreads. The valuation of mortgage loans on real estate is considered Level 3 in the fair value hierarchy.

*Policy Loans* Policy loans typically carry an interest rate that is adjusted annually based on an observable market index and therefore carrying value approximates fair value. The valuation of policy loans is considered Level 2 in the fair value hierarchy.



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*Funds Withheld at Interest* 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. Ceding companies use a variety of sources and pricing methodologies, which are not transparent to the Company and may include significant unobservable inputs, to value the securities that are held in distinct portfolios, therefore the valuation of these funds withheld assets are considered Level 3 in the fair value hierarchy.

*Investment Receivable* Investment receivable includes invested assets expected to be received pursuant to a reinsurance transaction and the related accrued investment income. The invested assets expected to be received include fixed maturity securities, mortgage loans on real estate, cash and cash equivalents, short-term investments and accrued interest. Fixed maturity securities include corporate securities, structured securities and government securities, included in Level 2 and Level 3 in the fair value hierarchy consistent with the valuation methods described above in the Assets and Liabilities by Hierarchy Level section. Mortgage loans on real estate are considered Level 3 in the fair value hierarchy. Cash and cash equivalents and short-term investments are considered Level 1 in the fair value hierarchy. The valuation of these invested assets is consistent with similar financial instruments discussed elsewhere within this note to the condensed consolidated financial statements.

*Cash and Cash Equivalents and Short-term Investments* The carrying values of cash and cash equivalents and short-term investments approximates fair values due to the short-term maturities of these instruments and are considered Level 1 in the fair value hierarchy.

*Other Invested Assets* This primarily includes limited partnership interests accounted for using the cost method, structured loans and Federal Home Loan Bank of Des Moines common stock. The fair value of limited partnerships is determined using the net asset values of the Company's ownership interest as provided in the financial statements of the investees. The valuation of limited partnerships is considered Level 3 in the fair value hierarchy due to the limited activity and price transparency inherent in the market for such investments. The fair value of structured loans is estimated based on a discounted cash flow analysis where the discount rate is based on a Japanese yen forward curve, this is considered Level 3 in the fair value hierarchy. The fair value of the Company's common stock investment in the Federal Home Loan Bank of Des Moines is considered to be the carrying value and it is considered Level 2 in the fair value hierarchy.

*Accrued Investment Income* The carrying value for accrued investment income approximates fair value as there are no adjustments made to the carrying value. This is considered Level 2 in the fair value hierarchy.

*Interest-Sensitive Contract Liabilities* 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 utilizes a market standard technique with both capital market inputs and policyholder behavior assumptions, as well as cash values adjusted for recapture fees. The capital market inputs to the model, such as interest rates, are generally observable. Policyholder behavior assumptions are generally not observable and may require use of significant management judgment. The valuation of interest-sensitive contract liabilities is considered Level 3 in the fair value hierarchy.

*Long-term Debt and Collateral Finance Facility* The fair value of the Company's long-term debt and collateral finance facility is generally estimated by discounting future cash flows using market rates currently available for debt with similar remaining maturities and reflecting the credit risk of the Company, including inputs when available, from actively traded debt of the Company or other companies with similar credit quality. The valuation of long-term debt and collateral finance facility are generally obtained from brokers and are considered Level 3 in the fair value hierarchy.

## **7. Segment Information**

The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies in Note 2 of the consolidated financial statements accompanying the DAC Current Report. The Company measures segment performance primarily based on profit or loss from operations before income taxes. There are no intersegment reinsurance transactions and the Company does not have any material long-lived assets. Investment income is allocated to the segments based upon average assets and related capital levels deemed appropriate to support the segment business volumes.

The Company allocates capital to its segments based on an internally developed economic capital model, the purpose of which is to measure the risk in the business and to provide a basis upon which capital is deployed. The economic capital model considers the unique and specific nature of the risks inherent in the Company's businesses. As a result of the economic capital allocation process, a portion of investment income and investment related gains and losses are attributed to the segments based on the level of allocated capital. In addition, the segments are charged for excess capital utilized above



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the allocated economic capital basis. This charge is included in policy acquisition costs and other insurance expenses. Information related to total revenues, income (loss) before income taxes, and total assets of the Company for each reportable segment are summarized below (dollars in thousands).

| <b>Total revenues:</b> | Three months ended June 30, |              | Six months ended June 30, |              |
|------------------------|-----------------------------|--------------|---------------------------|--------------|
|                        | 2012                        | 2011         | 2012                      | 2011         |
| U.S.                   | \$ 1,370,221                | \$ 1,255,317 | \$ 2,694,368              | \$ 2,608,543 |
| Canada                 | 276,239                     | 264,098      | 551,862                   | 530,625      |
| Europe & South Africa  | 323,943                     | 296,385      | 632,280                   | 577,388      |
| Asia Pacific           | 377,733                     | 346,474      | 737,418                   | 685,988      |
| Corporate and Other    | 27,617                      | 41,703       | 52,800                    | 83,868       |
| Total                  | \$ 2,375,753                | \$ 2,203,977 | \$ 4,668,728              | \$ 4,486,412 |

| <b>Income (loss) before income taxes:</b> | Three months ended June 30, |            | Six months ended June 30, |            |
|---|-----------------------------|------------|---------------------------|------------|
|   | 2012                        | 2011       | 2012                      | 2011       |
| U.S.                                      | \$ 140,586                  | \$ 114,277 | \$ 233,331                | \$ 261,846 |
| Canada                                    | 35,030                      | 44,089     | 90,093                    | 74,001     |
| Europe & South Africa                     | 19,591                      | 12,525     | 26,197                    | 35,060     |
| Asia Pacific                              | 23,859                      | 4,326      | 55,926                    | 26,302     |
| Corporate and Other                       | (3,174)                     | 11,952     | (8,892)                   | 16,715     |
| Total                                     | \$ 215,892                  | \$ 187,169 | \$ 396,655                | \$ 413,924 |

| <b>Total Assets:</b>  | June 30, 2012 | December 31, 2011 |
|-----------------------|---------------|-------------------|
| U.S.                  | \$ 24,620,708 | \$ 17,965,559     |
| Canada                | 3,605,798     | 3,347,771         |
| Europe & South Africa | 2,148,457     | 1,846,751         |
| Asia Pacific          | 3,000,018     | 2,902,101         |
| Corporate and Other   | 4,969,342     | 5,571,791         |
| Total                 | \$ 38,344,323 | \$ 31,633,973     |

The increase in total assets in the U.S. segment since December 31, 2011 is primarily due to a \$5.4 billion investment receivable related to a large fixed annuity transaction executed in the second quarter of 2012.

**8. Commitments and Contingent Liabilities**

At June 30, 2012, the Company's commitments to fund investments were \$186.2 million in limited partnerships, \$49.5 million in commercial mortgage loans and \$106.0 million in private placement investments, of which \$100.0 million was funded on July 13, 2012. At December 31, 2011, the Company's commitments to fund investments were \$156.6 million in limited partnerships, \$33.6 million in commercial mortgage loans and \$100.0 million in private placement investments. The Company anticipates that the majority of its current commitments will be invested over the next five years; however, these commitments could become due any time at the request of the counterparties. Investments in limited partnerships and private placements are carried at cost or accounted for using the equity method and included in other invested assets in the condensed consolidated balance sheets.

The Company is subject to litigation in the normal course of its business. The Company currently has no material litigation. A legal reserve is established when the Company is notified of an arbitration demand or litigation or is notified that an arbitration demand or litigation is imminent, it is probable that the Company will incur a loss as a result and the amount of the probable loss is reasonably capable of being estimated.

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The Company has obtained bank letters of credit in favor of various affiliated and unaffiliated insurance companies from which the Company assumes business. These letters of credit represent guarantees of performance under the reinsurance agreements and allow ceding companies to take statutory reserve credits. Certain of these letters of credit contain financial covenant restrictions. At June 30, 2012 and December 31, 2011, there were approximately \$16.0 million and \$15.8 million, respectively, of undrawn outstanding bank letters of credit in favor of third parties. Additionally, the Company utilizes letters of credit to secure reserve credits when it retrocedes business to its subsidiaries, including Parkway Reinsurance Company ( Parkway Re ), Rockwood Reinsurance Company ( Rockwood Re ), Timberlake Financial L.L.C. ( Timberlake Financial ), RGA Americas Reinsurance, Ltd. ( RGA Americas ), RGA Reinsurance Company (Barbados) Ltd. ( RGA Barbados ) and RGA Atlantic Reinsurance Company, Ltd. ( RGA Atlantic ). The Company cedes business to its affiliates to help reduce the amount of regulatory capital required in certain jurisdictions such as the U.S. and the United Kingdom.

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The capital required to support the business in the affiliates reflects more realistic expectations than the original jurisdiction of the business, where capital requirements are often considered to be quite conservative. As of June 30, 2012 and December 31, 2011, \$527.7 million and \$582.9 million, respectively, in undrawn letters of credit from various banks were outstanding, backing reinsurance between the various subsidiaries of the Company. The banks providing letters of credit to the Company are included on the National Association of Insurance Commissioners ( NAIC ) list of approved banks.

The Company maintains a syndicated revolving credit facility with a four year term and an overall capacity of \$850.0 million which is scheduled to mature in December 2015. The Company may borrow cash and obtain letters of credit in multiple currencies under this facility. As of June 30, 2012, the Company had \$263.3 million in issued, but undrawn, letters of credit under this facility, which is included in the total above. Applicable letter of credit fees and fees payable for the credit facility depend upon the Company's senior unsecured long-term debt rating. The Company also maintains two other letter of credit facilities with capacities of \$200.0 million and \$120.0 million which are scheduled to mature in September 2019 and May 2016, respectively. The \$200.0 million letter of credit facility is fully utilized and is expected to amortize to zero by 2019. Letter of credit fees for this facility are fixed for the term of the facility. As of June 30, 2012, the Company had no issued letters of credit under the \$120.0 million letter of credit facility. Letter of credit fees for this facility are fixed for the term of the facility. Fees associated with the Company's other letters of credit are not fixed for periods in excess of one year and are based on the Company's ratings and the general availability of these instruments in the marketplace.

RGA has issued guarantees to third parties on behalf of its subsidiaries for the payment of amounts due under certain reinsurance treaties, securities borrowing arrangements and office lease obligations, whereby, if a subsidiary fails to meet an obligation, RGA or one of its other subsidiaries will make a payment to fulfill the obligation. In limited circumstances, treaty guarantees are granted to ceding companies in order to provide them additional security, particularly in cases where RGA's subsidiary is relatively new, unrated, or not of a significant size, relative to the ceding company. Liabilities supported by the treaty guarantees, before consideration for any legally offsetting amounts due from the guaranteed party, totaled \$656.1 million and \$697.5 million as of June 30, 2012 and December 31, 2011, respectively, and are reflected on the Company's condensed consolidated balance sheets in future policy benefits. As of June 30, 2012 and December 31, 2011, the Company's exposure related to treaty guarantees, net of assets held in trust, was \$434.5 million and \$467.5 million, respectively. Potential guaranteed amounts of future payments will vary depending on production levels and underwriting results. Guarantees related to borrowed securities provide additional security to third parties should a subsidiary fail to make principal and/or interest payments when due. As of June 30, 2012 and December 31, 2011, RGA's obligation related to borrowed securities guarantees was \$237.5 million and \$150.0 million, respectively.

Manor Reinsurance, Ltd. ( Manor Re ), a subsidiary of RGA, has obtained \$300.0 million of collateral financing through 2020 from an international bank which enabled Manor Re to deposit assets in trust to support statutory reserve credits for an affiliated reinsurance transaction. The bank has recourse to RGA should Manor Re fail to make payments or otherwise not perform its obligations under this financing.

In addition, the Company indemnifies its directors and officers as provided in its charters and by-laws. Since this indemnity generally is not subject to limitation with respect to duration or amount, the Company does not believe that it is possible to determine the maximum potential amount due under this indemnity in the future.

**Table of Contents****9. Employee Benefit Plans**

The components of net periodic benefit costs for the three and six months ended June 30, 2012 and 2011 were as follows (dollars in thousands):

|   | Three months ended June 30, |                 | Six months ended June 30, |                 |
|---|-----------------------------|-----------------|---------------------------|-----------------|
|   | 2012                        | 2011            | 2012                      | 2011            |
| <b>Net periodic pension benefit cost:</b> |                             |                 |                           |                 |
| Service cost                              | \$ 2,196                    | \$ 1,597        | \$ 3,728                  | \$ 3,012        |
| Interest cost                             | 1,090                       | 1,052           | 2,070                     | 1,942           |
| Expected return on plan assets            | (799)                       | (825)           | (1,533)                   | (1,469)         |
| Amortization of prior service cost        | 87                          | 94              | 186                       | 101             |
| Amortization of prior actuarial gain      | 1,388                       | 314             | 1,663                     | 502             |
| <b>Total</b>                              | <b>\$ 3,962</b>             | <b>\$ 2,232</b> | <b>\$ 6,114</b>           | <b>\$ 4,088</b> |
| <b>Net periodic other benefits cost:</b>  |                             |                 |                           |                 |
| Service cost                              | \$ 279                      | \$ 212          | \$ 558                    | \$ 424          |
| Interest cost                             | 258                         | 221             | 517                       | 441             |
| Expected return on plan assets            | --                          | --              | --                        | --              |
| Amortization of prior service cost        | --                          | --              | --                        | --              |
| Amortization of prior actuarial gain      | 89                          | 59              | 177                       | 118             |
| <b>Total</b>                              | <b>\$ 626</b>               | <b>\$ 492</b>   | <b>\$ 1,252</b>           | <b>\$ 983</b>   |

The Company has made pension contributions of \$2.0 million during the first six months of 2012 and expects to make total pension contributions of \$6.2 million in 2012.

**10. Equity Based Compensation**

Equity compensation expense was \$5.5 million and \$4.3 million in the second quarter of 2012 and 2011, respectively. In the first quarter of 2012, the Company granted 0.7 million stock appreciation rights at \$56.65 weighted average per share and 0.2 million performance contingent units to employees. Additionally, non-employee directors were granted a total of 10,350 shares of common stock. As of June 30, 2012, 1.8 million share options at \$46.12 weighted average per share were vested and exercisable with a remaining weighted average exercise period of 4.5 years. As of June 30, 2012, the total compensation cost of non-vested awards not yet recognized in the financial statements was \$35.2 million. It is estimated that these costs will vest over a weighted average period of 2.3 years.

**11. Retrocession Arrangements and Reinsurance Ceded Receivables**

The Company generally reports retrocession activity on a gross basis. Amounts paid or deemed to have been paid for reinsurance are reflected in reinsurance ceded receivables. The cost of reinsurance related to long-duration contracts is recognized over the terms of the reinsured policies on a basis consistent with the reporting of those policies. In the normal course of business, the Company seeks to limit its exposure to loss on any single insured and to recover a portion of benefits paid by ceding reinsurance to other insurance enterprises or reinsurers under excess coverage, quota share and coinsurance contracts.

Certain retrocessions are arranged through the Company's retrocession pools for amounts in excess of the Company's retention limit. As of June 30, 2012 and December 31, 2011, all rated retrocession pool participants followed by the A.M. Best Company were rated A- (excellent) or better. The Company verifies retrocession pool participants' ratings on a quarterly basis. For a majority of the retrocessionaires that were not rated, security in the form of letters of credit or trust assets has been given as additional security in favor of RGA Reinsurance Company (RGA Reinsurance). In addition, the Company performs annual financial reviews of its retrocessionaires to evaluate financial stability and performance. In addition to its third party retrocessionaires, various RGA reinsurance subsidiaries retrocede amounts in excess of their retention to RGA Reinsurance, Parkway Re, Rockwood Re, RGA Barbados, RGA Americas, Manor Re, RGA Atlantic or RGA Worldwide Reinsurance Company, Ltd. (RGA Worldwide).

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As of June 30, 2012 and December 31, 2011, the Company had claims recoverable from retrocessionaires of \$173.1 million and \$151.9 million, respectively, which is included in reinsurance ceded receivables, in the condensed consolidated balance sheets. The Company considers outstanding claims recoverable in excess of 90 days to be past due. There were \$6.1 million and \$11.4 million of past due claims recoverable as of June 30, 2012 and December 31, 2011, respectively. Based on financial reviews of the counterparties, the Company has not established a valuation allowance for claims recoverable. The Company has never experienced a material default in connection with retrocession arrangements, nor has it experienced any difficulty in collecting claims recoverable from retrocessionaires; however, no assurance can be given as to the future performance of such retrocessionaires or as to recoverability of any such claims.

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**Table of Contents****12. New Accounting Standards**

Changes to the general accounting principles are established by the FASB in the form of accounting standards updates to the FASB Accounting Standards Codification. Accounting standards updates not listed below were assessed and determined to be either not applicable or are expected to have minimal impact on the Company's consolidated financial statements.

***Adoption of New Accounting Standards******Transfers and Servicing***

In April 2011, the FASB amended the general accounting principles for *Transfers and Servicing* as it relates to the reconsideration of effective control for repurchase agreements. This amendment removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets and also removes the collateral maintenance implementation guidance related to that criterion. The amendment is effective for interim and annual periods beginning after December 15, 2011. The adoption of this amendment did not have an impact on the Company's condensed consolidated financial statements.

***Fair Value Measurements and Disclosures***

In May 2011, the FASB amended the general accounting principles for *Fair Value Measurements and Disclosures* as it relates to the measurement and disclosure requirements about fair value measurements. This amendment clarifies the FASB's intent about the application of existing fair value measurement requirements. It also changes particular principles and requirements for measuring fair value and for disclosing information about fair value measurements. The amendment is effective for interim and annual periods beginning after December 15, 2011. The Company adopted this amendment and the required disclosures are provided in Note 6 – Fair Value of Assets and Liabilities.

***Deferred Policy Acquisition Costs***

In October 2010, the FASB amended the general accounting principles for *Financial Services – Insurance* as it relates to accounting for costs associated with acquiring or renewing insurance contracts. This amendment clarifies that only those costs that result directly from and are essential to the contract transaction and that would not have been incurred had the contract transaction not occurred can be capitalized. It also defines acquisition costs as costs that are related directly to the successful acquisitions of new or renewal insurance contracts. The amendment is effective for fiscal years and interim periods beginning after December 15, 2011. The retrospective adoption of this amendment on January 1, 2012, resulted in a reduction in the Company's deferred acquisition cost asset and a corresponding reduction to equity. There will be a decrease in amortization subsequent to adoption due to the reduced deferred acquisition cost asset. There will also be a reduction in the level of future costs the Company defers; thereby increasing expenses incurred in future periods. The Company retrospectively adopted this amendment and the required disclosures are provided in Note 1 – Organization and Basis of Presentation.

***Comprehensive Income***

In June 2011, the FASB amended the general accounting principles for *Comprehensive Income* as it relates to the presentation of comprehensive income. This amendment requires entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in either a continuous statement of comprehensive income or in two separate but consecutive statements. The amendment does not change the items that must be reported in other comprehensive income. In December 2011, the FASB amended the general accounting principles for *Comprehensive Income* as it relates to the presentation of comprehensive income. This amendment defers the requirement to present the effects of reclassifications out of accumulated other comprehensive income on the Company's consolidated statements of income, which was required in the *Comprehensive Income* amendment made in June 2011. These amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted these amendments and the required presentation is provided in the Condensed Consolidated Statements of Comprehensive Income.



**Table of Contents****Future Adoption of New Accounting Standards***Basis of Presentation*

In December 2011, the FASB amended the general accounting principles for *Balance Sheet* as it relates to the disclosures about offsetting assets and liabilities. The amendment requires disclosures about the Company's rights of offset and related arrangements associated with its financial instruments and derivative instruments. This amendment also requires the disclosure of both gross and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendment is effective for interim and annual reporting periods beginning on or after January 1, 2013. The Company is currently evaluating the impact of this amendment on its condensed consolidated financial statements.

**13. Subsequent Event**

In satisfaction of the investment receivable of \$5,406.9 million, as of June 30, 2012, the Company received the following on July 31, 2012 and August 3, 2012 (dollars in thousands):

|   | Amortized Cost/<br>Recorded<br>Investment | Estimated<br>Fair Value |
|---|---|-------------------------|
| Fixed maturity securities available for sale:   |   |                         |
| Corporate securities  | \$ 2,585,095                              | \$ 2,606,816            |
| Asset-backed securities   | 137,251                                   | 138,918                 |
| Commercial mortgage-backed securities   | 703,313                                   | 704,065                 |
| U.S. Government and agencies securities   | 240,952                                   | 256,168                 |
| State and political subdivision securities  | 27,297                                    | 27,555                  |
| Other foreign government, supranational, and foreign government-sponsored enterprises | 56,776                                    | 55,437                  |
| <br>  |   |                         |
| Total fixed maturity securities available for sale                                    | 3,750,684                                 | 3,788,959               |
| Mortgage loans on real estate   | 1,009,454                                 | 1,021,661               |
| Short-term investments  | 101,428                                   | 101,338                 |
| Cash and cash equivalents   | 501,593                                   | 501,593                 |
| Accrued interest  | 43,739                                    | 43,739                  |
| <br>  |   |                         |
| Total   | \$ 5,406,898                              | \$ 5,457,290            |

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward-Looking and Cautionary Statements**

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 including, among others, statements relating to projections of the strategies, earnings, revenues, income or loss, ratios, future financial performance, and growth potential of the Company. The words intend, expect, project, estimate, predict, anticipate, should, believe, and other similar expressions are intended to identify forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future events and actual results, performance, and achievements could differ materially from those set forth in, contemplated by, or underlying the forward-looking statements.

Numerous important factors could cause actual results and events to differ materially from those expressed or implied by forward-looking statements including, without limitation, (1) adverse capital and credit market conditions and their impact on the Company's liquidity, access to capital and cost of capital, (2) the impairment of other financial institutions and its effect on the Company's business, (3) requirements to post collateral or make payments due to declines in market value of assets subject to the Company's collateral arrangements, (4) the fact that the determination of allowances and impairments taken on the Company's investments is highly subjective, (5) adverse changes in mortality, morbidity, lapsation or claims experience, (6) changes in the Company's financial strength and credit ratings and the effect of such changes on the Company's future results of operations and financial condition, (7) inadequate risk analysis and underwriting, (8) general economic conditions or a prolonged economic downturn affecting the demand for insurance and reinsurance in the Company's current and planned markets, (9) the availability and cost of collateral necessary for regulatory reserves and capital, (10) market or economic conditions that adversely affect the value of the Company's investment securities or result in the impairment of all or a portion of the value of certain of the Company's investment securities, that in turn could affect regulatory capital, (11) market or economic conditions that adversely affect the Company's ability to make timely sales of investment securities, (12) risks inherent in the Company's risk management and investment strategy, including changes in investment portfolio yields due to interest rate or credit quality changes, (13) fluctuations in U.S. or foreign currency exchange rates, interest rates, or securities and real estate markets, (14) adverse litigation or arbitration results, (15) the adequacy of reserves, resources and accurate information relating to settlements, awards and terminated and discontinued lines of business, (16) the stability of and actions by governments and economies in the markets in which the Company operates, including ongoing uncertainties regarding the amount of United States sovereign debt and the credit ratings thereof, (17) competitive factors and competitors' responses to the Company's initiatives, (18) the success of the Company's clients, (19) successful execution of the Company's entry into new markets, (20) successful development and introduction of new products and distribution opportunities, (21) the Company's ability to successfully integrate and operate reinsurance business that the Company acquires, (22) action by regulators who have authority over the Company's reinsurance operations in the jurisdictions in which it operates, (23) the Company's dependence on third parties, including those insurance companies and reinsurers to which the Company cedes some reinsurance, third-party investment managers and others, (24) the threat of natural disasters, catastrophes, terrorist attacks, epidemics or pandemics anywhere in the world where the Company or its clients do business, (25) changes in laws, regulations, and accounting standards applicable to the Company, its subsidiaries, or its business, (26) the effect of the Company's status as an insurance holding company and regulatory restrictions on its ability to pay principal of and interest on its debt obligations, and (27) other risks and uncertainties described in this document and in the Company's other filings with the SEC.

Forward-looking statements should be evaluated together with the many risks and uncertainties that affect the Company's business, including those mentioned in this document and the cautionary statements described in the periodic reports the Company files with the SEC. These forward-looking statements speak only as of the date on which they are made. The Company does not undertake any obligations to update these forward-looking statements, even though the Company's situation may change in the future. The Company qualifies all of its forward-looking statements by these cautionary statements. For a discussion of these risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements, you are advised to see Item 1A Risk Factors in the 2011 Annual Report and the DAC Current Report.

**Overview**

RGA is an insurance holding company that was formed on December 31, 1992. The Company is primarily engaged in the reinsurance of traditional life and health for individual and group coverages, longevity, disability income, annuity, critical illness and financial reinsurance.

The Company derives revenues primarily from renewal premiums from existing reinsurance treaties, new business premiums from existing or new reinsurance treaties and income earned on invested assets. The Company believes that industry trends have not changed materially from those discussed in its DAC Current Report.



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The Company's primary business is life reinsurance, which involves reinsuring life insurance policies that are often in force for the remaining lifetime of the underlying individuals insured, with premiums earned typically over a period of 10 to 30 years. Each year, however, a portion of the business under existing treaties terminates due to, among other things, lapses or surrenders of underlying policies, deaths of policyholders, and the exercise of recapture options by ceding companies.

As is customary in the reinsurance business, clients continually update, refine, and revise reinsurance information provided to the Company. Such revised information is used by the Company in preparation of its financial statements and the financial effects resulting from the incorporation of revised data are reflected in the current period.

The Company's long-term profitability primarily depends on the volume and amount of death claims incurred and the ability to adequately price the risks it assumes. While death claims are reasonably predictable over a period of many years, claims become less predictable over shorter periods and are subject to significant fluctuation from quarter to quarter and year to year. The maximum amount of individual life coverage the Company retains per life varies by market and can be as high as \$8.0 million. In certain limited situations the Company has retained more than \$8.0 million per individual life. Exposures in excess of these retention amounts are typically retroceded to retrocessionaires; however, the Company remains fully liable to the ceding company for the entire amount of risk it assumes. The Company believes its sources of liquidity are sufficient to cover potential claims payments on both a short-term and long-term basis.

The Company has five geographic-based or function-based operational segments, each of which is a distinct reportable segment: U.S., Canada, Europe & South Africa, Asia Pacific and Corporate and Other. The U.S. operations provide traditional life, long-term care, group life and health reinsurance, annuity and financial reinsurance products. The Canada operations reinsure traditional life products as well as creditor reinsurance, group life and health reinsurance, non-guaranteed critical illness products and longevity reinsurance. Europe & South Africa operations include a variety of life and health products, critical illness and longevity business throughout Europe and in South Africa, in addition to other markets the Company is developing. The principle types of reinsurance in Asia Pacific include life, critical illness, disability income, superannuation and financial reinsurance. Corporate and Other includes results from, among others, RGA Technology Partners, Inc. ( RTP ), a wholly-owned subsidiary that develops and markets technology solutions for the insurance industry, interest expense related to debt and the investment income and expense associated with the Company's collateral finance facility. The Company measures segment performance based on profit or loss from operations before income taxes.

The Company allocates capital to its segments based on an internally developed economic capital model, the purpose of which is to measure the risk in the business and to provide a consistent basis upon which capital is deployed. The economic capital model considers the unique and specific nature of the risks inherent in RGA's businesses. As a result of the economic capital allocation process, a portion of investment income and investment related gains and losses is credited to the segments based on the level of allocated capital. In addition, the segments are charged for excess capital utilized above the allocated economic capital basis. This charge is included in policy acquisition costs and other insurance expenses.

## **Results of Operations**

The Company has adopted the amended general accounting principles for *Financial Services - Insurance* as it relates to accounting for costs associated with acquiring or renewing insurance contracts. The prior-period results of operations presented herein have been adjusted to reflect the retrospective adoption of the new accounting principles. See Note 1- Organization and Basis of Presentation in the Notes to Condensed Consolidated Financial Statements for additional information.

During the second quarter of 2012, the Company added a large fixed deferred annuity reinsurance transaction in its U.S. Asset Intensive sub-segment. The Company deployed approximately \$350.0 million of capital to support this transaction, which increased the Company's invested asset base by approximately \$5.4 billion.

## **Consolidated**

Consolidated income before income taxes increased \$28.7 million, or 15.3%, and decreased \$17.3 million, or 4.2%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase in income before income taxes for the second quarter of 2012 was primarily due to an increase in net premiums in all segments and favorable mortality experience in the Asia Pacific segment compared to the same period in 2011. The decrease in income before income taxes for the first six months of 2012 was primarily due to a decline in investment related gains and lower investment income partially offset by increased net premiums. The decrease in investment related gains reflects changes in the value of embedded derivatives within the U.S. segment. The effect of tightening credit spreads in the U.S. markets generated an increase in revenue related to embedded derivatives to a greater extent in the first six months of 2011 than 2012. Foreign currency fluctuations relative to the prior year unfavorably affected income before income taxes by approximately \$3.9 million and \$4.5 million for the second quarter and first

six months of 2012, respectively, as compared to the same periods in 2011.

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The Company recognizes in consolidated income, changes in the value of embedded derivatives on modco or funds withheld treaties, equity-indexed annuity treaties ( EIA's ) and variable annuity products. The change in the value of embedded derivatives related to reinsurance treaties written on a modco or funds withheld basis are subject to the general accounting principles for Derivatives and Hedging related to embedded derivatives. The unrealized gains and losses associated with these embedded derivatives, after adjustment for deferred acquisition costs, decreased income before income taxes by \$9.8 million and \$36.4 million in the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011. Changes in risk-free rates used in the fair value estimates of embedded derivatives associated with EIAs affect the amount of unrealized gains and losses the Company recognizes. The unrealized gains and losses associated with EIAs, after adjustment for deferred acquisition costs and retrocession, increased income before income taxes by \$5.4 million and reduced it by \$1.5 million in the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011. The change in the Company's liability for variable annuities associated with guaranteed minimum living benefits affects the amount of unrealized gains and losses the Company recognizes. The unrealized gains and losses associated with guaranteed minimum living benefits, after adjustment for deferred acquisition costs, decreased income before income taxes by \$13.5 million and \$3.8 million in the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011.

The combined changes in these three types of embedded derivatives, after adjustment for deferred acquisition costs and retrocession, resulted in a decrease of approximately \$17.9 million and approximately \$41.7 million in consolidated income before income taxes in the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011. These fluctuations do not affect current cash flows, crediting rates or spread performance on the underlying treaties. Therefore, management believes it is helpful to distinguish between the effects of changes in the fair value of these embedded derivatives, net of related hedging activity, and the primary factors that drive profitability of the underlying treaties, namely investment income, fee income, and interest credited.

Consolidated net premiums increased \$162.0 million, or 9.1%, and \$289.3 million, or 8.2%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily due to growth in life reinsurance partially offset by foreign currency fluctuations. Foreign currency fluctuations unfavorably affected net premiums by approximately \$45.8 million and \$50.7 million for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Consolidated assumed insurance in force increased to \$2,782.3 billion as of June 30, 2012 from \$2,658.8 billion as of June 30, 2011 due to new business production. Foreign currency fluctuations negatively affected the increase in assumed life insurance in force from June 30, 2011 by \$74.4 billion. The Company added new business production, measured by face amount of insurance in force, of \$86.8 billion and \$95.0 billion during the second quarter of 2012 and 2011, respectively, and \$205.3 billion and \$183.2 billion during the first six months of 2012 and 2011, respectively. Management believes industry consolidation and the established practice of reinsuring mortality risks should continue to provide opportunities for growth, albeit at rates less than historically experienced in some markets.

Consolidated investment income, net of related expenses, decreased \$9.1 million, or 2.7%, and \$39.2 million, or 5.5%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The decreases were primarily due to market value changes related to the Company's funds withheld at interest investment associated with the reinsurance of certain EIAs which contributed to the decreases in investment income by \$45.1 million and \$94.2 million in the second quarter and first six months of 2012, respectively. The effect on investment income of the EIAs market value changes is substantially offset by a corresponding change in interest credited to policyholder account balances resulting in an insignificant effect on net income. The decreases in investment income for the second quarter and first six months were somewhat offset by \$36.8 million of investment income from an investment receivable associated with a large fixed annuity transaction executed in the second quarter of 2012. The decreases in investment income for the second quarter and first six months of 2012 also reflects a lower effective investment portfolio yield offset by a larger average invested asset base. Average invested assets at amortized cost for the six months ended June 30, 2012 totaled \$18.4 billion, an 8.0% increase over the same period in 2011. The average yield earned on investments, excluding funds withheld and investment receivable, decreased to 5.05% for the second quarter of 2012 from 5.35% for the second quarter of 2011. The average yield earned on investments, excluding funds withheld, decreased to 5.05% for the first six months of 2012 from 5.35% for the first six months of 2011. The 2012 average invested asset base and average yields exclude the previously mentioned investment receivable. The average yield will vary from quarter to quarter and year to year depending on a number of variables, including the prevailing interest rate and credit spread environment, changes in the mix of the underlying investments and cash balances, and the timing of dividends and distributions on certain investments. A continued low interest rate environment in the U.S. would be expected to put downward pressure on this yield in future reporting periods.

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Total investment related gains (losses), net decreased by \$3.6 million and \$83.7 million, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The unfavorable change for the second quarter was primarily due to an unfavorable change in the embedded derivatives related to guaranteed minimum living benefits of \$49.1 million and an unfavorable change in the embedded derivatives related to reinsurance treaties written on a modco or funds withheld basis of \$15.0 million offset by an increase in the fair value of derivatives used to hedge the embedded derivative liabilities associated with guaranteed minimum living benefits of \$63.9 million. The unfavorable change for the first six months is primarily due to unfavorable changes in the value of embedded derivatives associated with reinsurance treaties written on a modco or funds withheld basis of \$114.9 million, a decrease in the fair value of derivatives used to hedge the embedded derivative liabilities associated with guaranteed minimum living benefits of \$11.8 million and an increase in investment impairments on fixed maturity and equity securities of \$9.1 million partially offset by a favorable change in the embedded derivatives related to guaranteed minimum living benefits of \$64.7 million. See Note 4 Investments and Note 5 Derivative Instruments in the Notes to Condensed Consolidated Financial Statements for additional information on investment related gains (losses), net and derivatives. Investment income and investment related gains and losses are allocated to the operating segments based upon average assets and related capital levels deemed appropriate to support segment operations.

The effective tax rate on a consolidated basis was 34.6% and 33.8% for the second quarter of 2012 and 2011, respectively, and 33.3% and 34.1% for the first six months of 2012 and 2011, respectively. The second quarter and first six months of 2012 effective tax rates were lower than the U.S. statutory rate of 35.0% primarily as a result of income in non-U.S. jurisdictions with lower tax rates than the U.S. and differences in tax bases in foreign jurisdictions, offset by a tax accrual of \$2.1 million related to business extender provisions that the U.S. Congress did not pass prior to the end of the quarter and an accrual of uncertain tax positions. The 2011 effective tax rate was lower than the U.S. statutory rate of 35.0% primarily as a result of income in non-U.S. jurisdictions with lower tax rates than the U.S.

**Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or U.S. GAAP, requires the application of accounting policies that often involve a significant degree of judgment. Management, on an ongoing basis, reviews estimates and assumptions used in the preparation of financial statements. If management determines that modifications in assumptions and estimates are appropriate given current facts and circumstances, results of operations and financial position as reported in the condensed consolidated financial statements could change significantly.

Management believes the critical accounting policies relating to the following areas are most dependent on the application of estimates and assumptions:

- Deferred acquisition costs;
- Liabilities for future policy benefits and other policy liabilities;
- Valuation of fixed maturity securities;
- Valuation of embedded derivatives;
- Income taxes; and
- Arbitration and litigation reserves.

A discussion of each of the critical accounting policies may be found in the Company's DAC Current Report under Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies.

Further discussion and analysis of the results for 2012 compared to 2011 are presented by segment.

**U.S. Operations**

U.S. operations consist of two major sub-segments: Traditional and Non-Traditional. The Traditional sub-segment primarily specializes in individual mortality-risk reinsurance and to a lesser extent, group, health and long-term care reinsurance. The Non-Traditional sub-segment consists of Asset-Intensive and Financial Reinsurance.

**Table of Contents****For the three months ended June 30, 2012**

(dollars in thousands)

|  | Traditional  | Asset-Intensive | Non-Traditional<br>Financial<br>Reinsurance | Total<br>U.S. |
|--|--------------|-----------------|---|---------------|
| <b>Revenues:</b>   |              |                 |   |               |
| Net premiums   | \$ 1,082,400 | \$ 3,355        | \$ --                                       | \$ 1,085,755  |
| Investment income, net of related expenses   | 133,652      | 95,957          | 179   | 229,788       |
| Investment related gains (losses), net:  |              |                 |   |               |
| Other-than-temporary impairments on fixed maturity securities  | (1,822)      | --              | --  | (1,822)       |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | 162          | --              | --  | 162           |
| Other investment related gains (losses), net   | 2,449        | 12,468          | 32  | 14,949        |
| Total investment related gains (losses), net   | 789          | 12,468          | 32  | 13,289        |
| Other revenues   | 401          | 29,254          | 11,734                                      | 41,389        |
| Total revenues   | 1,217,242    | 141,034         | 11,945                                      | 1,370,221     |
| <b>Benefits and expenses:</b>  |              |                 |   |               |
| Claims and other policy benefits   | 934,807      | 5,102           | --  | 939,909       |
| Interest credited  | 14,555       | 51,926          | --  | 66,481        |
| Policy acquisition costs and other insurance expenses  | 150,958      | 46,597          | 704   | 198,259       |
| Other operating expenses   | 20,586       | 2,807           | 1,593                                       | 24,986        |
| Total benefits and expenses  | 1,120,906    | 106,432         | 2,297                                       | 1,229,635     |
| Income before income taxes   | \$ 96,336    | \$ 34,602       | \$ 9,648                                    | \$ 140,586    |

**For the three months ended June 30, 2011**

(dollars in thousands)

|  | Traditional | Asset-Intensive | Non-Traditional<br>Financial<br>Reinsurance | Total<br>U.S. |
|--|-------------|-----------------|---|---------------|
| <b>Revenues:</b>   |             |                 |   |               |
| Net premiums   | \$ 973,837  | \$ 3,459        | \$ --                                       | \$ 977,296    |
| Investment income (loss), net of related expenses  | 125,688     | 105,265         | 62  | 231,015       |
| Investment related gains (losses), net:  |             |                 |   |               |
| Other-than-temporary impairments on fixed maturity securities  | (6,275)     | 101             | (26)  | (6,200)       |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | 2,307       | (252)           | 10  | 2,065         |
| Other investment related gains (losses), net   | 4,173       | 13,477          | 23  | 17,673        |
| Total investment related gains (losses), net   | 205         | 13,326          | 7   | 13,538        |
| Other revenues   | 738         | 23,536          | 9,194                                       | 33,468        |
| Total revenues   | 1,100,468   | 145,586         | 9,263                                       | 1,255,317     |
| <b>Benefits and expenses:</b>  |             |                 |   |               |
| Claims and other policy benefits   | 839,173     | 4,264           | --  | 843,437       |
| Interest credited  | 14,967      | 80,614          | --  | 95,581        |
| Policy acquisition costs and other insurance expenses  | 135,602     | 42,925          | 797   | 179,324       |
| Other operating expenses   | 19,486      | 1,743           | 1,469                                       | 22,698        |
| Total benefits and expenses  | 1,009,228   | 129,546         | 2,266                                       | 1,141,040     |
| Income before income taxes   | \$ 91,240   | \$ 16,040       | \$ 6,997                                    | \$ 114,277    |



**Table of Contents****For the six months ended June 30, 2012**

(dollars in thousands)

|  | Non-Traditional |                 |                          | Total<br>U.S. |
|--|-----------------|-----------------|--------------------------|---------------|
|  | Traditional     | Asset-Intensive | Financial<br>Reinsurance |               |
| <b>Revenues:</b>   |                 |                 |                          |               |
| Net premiums   | \$ 2,103,907    | \$ 6,951        | \$ --                    | \$ 2,110,858  |
| Investment income, net of related expenses   | 266,069         | 205,234         | 343                      | 471,646       |
| Investment related gains (losses), net:  |                 |                 |                          |               |
| Other-than-temporary impairments on fixed maturity securities  | (7,852)         | --              | --                       | (7,852)       |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | (5,745)         | --              | --                       | (5,745)       |
| Other investment related gains (losses), net   | 1,302           | 53,071          | (107)                    | 54,266        |
| Total investment related gains (losses), net   | (12,295)        | 53,071          | (107)                    | 40,669        |
| Other revenues   | 1,404           | 49,147          | 20,644                   | 71,195        |
| Total revenues   | 2,359,085       | 314,403         | 20,880                   | 2,694,368     |
| <b>Benefits and expenses:</b>  |                 |                 |                          |               |
| Claims and other policy benefits   | 1,842,268       | 7,004           | --                       | 1,849,272     |
| Interest credited  | 29,609          | 124,676         | --                       | 154,285       |
| Policy acquisition costs and other insurance expenses  | 296,443         | 105,662         | 1,474                    | 403,579       |
| Other operating expenses   | 44,587          | 5,869           | 3,445                    | 53,901        |
| Total benefits and expenses  | 2,212,907       | 243,211         | 4,919                    | 2,461,037     |
| Income before income taxes   | \$ 146,178      | \$ 71,192       | \$ 15,961                | \$ 233,331    |

**For the six months ended June 30, 2011**

(dollars in thousands)

|  | Non-Traditional |                 |                          | Total<br>U.S. |
|--|-----------------|-----------------|--------------------------|---------------|
|  | Traditional     | Asset-Intensive | Financial<br>Reinsurance |               |
| <b>Revenues:</b>   |                 |                 |                          |               |
| Net premiums   | \$ 1,908,890    | \$ 6,784        | \$ --                    | \$ 1,915,674  |
| Investment income (loss), net of related expenses  | 246,436         | 252,757         | (135)                    | 499,058       |
| Investment related gains (losses), net:  |                 |                 |                          |               |
| Other-than-temporary impairments on fixed maturity securities  | (6,275)         | (451)           | (26)                     | (6,752)       |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | 2,307           | (252)           | 10                       | 2,065         |
| Other investment related gains (losses), net   | 13,048          | 118,498         | (12)                     | 131,534       |
| Total investment related gains (losses), net   | 9,080           | 117,795         | (28)                     | 126,847       |
| Other revenues   | 1,231           | 47,537          | 18,196                   | 66,964        |
| Total revenues   | 2,165,637       | 424,873         | 18,033                   | 2,608,543     |
| <b>Benefits and expenses:</b>  |                 |                 |                          |               |
| Claims and other policy benefits   | 1,661,580       | 7,080           | --                       | 1,668,660     |
| Interest credited  | 29,551          | 172,093         | --                       | 201,644       |
| Policy acquisition costs and other insurance expenses  | 267,518         | 159,226         | 1,650                    | 428,394       |
| Other operating expenses   | 40,836          | 3,897           | 3,266                    | 47,999        |
| Total benefits and expenses  | 1,999,485       | 342,296         | 4,916                    | 2,346,697     |
| Income before income taxes   | \$ 166,152      | \$ 82,577       | \$ 13,117                | \$ 261,846    |

Income before income taxes for the U.S. operations segment increased by \$26.3 million, or 23.0%, and decreased by \$28.5 million, or 10.9%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase in income before income taxes in the three months can primarily be attributed to net changes in investment related gains and losses associated with funds withheld portfolios and the related DAC impact, higher investment income due to a larger asset base in the U.S. Traditional sub-segment and higher fees in the Financial Reinsurance sub-segment. The decrease in income before income taxes in the six months can primarily be attributed to a decrease in investment related gains. Compared to 2011, investment related gains decreased as a result of both changes in credit spreads on the fair value of embedded derivatives associated with treaties written on a modified coinsurance or funds withheld basis and other than temporary impairments on fixed maturity securities. Decreases or increases in credit spreads result in an increase or decrease in value of the embedded derivative, and therefore, an increase or decrease in investment related gains or losses, respectively. Offsetting this was favorable investment income in the U.S. Traditional sub-segment, primarily as a result of a higher asset base and an increase in the net impact of the embedded derivative supporting the guaranteed minimum living benefits associated with the Company's variable annuities.

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**Table of Contents***Traditional Reinsurance*

The U.S. Traditional sub-segment provides life and health reinsurance to domestic clients for a variety of products through yearly renewable term, coinsurance and modified coinsurance agreements. These reinsurance arrangements may involve either facultative or automatic agreements. This sub-segment added new business production, measured by face amount of insurance in force, of \$24.2 billion and \$24.3 billion during the second quarters, and \$109.1 billion and \$55.6 billion during the first six months of 2012 and 2011, respectively. Approximately \$42.4 billion of the increase in the first six months compared to the same period in 2011 relates to one large in force transaction recorded in the first quarter of 2012.

Income before income taxes for the U.S. Traditional sub-segment increased by \$5.1 million, or 5.6%, and decreased by \$20.0 million, or 12.0% for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase in the second quarter can be primarily attributed to higher investment income mainly as a result of a larger asset base. The decrease in the first six months can in part be attributed to a decrease in investment related gains (losses), net as well as slightly higher mortality experience compared to the same period in 2011 somewhat offset by higher investment income related to the increased asset base.

Net premiums for the U.S. Traditional sub-segment increased \$108.6 million, or 11.1%, and \$195.0 million, or 10.2% for the three and six months ended June 30, 2012, as compared to the same periods in 2011. These increases in net premiums were driven by the growth in total U.S. Traditional business in force. At June 30, 2012, total face amount of individual life insurance for the U.S. Traditional sub-segment was \$1,400.0 billion compared to \$1,337.5 billion at June 30, 2011. Contributing to the increase was the large in force block transaction of \$42.4 billion mentioned above which contributed \$18.8 million and \$29.8 million to the increase in net premiums for the first three and six months of 2012, respectively. Premiums on health and group related coverages contributed \$39.2 million and \$77.7 million to the increase in net premiums for the second quarter and first six months of 2012, respectively.

Net investment income increased \$8.0 million, or 6.3%, and \$19.6 million, or 8.0%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily due to a 11.4% increase in the average invested asset base. Investment related gains increased \$0.6 million and decreased \$21.4 million for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Investment income and investment related gains and losses are allocated to the various operating segments based on average assets and related capital levels deemed appropriate to support segment operations. Investment performance varies with the composition of investments and the relative allocation of capital to the operating segments.

Claims and other policy benefits as a percentage of net premiums ( loss ratios ) were 86.4% and 86.2% for the second quarter of 2012 and 2011, respectively, and 87.6% and 87.0% for the six months ended June 30, 2012 and 2011, respectively. The increase in the percentages for both the second quarter and first six months was primarily due to normal volatility in mortality claims. Although reasonably predictable over a period of years, claims can be volatile over short-term periods.

Interest credited expense decreased \$0.4 million, or 2.8%, and increased \$0.1 million, or 0.2%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The variances in interest credited expense are largely offset by offsetting variances in investment income. The decrease in the second quarter is the result of one treaty that had a slight increase in its asset base with a credited loan rate that decreased approximately 17 basis points. Interest credited in this sub-segment relates to amounts credited on cash value products which also have a significant mortality component.

Policy acquisition costs and other insurance expenses as a percentage of net premiums were 13.9% for the second quarter of 2012 and 2011, and 14.1% and 14.0% for the six months ended June 30, 2012 and 2011, respectively. Overall, while these ratios are expected to remain in a predictable range, they may fluctuate from period to period due to varying allowance levels within coinsurance-type arrangements. In addition, the amortization pattern of previously capitalized amounts, which are subject to the form of the reinsurance agreement and the underlying insurance policies, may vary. Also, the mix of first year coinsurance business versus yearly renewable term business can cause the percentage to fluctuate from period to period.

Other operating expenses increased \$1.1 million, or 5.6%, and \$3.8 million, or 9.2%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Other operating expenses as a percentage of net premiums were 1.9% and 2.0% for the second quarter of 2012 and 2011, respectively, and 2.1% for the six months ended June 30, 2012 and 2011.

*Asset-Intensive Reinsurance*

The U.S. Asset-Intensive sub-segment assumes primarily investment risk within underlying annuities and corporate-owned life insurance policies. Most of these agreements are coinsurance, coinsurance with funds withheld or modco whereby the Company recognizes profits or

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losses primarily from the spread between the investment income earned and the interest credited on the underlying deposit liabilities, as well as fees associated with variable annuity account values.

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## Impact of certain derivatives:

Income for the asset-intensive business tends to be volatile due to changes in the fair value of certain derivatives, including embedded derivatives associated with reinsurance treaties structured on a modco basis or funds withheld basis, as well as embedded derivatives associated with the Company's reinsurance of equity-indexed annuities and variable annuities with guaranteed minimum benefit riders. The following table summarizes the asset-intensive results and quantifies the impact of these embedded derivatives for the periods presented.

| (dollars in thousands)  | For the three months ended<br>June 30, |            | For the six months ended<br>June 30, |            |
|---|--|------------|--------------------------------------|------------|
|   | 2012                                   | 2011       | 2012                                 | 2011       |
| <b>Revenues:</b>  |  |            |                                      |            |
| Total revenues  | \$ 141,034                             | \$ 145,586 | \$ 314,403                           | \$ 424,873 |
| Less:   |  |            |                                      |            |
| Embedded derivatives modco/Funds withheld treaties                      | (4,593)                                | 10,525     | (13,980)                             | 101,060    |
| Guaranteed minimum benefit riders and related free standing derivatives | 16,127                                 | 1,341      | 66,797                               | 13,962     |
| Revenues before certain derivatives                                     | 129,500                                | 133,720    | 261,586                              | 309,851    |
| <b>Benefits and expenses:</b>   |  |            |                                      |            |
| Total benefits and expenses   | 106,432                                | 129,546    | 243,211                              | 342,296    |
| Less:   |  |            |                                      |            |
| Embedded derivatives modco/Funds withheld treaties                      | (455)                                  | 4,698      | (12,857)                             | 65,720     |
| Guaranteed minimum benefit riders and related free standing derivatives | 10,011                                 | 832        | 43,481                               | 8,955      |
| Equity-indexed annuities  | 1,793                                  | 7,155      | (43)                                 | (1,537)    |
| Benefits and expenses before certain derivatives                        | 95,083                                 | 116,861    | 212,630                              | 269,158    |
| <b>Income (loss) before income taxes:</b>                               |  |            |                                      |            |
| Income (loss) before income taxes                                       | 34,602                                 | 16,040     | 71,192                               | 82,577     |
| Less:   |  |            |                                      |            |
| Embedded derivatives modco/Funds withheld treaties                      | (4,138)                                | 5,827      | (1,123)                              | 35,340     |
| Guaranteed minimum benefit riders and related free standing derivatives | 6,116                                  | 509        | 23,316                               | 5,007      |
| Equity-indexed annuities  | (1,793)                                | (7,155)    | 43                                   | 1,537      |
| Income before income taxes and certain derivatives                      | 34,417                                 | 16,859     | 48,956                               | 40,693     |

*Embedded Derivatives - modco/Funds Withheld Treaties*- Represents the change in the fair value of embedded derivatives on funds withheld at interest associated with treaties written on a modco or funds withheld basis, allowing for deferred acquisition expenses. Changes in the fair value of the embedded derivative are driven by changes in investment credit spreads, including the Company's own credit spread. Generally, an increase in investment credit spreads, ignoring changes in the Company's own credit spread, will have a negative impact on the fair value of the embedded derivative (decrease in income). Changes in fair values of these embedded derivatives are net of an increase (decrease) in revenues of \$6.3 million and \$(0.4) million for the three months and \$(57.2) million and \$(24.3) million for the six months ended June 30, 2012 and 2011, respectively, associated with the Company's own credit risk. A 10% increase in the Company's own credit risk rate would have increased revenues by approximately \$0.8 million for the six months ended June 30, 2012. Conversely, a 10% decrease in the Company's own credit risk rate would have decreased revenues by approximately \$0.8 million for the six months ended June 30, 2012.

In the second quarter of 2012, the change in fair value of the embedded derivative decreased revenues by \$4.6 million and related deferred acquisition expenses decreased benefits and expenses by \$0.5 million, for a negative pre-tax income impact of \$4.1 million. During the second quarter of 2011, the change in fair value of the embedded derivative increased revenues by \$10.5 million and related deferred acquisition expenses increased benefits and expenses by \$4.7 million, for a positive pre-tax income impact of \$5.8 million, primarily due to an increase in investment credit spreads. In the first six months of 2012, the change in fair value of the embedded derivative decreased revenues by \$14.0 million and related deferred acquisition expenses decreased benefits and expenses by \$12.9 million, for a negative pre-tax income impact of \$1.1 million, primarily due to an increase in investment credit spreads. During the first six months of 2011, the change in fair value of the embedded

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derivative increased revenues by \$101.1 million and related deferred acquisition expenses increased benefits and expenses by \$65.7 million, for a positive pre-tax income impact of \$35.3 million, primarily due to an increase in investment credit spreads.

*Guaranteed Minimum Benefit Riders*- Represents the impact related to guaranteed minimum benefits associated with the Company's reinsurance of variable annuities. The fair value changes of the guaranteed minimum benefits along with the changes in fair value of the free standing derivatives (interest rate swaps, financial futures and equity options), purchased by

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the Company to hedge the liability are reflected in revenues, while the related impact on deferred acquisition expenses is reflected in benefits and expenses. Changes in fair values of these embedded derivatives are net of an increase in revenues of \$14.6 million and \$51.6 million for the three and six months ended June 30, 2012, respectively, associated with the Company's own credit risk. A 10% increase in the Company's own credit risk rate would have increased revenues by approximately \$4.6 million for six months ended June 30, 2012. Conversely, a 10% decrease in the Company's own credit risk rate would have decreased revenues by approximately \$4.6 million for the six months ended June 30, 2012.

In the second quarter of 2012, the change in the fair value of the guaranteed minimum benefits, after allowing for changes in the associated free standing derivatives, increased revenues by \$16.1 million and related deferred acquisition expenses increased benefits and expenses by \$10.0 million for a positive pre-tax income impact of \$6.1 million. In the second quarter of 2011, the change in the fair value of the guaranteed minimum benefits after allowing for changes in the associated free-standing derivatives increased revenues by \$1.3 million and related deferred acquisition expenses increased benefits and expenses by \$0.8 million for a positive pre-tax income impact of \$0.5 million. In the first six months of 2012, the change in the fair value of the guaranteed minimum benefits, after allowing for changes in the associated free standing derivatives, increased revenues by \$66.8 million and related deferred acquisition expenses increased benefits and expenses by \$43.5 million for a positive pre-tax income impact of \$23.3 million. In the first six months of 2011, the change in the fair value of the guaranteed minimum benefits after allowing for changes in the associated hedge instruments increased revenues by \$14.0 million and related deferred acquisition expenses increased benefits and expenses by \$9.0 million for a positive pre-tax income impact of \$5.0 million.

*Equity-Indexed Annuities*- Represents the impact of changes in the risk-free rate on the calculation of the fair value of embedded derivative liabilities associated with EIAs, after adjustments for related deferred acquisition expenses and retrocession. In the second quarter of 2012 and 2011, benefits and expenses increased \$1.8 million and \$7.2 million, respectively. In the first six months of 2012 and 2011, benefits and expenses decreased less than \$0.1 million and \$1.5 million, respectively.

The changes in derivatives discussed above are considered unrealized by management and do not affect current cash flows, crediting rates or spread performance on the underlying treaties. Fluctuations occur period to period primarily due to changing investment conditions including, but not limited to, interest rate movements (including risk-free rates and credit spreads), implied volatility and equity market performance, all of which are factors in the calculations of fair value. Therefore, management believes it is helpful to distinguish between the effects of changes in these derivatives, net of related hedging activity, and the primary factors that drive profitability of the underlying treaties, namely investment income, fee income (included in other revenues), and interest credited.

Discussion and analysis before certain derivatives:

Income before income taxes and certain derivatives increased by \$17.6 million and \$8.3 million for the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily due to net changes in investment related gains and losses associated with the fund withhelds and coinsurance portfolios and their related DAC impact. Funds withheld capital gains and losses are reported through investment income while coinsurance activity is reflected in investment related gains (losses), net.

Revenue before certain derivatives decreased by \$4.2 million and increased by \$48.3 million for the three and six months ended June 30, 2012, as compared to the same periods in 2011. These variances were driven by a decrease in investment income related to equity options held in a funds withheld portfolio associated with equity-indexed annuity treaties offset by an increase in investment income related to a new coinsurance transaction in the second quarter of 2012. In addition, other revenues for the three months ended June 30, 2012 increased \$5.7 million due primarily to the amortization of the deferred profit liability associated with a new coinsurance transaction. Increases and decreases in investment income related to equity options were mostly offset by corresponding increases and decreases in interest credited expense.

Benefits and expenses before certain derivatives decreased by \$21.8 million and \$56.5 million for the three and six months ended June 30, 2012, as compared to the same periods in 2011, primarily due to a change in the interest credited expense related to equity option income on funds withheld equity-indexed annuity treaties offset by an increase in interest credited related to a new coinsurance transaction in the second quarter of 2012. These changes were mostly offset by corresponding changes in investment income.

The invested asset base supporting this sub-segment increased to \$11.6 billion in the second quarter of 2012 from \$5.9 billion in the second quarter of 2011. The growth in the asset base was driven primarily by a new fixed annuity coinsurance transaction executed in the second quarter. As of June 30, 2012, \$4.3 billion of the invested assets were funds withheld at interest, of which 86.5% is associated with one client.

**Table of Contents***Financial Reinsurance*

U.S. Financial Reinsurance sub-segment income consists primarily of net fees earned on financial reinsurance transactions. The majority of the financial reinsurance business is retroceded to other insurance companies. Additionally, a portion of the business is brokered business in which the Company does not participate in the assumption of risk. The fees earned from financial reinsurance contracts and brokered business are reflected in other revenues, and the fees paid to retrocessionaires are reflected in policy acquisition costs and other insurance expenses.

Income before income taxes increased \$2.7 million, or 37.9%, and \$2.8 million, or 21.7% for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increases in the second quarter and first six months of 2012 were primarily related to additional fees from financial reinsurance as compared to the same periods in 2011. At June 30, 2012 and 2011, the amount of reinsurance assumed from client companies, as measured by pre-tax statutory surplus, risk based capital and other financial reinsurance structures, was \$2.1 billion and \$1.9 billion, respectively. Fees earned from this business can vary significantly depending on the size of the transactions and the timing of their completion and, therefore, can fluctuate from period to period.

**Canada Operations**

The Company conducts reinsurance business in Canada primarily through RGA Life Reinsurance Company of Canada ( RGA Canada ), a wholly-owned subsidiary. RGA Canada assists clients with capital management activity and mortality and morbidity risk management, and is primarily engaged in traditional individual life reinsurance, as well as creditor, group life and health, critical illness, and longevity reinsurance. Creditor insurance covers the outstanding balance on personal, mortgage or commercial loans in the event of death, disability or critical illness and is generally shorter in duration than traditional life insurance.

| (dollars in thousands)   | For the three months ended |            | For the six months ended |            |
|--|----------------------------|------------|--------------------------|------------|
|  | June 30,                   |            | June 30,                 |            |
|  | 2012                       | 2011       | 2012                     | 2011       |
| <b>Revenues:</b>   |                            |            |                          |            |
| Net premiums   | \$ 221,167                 | \$ 209,717 | \$ 439,377               | \$ 424,745 |
| Investment income, net of related expenses   | 46,242                     | 46,083     | 95,142                   | 92,002     |
| Investment related gains (losses), net:  |                            |            |                          |            |
| Other-than-temporary impairments on fixed maturity securities  | --                         | --         | --                       | --         |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | --                         | --         | --                       | --         |
| Other investment related gains (losses), net   | 5,625                      | 3,318      | 14,168                   | 8,876      |
| Total investment related gains (losses), net   | 5,625                      | 3,318      | 14,168                   | 8,876      |
| Other revenues   | 3,205                      | 4,980      | 3,175                    | 5,002      |
| Total revenues   | 276,239                    | 264,098    | 551,862                  | 530,625    |
| <b>Benefits and expenses:</b>  |                            |            |                          |            |
| Claims and other policy benefits   | 184,857                    | 165,860    | 345,482                  | 344,915    |
| Policy acquisition costs and other insurance expenses  | 47,476                     | 45,356     | 97,761                   | 94,222     |
| Other operating expenses   | 8,876                      | 8,793      | 18,526                   | 17,487     |
| Total benefits and expenses  | 241,209                    | 220,009    | 461,769                  | 456,624    |
| Income before income taxes   | \$ 35,030                  | \$ 44,089  | \$ 90,093                | \$ 74,001  |

Income before income taxes decreased \$9.1 million, or 20.5%, and increased by \$16.1 million, or 21.7%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The decrease in the second quarter is primarily due to better traditional individual life mortality experience in the second quarter of 2011 compared to 2012. The increase in income in the first six months of 2012 is primarily due to an increase in net investment related gains of \$5.3 million, \$6.3 million of income from the recapture of a previously assumed block of individual life business and improved traditional individual life mortality experience. A weaker Canadian dollar resulted in a decrease to income before income taxes of approximately \$3.3 million and \$3.8 million in the second quarter and first six months of 2012, respectively.

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Net premiums increased \$11.5 million, or 5.5%, and increased \$14.6 million, or 3.4%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Premiums increased in the second quarter and first six months of 2012 due to new business from both new and existing treaties. Excluding the impact of foreign exchange, reinsurance in force at June 30, 2012 increased 10.2% compared to June 30, 2011. Also contributing to the increase in net premiums is an



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increase in premiums from creditor treaties of \$12.3 million and \$6.2 million for the second quarter and first six months of 2012 compared to the same periods in 2011. Foreign currency exchange fluctuation in the Canadian dollar resulted in a decrease in net premiums of approximately \$9.8 million and \$13.1 million in the second quarter and first six months of 2012, respectively, as compared to 2011. Premium levels can be significantly influenced by currency fluctuations, large transactions, mix of business and reporting practices of ceding companies and therefore may fluctuate from period to period.

Net investment income increased \$0.2 million, or 0.3%, and \$3.1 million, or 3.4%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Foreign currency exchange fluctuation in the Canadian dollar resulted in a decrease to net investment income of approximately \$3.3 million and \$3.6 million in the second quarter and first six months of 2012, respectively, as compared to 2011. Investment income and investment related gains and losses are allocated to the segments based upon average assets and related capital levels deemed appropriate to support segment operations. Investment performance varies with the composition of investments and the relative allocation of capital to the operating segments. The increase in investment income, excluding the impact of foreign exchange, was mainly the result of a higher investment yield.

Loss ratios for this segment were 83.6% and 79.1% for the second quarter of 2012 and 2011, respectively, and 78.6% and 81.2% for the six months ended June 30, 2012 and 2011, respectively. Excluding creditor business, loss ratios for this segment were 95.5% and 88.9% for the second quarter of 2012 and 2011, respectively, and 89.7% and 93.2% for the six months ended June 30, 2012 and 2011, respectively. Historically, the loss ratio had increased primarily as the result of several large permanent level premium in force blocks assumed in 1997 and 1998. These are mature blocks of permanent level premium business in which claims and policy benefits as a percentage of net premiums are expected to be higher than historical ratios. The nature of permanent level premium policies requires the Company to set up actuarial liabilities and invest the amounts received in excess of early-year claims costs to fund claims in the later years when premiums, by design, continue to be level as compared to expected increasing mortality or claim costs. Excluding creditor business, claims and other policy benefits, as a percentage of net premiums and investment income for this segment were 75.6% and 70.1% in the second quarter of 2012 and 2011, respectively, and 70.5% and 73.3% for the six months ended June 30, 2012 and 2011, respectively. The increase in the loss ratios for the second quarter of 2012, compared to 2011, was due to better than expected traditional individual life mortality experience in the prior quarter compared to the current quarter. The decrease in the loss ratios for the first six months of 2012, compared to 2011, was due to improved traditional individual life mortality experience.

Policy acquisition costs and other insurance expenses as a percentage of net premiums were 21.5% and 21.6% for the second quarter of 2012 and 2011, respectively, and 22.2% for the six months ended June 30, 2012 and 2011. Policy acquisition costs and other insurance expenses as a percentage of net premiums for traditional individual life business were 12.1% and 13.1% for the second quarter of 2012 and 2011, respectively, and 13.4% and 13.0% for the six months ended June 30, 2012 and 2011, respectively. Overall, while these ratios are expected to remain in a predictable range, they may fluctuate from period to period due to varying allowance levels and product mix. In addition, the amortization pattern of previously capitalized amounts, which are subject to the form of the reinsurance agreement and the underlying insurance policies, may vary.

Other operating expenses increased by \$0.1 million, or 0.9%, and \$1.0 million, or 5.9%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Other operating expenses as a percentage of net premiums were 4.0% and 4.2% for the second quarter of 2012 and 2011, respectively, and 4.2% and 4.1% for the six months ended June 30, 2012 and 2011, respectively.

**Europe & South Africa Operations**

The Europe & South Africa segment includes operations in the United Kingdom ( UK ), South Africa, France, Germany, India, Italy, Mexico, the Netherlands, Poland, Spain and the United Arab Emirates. The segment provides reinsurance for a variety of life and health products through yearly renewable term and coinsurance agreements, critical illness coverage and longevity risk related to payout annuities. Reinsurance agreements may be facultative or automatic agreements covering primarily individual risks and, in some markets, group risks.

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| (dollars in thousands)   | For the three months ended |            | For the six months ended |            |
|--|----------------------------|------------|--------------------------|------------|
|  | June 30,                   |            | June 30,                 |            |
|  | 2012                       | 2011       | 2012                     | 2011       |
| <b>Revenues:</b>   |                            |            |                          |            |
| Net premiums   | \$ 310,075                 | \$ 283,019 | \$ 602,846               | \$ 552,139 |
| Investment income, net of related expenses   | 11,248                     | 10,865     | 22,579                   | 21,400     |
| Investment related gains (losses), net:  |                            |            |                          |            |
| Other-than-temporary impairments on fixed maturity securities  | -                          | -          | -                        | -          |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | -                          | -          | -                        | -          |
| Other investment related gains (losses), net   | 1,156                      | 756        | 3,138                    | 1,049      |
| Total investment related gains (losses), net   | 1,156                      | 756        | 3,138                    | 1,049      |
| Other revenues   | 1,464                      | 1,745      | 3,717                    | 2,800      |
| Total revenues   | 323,943                    | 296,385    | 632,280                  | 577,388    |
| <b>Benefits and expenses:</b>  |                            |            |                          |            |
| Claims and other policy benefits   | 263,992                    | 242,973    | 525,476                  | 459,905    |
| Policy acquisition costs and other insurance expenses  | 13,550                     | 14,360     | 28,602                   | 30,884     |
| Other operating expenses   | 26,810                     | 26,527     | 52,005                   | 51,539     |
| Total benefits and expenses  | 304,352                    | 283,860    | 606,083                  | 542,328    |
| Income before income taxes   | \$ 19,591                  | \$ 12,525  | \$ 26,197                | \$ 35,060  |

Income before income taxes increased \$7.1 million, or 56.4% and decreased \$8.9 million, or 25.3%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase in income before income taxes for the second quarter was primarily due to an increase in net premiums in the UK, India, Italy, Mexico, Spain and France partially offset by unfavorable claims experience in the UK. The decrease in income before income taxes for the first six months was primarily due to unfavorable claims experience mainly in the UK, India and France. Unfavorable foreign currency exchange fluctuations resulted in a decrease to income before income taxes totaling approximately \$1.8 million and \$2.6 million for the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011.

Net premiums increased \$27.1 million, or 9.6%, and \$50.7 million, or 9.2%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Net premiums increased as a result of new business from both new and existing treaties including an increase associated with reinsurance of longevity risk in the UK of \$6.2 million and \$16.0 million for the three and six months of 2012, respectively. During 2012, there were unfavorable foreign currency exchange fluctuations, particularly with the British pound, the euro and the South African rand weakening against the U.S. dollar when compared to the same periods in 2011, which decreased net premiums by approximately \$23.0 million and \$34.4 million in the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011.

A portion of the net premiums for the segment, in each period presented, relates to reinsurance of critical illness coverage, primarily in the UK. This coverage provides a benefit in the event of the diagnosis of a pre-defined critical illness. Net premiums earned from this coverage totaled \$62.0 million and \$63.3 million in the second quarter of 2012 and 2011, respectively, and \$123.5 million and \$123.6 million for the six months ended June 30, 2012 and 2011, respectively. Premium levels can be significantly influenced by currency fluctuations, large transactions and reporting practices of ceding companies and therefore can fluctuate from period to period.

Net investment income increased \$0.4 million, or 3.5%, and \$1.2 million, or 5.5%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. These increases were primarily due to growth of 28.4% in the invested asset base partially offset by a lower investment yield. Foreign currency exchange fluctuations resulted in a decrease in net investment income of approximately \$0.9 million and \$1.4 million in the second quarter and first six months of 2012, respectively. Investment income and investment related gains and losses are allocated to the various operating segments based on average assets and related capital levels deemed appropriate to support segment operations.

Loss ratios were 85.1% and 85.9% for the second quarter of 2012 and 2011, respectively, and 87.2% and 83.3% for the six months ended June 30, 2012 and 2011, respectively. The increase in the loss ratio for the first six months of 2012 was due to unfavorable claims experience, primarily from UK critical illness and mortality coverages. Although reasonably predictable over a period of years, claims can be volatile over shorter periods. Management views recent experience as normal short-term volatility that is inherent in the business.

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Policy acquisition costs and other insurance expenses as a percentage of net premiums were 4.4% and 5.1% for the second quarter of 2012 and 2011, respectively, and 4.7% and 5.6% for the six months ended June 30, 2012 and 2011, respectively. These percentages fluctuate due to timing of client company reporting, variations in the mixture of business being reinsured and the relative maturity of the business. In addition, as the segment grows, renewal premiums, which generally have lower allowances than first-year premiums, represent a greater percentage of the total net premiums.

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Other operating expenses increased \$0.3 million, or 1.1%, and \$0.5 million, or 0.9%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Other operating expenses as a percentage of net premiums totaled 8.6% and 9.4% for the second quarter of 2012 and 2011, respectively, and 8.6% and 9.3% for the six months ended June 30, 2012 and 2011, respectively.

While concerns continue in 2012 relating to the euro area sovereign debt situation and economies, approximately 80.4% of revenues for the segment were earned outside of the eurozone for the second quarter of 2012. Approximately 13.1% of the segment's revenues were earned in Spain, Italy and Portugal over the same period.

**Asia Pacific Operations**

The Asia Pacific segment includes operations in Australia, Hong Kong, Japan, Malaysia, Singapore, New Zealand, South Korea, Taiwan and mainland China. The principal types of reinsurance include life, critical illness, disability income, superannuation, and financial reinsurance. Superannuation is the Australian government mandated compulsory retirement savings program. Superannuation funds accumulate retirement funds for employees, and, in addition, offer life and disability insurance coverage. Reinsurance agreements may be facultative or automatic agreements covering primarily individual risks and in some markets, group risks.

| (dollars in thousands)   | For the three months ended |            | For the six months ended |            |
|--|----------------------------|------------|--------------------------|------------|
|  | June 30,                   | June 30,   | June 30,                 | June 30,   |
|  | 2012                       | 2011       | 2012                     | 2011       |
| <b>Revenues:</b>   |                            |            |                          |            |
| Net premiums   | \$ 331,945                 | \$ 316,356 | \$ 657,295               | \$ 627,873 |
| Investment income, net of related expenses   | 20,711                     | 21,756     | 43,289                   | 41,699     |
| Investment related gains (losses), net:  |                            |            |                          |            |
| Other-than-temporary impairments on fixed maturity securities  | --                         | --         | --                       | --         |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | --                         | --         | --                       | --         |
| Other investment related gains (losses), net   | 968                        | 1,079      | 5,317                    | 641        |
| Total investment related gains (losses), net   | 968                        | 1,079      | 5,317                    | 641        |
| Other revenues   | 24,109                     | 7,283      | 31,517                   | 15,775     |
| Total revenues   | 377,733                    | 346,474    | 737,418                  | 685,988    |
| <b>Benefits and expenses:</b>  |                            |            |                          |            |
| Claims and other policy benefits   | 236,733                    | 267,362    | 485,353                  | 515,292    |
| Interest credited  | 216                        | 615        | 454                      | 615        |
| Policy acquisition costs and other insurance expenses  | 89,996                     | 48,082     | 140,843                  | 92,563     |
| Other operating expenses   | 26,929                     | 26,089     | 54,842                   | 51,216     |
| Total benefits and expenses  | 353,874                    | 342,148    | 681,492                  | 659,686    |
| Income before income taxes   | \$ 23,859                  | \$ 4,326   | \$ 55,926                | \$ 26,302  |

Income before income taxes increased \$19.5 million, or 451.5%, and increased \$29.6 million, or 112.6%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase in income before income taxes for the second quarter is primarily attributable to an increase in net premiums in Australia, Hong Kong, Southeast Asia and Korea and favorable claims experience in Australia, Japan and Taiwan. The increase in income for the first six months was primarily attributable to an increase in net premiums in Australia, Hong Kong, Southeast Asia, Korea and Taiwan and favorable claims experience in Australia, Hong Kong and Japan. Additionally, foreign currency exchange fluctuations resulted in a decrease to income before income taxes totaling approximately \$0.1 million and an increase totaling approximately \$0.8 million for the second quarter and first six months of 2012, respectively.

Net premiums increased \$15.6 million, or 4.9%, and \$29.4 million, or 4.7%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Premiums in the second quarter and first six months of 2012 increased throughout the segment primarily due to new treaties and increased production under existing treaties. Unfavorable changes in Asia Pacific segment currencies resulted in a decrease in net

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premiums of approximately \$13.0 million and \$3.2 million for the second quarter and first six months of 2012, respectively, as compared to the same periods in 2011.

A portion of net premiums relates to reinsurance of critical illness coverage. This coverage provides a benefit in the event of the diagnosis of a pre-defined critical illness. Reinsurance of critical illness in the Asia Pacific operations is offered primarily in South Korea, Australia and Hong Kong. Net premiums earned from this coverage totaled \$46.7 million and \$41.0 million in the second quarter of 2012 and 2011, respectively and \$87.0 million and \$86.6 million for the first six months of 2012 and 2011, respectively. Premium levels can be significantly influenced by currency fluctuations, large transactions and reporting practices of ceding companies and can fluctuate from period to period.

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Net investment income decreased \$1.0 million, or 4.8%, and increased by \$1.6 million, or 3.8%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The decrease in the second quarter was primarily due to lower investment yields. The increase in the first six months was primarily due to growth in average asset levels. Foreign currency exchange fluctuations resulted in a decrease in net investment income of approximately \$0.7 million and an increase of approximately \$0.2 million in the second quarter and first six months of 2012, respectively. Investment income and investment related gains and losses are allocated to the various operating segments based on average assets and related capital levels deemed appropriate to support segment operations. Investment performance varies with the composition of investments and the relative allocation of capital to the operating segments.

Other revenues increased \$16.8 million, or 231.0%, and \$15.7 million, or 99.8%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The primary source of other revenues is fees from financial reinsurance treaties in Japan. The increase in other revenues for the second quarter included a transaction with a client in Australia which resulted in a one-time fee income amount of \$12.2 million. The transaction did not have a significant impact on income before taxes because the amount is offset by additional amortization of deferred acquisition costs, net of the release of reserves. Other revenues for the second quarter and first six months of 2012 also reflected fees from two new financial reinsurance treaties in Japan. At June 30, 2012 and 2011, the amount of reinsurance assumed from client companies, as measured by pre-tax statutory surplus, risk based capital and other financial reinsurance structures was \$2.5 billion and \$1.7 billion, respectively. Fees earned from this business can vary significantly depending on the size of the transactions and the timing of their completion and, therefore, can fluctuate from period to period.

Loss ratios for this segment were 71.3% and 84.5% for the second quarter of 2012 and 2011, respectively, and 73.8% and 82.1% for the six months ended June 30, 2012 and 2011, respectively. The decrease in the loss ratios for the second quarter and first six months of 2012, compared to 2011, was due to the release of reserves related to the aforementioned transaction with a client in Australia and favorable claims experience in Australia and Japan. Although reasonably predictable over a period of years, claims can be volatile over shorter periods. Management views recent experience as normal short-term volatility that is inherent in the business. Loss ratios will fluctuate due to timing of client company reporting, variations in the mixture of business and the relative maturity of the business.

Policy acquisition costs and other insurance expenses as a percentage of net premiums were 27.1% and 15.2% for the second quarter of 2012 and 2011, respectively, and 21.4% and 14.7% for the six months ended June 30, 2012 and 2011, respectively. The increase in the ratios for the second quarter and first six months of 2012, compared to 2011, was due to additional amortization of deferred acquisition costs which largely offsets the one-time fee related to the aforementioned transaction with a client in Australia. The ratio of policy acquisition costs and other insurance expenses as a percentage of net premiums should generally decline as the business matures; however, the percentage does fluctuate periodically due to timing of client company reporting and variations in the mixture of business.

Other operating expenses increased \$0.8 million, or 3.2%, and \$3.6 million, or 7.1%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. Other operating expenses as a percentage of net premiums totaled 8.1% and 8.2% for the second quarter of 2012 and 2011, and 8.3% and 8.2% for the six months ended June 30, 2012 and 2011, respectively. The timing of premium flows and the level of costs associated with the entrance into and development of new markets in the growing Asia Pacific segment may cause other operating expenses as a percentage of net premiums to fluctuate over time.

**Corporate and Other**

Corporate and Other revenues include investment income and investment related gains and losses from unallocated invested assets. Corporate and Other expenses consist of the offset to capital charges allocated to the operating segments within the policy acquisition costs and other insurance expenses line item, unallocated overhead and executive costs, and interest expense related to debt and trust preferred securities. Additionally, Corporate and Other includes results from, among others, RTP, a wholly-owned subsidiary that develops and markets technology solutions for the insurance industry and the investment income and expense associated with the Company's collateral finance facility.

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| (dollars in thousands)   | For the three months ended |           | For the six months ended |           |
|--|----------------------------|-----------|--------------------------|-----------|
|  | June 30,                   |           | June 30,                 |           |
|  | 2012                       | 2011      | 2012                     | 2011      |
| <b>Revenues:</b>   |                            |           |                          |           |
| Net premiums   | \$ 1,719                   | \$ 2,288  | \$ 3,767                 | \$ 4,375  |
| Investment income, net of related expenses   | 20,345                     | 27,717    | 36,618                   | 54,317    |
| Investment related gains (losses), net:  |                            |           |                          |           |
| Other-than-temporary impairments on fixed maturity securities  | (137)                      | 618       | (1,714)                  | (386)     |
| Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income | -                          | (1,773)   | (1,314)                  | (1,773)   |
| Other investment related gains (losses), net   | 2,900                      | 9,852     | 7,057                    | 15,754    |
| Total investment related gains (losses), net   | 2,763                      | 8,697     | 4,029                    | 13,595    |
| Other revenues   | 2,790                      | 3,001     | 8,386                    | 11,581    |
| Total revenues   | 27,617                     | 41,703    | 52,800                   | 83,868    |
| <b>Benefits and expenses:</b>  |                            |           |                          |           |
| Claims and other policy benefits   | (45)                       | 381       | 12                       | 690       |
| Interest credited  | -                          | -         | -                        | -         |
| Policy acquisition costs and other insurance expenses (income)   | (13,342)                   | (12,603)  | (27,212)                 | (25,297)  |
| Other operating expenses   | 17,940                     | 13,054    | 36,365                   | 35,070    |
| Interest expense   | 23,360                     | 25,818    | 46,682                   | 50,387    |
| Collateral finance facility expense  | 2,878                      | 3,101     | 5,845                    | 6,303     |
| Total benefits and expenses  | 30,791                     | 29,751    | 61,692                   | 67,153    |
| Income (loss) before income taxes  | \$ (3,174)                 | \$ 11,952 | \$ (8,892)               | \$ 16,715 |

Income before income taxes decreased \$15.1 million, or 126.6%, and \$25.6 million, or 153.2% for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The decrease for the second quarter was primarily due to a \$7.4 million decrease in investment income and a \$5.9 million decrease in investment related gains. The decrease for the first six months is primarily due to a \$17.7 million decrease in investment income and a \$9.6 million decrease in investment related gains.

Total revenues decreased \$14.1 million, or 33.8%, and \$31.1 million, or 37.0%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The decrease for the second quarter was primarily due to a \$7.4 million decrease in investment income, due to a lower invested asset base and lower investment yields, and a \$5.9 million decrease in investment related gains. The decrease in revenues for the first six months was largely due to a \$17.7 million decrease in investment income due to a lower invested asset base and lower investment yields. Additionally, there was a \$9.6 million decrease in investment related gains.

Total benefits and expenses increased \$1.0 million, or 3.5%, and decreased \$5.5 million, or 8.1%, for the three and six months ended June 30, 2012, as compared to the same periods in 2011. The increase for the second quarter was primarily due to an increase in other operating expenses of \$4.9 million caused by an increase in employee compensation partially offset by a decrease in interest expense of \$2.5 million due to debt that matured in 2011 being replaced by debt issued at a lower interest rate. The decrease for the first six months was primarily due to a decrease in interest expense of \$3.7 million due to the previously mentioned debt activity in 2011 and an increase in policy acquisition costs and other insurance income of \$1.9 million.

**Liquidity and Capital Resources****Current Market Environment**

The current low interest rate environment is negatively affecting the Company's earnings. Investment yield, excluding funds withheld and invested assets associated with a large fixed annuity transaction executed in the second quarter of 2012, has decreased 30 basis points for the six months ended June 30, 2012 as compared to the same period in 2011. In addition, the Company's insurance liabilities, in particular its annuity products, are sensitive to changing market factors. Results of operations in the first six months of 2012 compared to the same period in 2011 are unfavorable, largely due to changes in the value of embedded derivatives. While the results for both periods reflect tightening credit spreads, the

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impact of credit spread movements was much greater in the second quarter and first six months months of 2011 compared to 2012. There has been a continued increase in gross unrealized gains on fixed maturity and equity securities available-for-sale, which were \$2,487.0 million and \$1,349.8 million at June 30, 2012 and 2011, respectively. Gross unrealized losses have not been as volatile, totaling \$196.3 million and \$233.8 million at June 30, 2012 and 2011, respectively. The increase in the gross unrealized gains is primarily due to lower interest rates.



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The Company continues to be in a position to hold its investment securities until recovery, provided it remains comfortable with the credit of the issuers. As indicated above, gross unrealized gains on investment securities of \$2,487.0 million are well in excess of gross unrealized losses of \$196.3 million as of June 30, 2012. Historically low interest rates continued to put pressure on the Company's investment yield. In January 2012, U.S. Federal Reserve officials indicated that economic conditions in the U.S. would likely warrant exceptionally low federal funds rate through 2014. The Company does not rely on short-term funding or commercial paper and to date it has experienced no liquidity pressure, nor does it anticipate such pressure in the foreseeable future.

The Company projects its reserves to be sufficient and it would not expect to write down deferred acquisition costs or be required to take any actions to augment capital, even if interest rates remain at current levels for the next five years. While the Company has felt the pressures of sustained low interest rates and volatile equity markets and may continue to do so, management believes its business is not overly sensitive to these risks due to its relatively lower levels of asset leverage compared to direct life insurance companies. Although management believes the Company's current capital base is adequate to support its business at current operating levels, it continues to monitor new business opportunities and any associated new capital needs that could arise from the changing financial landscape.

## **The Holding Company**

RGA is an insurance holding company whose primary uses of liquidity include, but are not limited to, the immediate capital needs of its operating companies, dividends paid to its shareholders, repurchase of common stock and interest payments on its indebtedness. RGA recognized interest expense of \$65.6 million and \$53.2 million for the six months ended June 30, 2012 and 2011, respectively. RGA made capital contributions to subsidiaries of \$0.8 million and \$1.5 million for the six months ended June 30, 2012 and 2011, respectively. Dividends to shareholders were \$26.5 million and \$17.7 million for the six months ended June 30, 2012 and 2011, respectively. There were no principal payments on RGA's debt for the six months ended June 30, 2012 and 2011. The primary sources of RGA's liquidity include proceeds from its capital raising efforts, interest income on undeployed corporate investments, interest income received on surplus notes with RGA Reinsurance, Reinsurance Company of Missouri, Incorporated (RCM) and Rockwood Re and dividends from operating subsidiaries. RGA recognized interest and dividend income of \$40.8 million and \$25.0 million for the six months ended June 30, 2012 and 2011, respectively. There was no issuance of unaffiliated or affiliated long-term debt for the six months ended June 30, 2012. Net proceeds from unaffiliated long-term issuance were \$400.0 million for the six months ended 2011. There was no issuance of affiliated long-term debt for the six months ended 2011. As the Company continues its business operations, RGA will continue to be dependent upon these sources of liquidity. As of June 30, 2012 and December 31, 2011, RGA held \$565.8 million and \$583.6 million, respectively, of cash and cash equivalents, short-term and other investments and fixed maturity investments.

RGA established an intercompany revolving credit facility where certain subsidiaries can lend to or borrow from each other and from RGA in order to manage capital and liquidity more efficiently. The intercompany revolving credit facility, which is a series of demand loans among RGA and its affiliates, is permitted under applicable insurance laws and has been approved by the Missouri Department of Insurance. This facility reduces overall borrowing costs by allowing RGA and its operating companies to access internal cash resources instead of incurring third-party transaction costs. The statutory borrowing and lending limit for RGA's Missouri-domiciled insurance subsidiaries is currently the lesser of 3% of the insurance company's admitted assets and 25% of its surplus, in both cases, as of its most recent year-end. There were no amounts outstanding under the intercompany revolving credit facility as of June 30, 2012 and December 31, 2011.

The Company believes that it has sufficient liquidity for the next 12 months to fund its cash needs under various scenarios that include the potential risk of early recapture of reinsurance treaties and higher than expected death claims. Historically, the Company has generated positive net cash flows from operations. However, in the event of significant unanticipated cash requirements beyond normal liquidity, the Company has multiple liquidity alternatives available based on market conditions and the amount and timing of the liquidity need. These options include borrowings under committed credit facilities, secured borrowings, the ability to issue long-term debt, preferred securities or common equity and, if necessary, the sale of invested assets subject to market conditions.

In July 2012, the quarterly dividend was increased to \$0.24 per share from \$0.18 per share. All future payments of dividends are at the discretion of RGA's board of directors and will depend on the Company's earnings, capital requirements, insurance regulatory conditions, operating conditions, and other such factors as the board of directors may deem relevant. The amount of dividends that RGA can pay will depend in part on the operations of its reinsurance subsidiaries.

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### **Cash Flows**

The Company's net cash flows provided by operating activities for the six months ended June 30, 2012 and 2011 were \$818.3 million and \$537.8 million, respectively. Cash flows from operating activities are affected by the timing of premiums received, claims paid, and working capital changes. The Company believes the short-term cash requirements of its business operations will be sufficiently met by the positive cash flows generated. Additionally, the Company believes it maintains a high quality fixed maturity portfolio that can be sold, if necessary, to meet the Company's short- and long-term obligations.

Net cash used in investing activities for the six months ended June 30, 2012 and 2011 was \$784.8 million and \$497.2 million, respectively. Cash flows from investing activities primarily reflect the sales, maturities and purchases of fixed maturity securities related to the management of the Company's investment portfolios and the investment of excess cash generated by operating and financing activities. Cash flows from investing activities also include the investment activity related to mortgage loans, policy loans, funds withheld at interest, short-term investments and other invested assets.

Net cash (used in) provided by financing activities for the six months ended June 30, 2012 and 2011 was \$(40.8) million and \$191.0 million, respectively. Cash flows from financing activities primarily reflects the Company's capital management efforts, treasury stock activity, dividends to stockholders, changes in collateral for derivative positions and the activity related to universal life and other investment type policies and contracts.

### **Debt**

Certain of the Company's debt agreements contain financial covenant restrictions related to, among others, liens, the issuance and disposition of stock of restricted subsidiaries, minimum requirements of consolidated net worth, maximum ratios of debt to capitalization and change of control provisions. The Company is required to maintain a minimum consolidated net worth, as defined in the debt agreements, of \$2.8 billion, calculated as of the last day of each fiscal quarter. Also, consolidated indebtedness, calculated as of the last day of each fiscal quarter, cannot exceed 35% of the sum of the Company's consolidated indebtedness plus adjusted consolidated net worth. A material ongoing covenant default could require immediate payment of the amount due, including principal, under the various agreements. Additionally, the Company's debt agreements contain cross-default covenants, which would make outstanding borrowings immediately payable in the event of a material uncured covenant default under any of the agreements, including, but not limited to, non-payment of indebtedness when due for an amount in excess of \$100.0 million, bankruptcy proceedings, or any other event which results in the acceleration of the maturity of indebtedness. As of June 30, 2012 and December 31, 2011, the Company had \$1,415.0 million and \$1,414.7 million, respectively, in outstanding borrowings under its debt agreements and was in compliance with all covenants under those agreements. The ability of the Company to make debt principal and interest payments depends on the earnings and surplus of subsidiaries, investment earnings on undeployed capital proceeds, and the Company's ability to raise additional funds.

The Company enters into derivative agreements with counterparties that reference either RGA's debt rating or certain subsidiary financial strength ratings. If either rating is downgraded in the future, it could trigger certain terms in the Company's derivative agreements, which could negatively affect overall liquidity. For the most restrictive of the Company's derivative agreements, there is a termination event should the long-term senior debt ratings drop below either BBB+ (S&P) or Baa1 (Moody's) or the financial strength ratings drop below either A- (S&P) or A3 (Moody's).

The Company maintains a syndicated revolving credit facility with an overall capacity of \$850.0 million which is scheduled to mature in December 2015. The Company may borrow cash and may obtain letters of credit in multiple currencies under this facility. As of June 30, 2012, the Company had no cash borrowings outstanding and \$263.3 million in issued, but undrawn, letters of credit under this facility. As of June 30, 2012 and December 31, 2011, the average interest rate on long-term debt outstanding was 5.94%.

Based on the historic cash flows and the current financial results of the Company, management believes RGA's cash flows will be sufficient to enable RGA to meet its obligations for at least the next 12 months.

### **Collateral Finance Facility**

In 2006, RGA's subsidiary, Timberlake Financial L.L.C. (Timberlake Financial), issued \$850.0 million of Series A Floating Rate Insured Notes due June 2036 in a private placement. The notes were issued to fund the collateral requirements for statutory reserves required by the U.S. Valuation of Life Policies Model Regulation (commonly referred to as Regulation XXX) on specified term life insurance policies reinsured by RGA Reinsurance and retroceded to Timberlake Reinsurance Company II (Timberlake Re). Proceeds from the notes, along with a \$112.8 million direct investment by the Company, were deposited into a series of accounts that collateralize the notes and are not available to satisfy the

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general obligations of the Company. Interest on the notes accrues at an annual rate of 1-month LIBOR plus a base rate margin, payable monthly. The payment of interest and principal on the notes is insured through a financial guaranty insurance policy by a monoline insurance company whose parent company is operating under Chapter 11 bankruptcy. The notes represent senior, secured indebtedness of Timberlake Financial without legal recourse to RGA or its other subsidiaries.

Timberlake Financial relies primarily upon the receipt of interest and principal payments on a surplus note and dividend payments from its wholly-owned subsidiary, Timberlake Re, a South Carolina captive insurance company, to make payments of interest and principal on the notes. The ability of Timberlake Re to make interest and principal payments on the surplus

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note and dividend payments to Timberlake Financial is contingent upon the South Carolina Department of Insurance's regulatory approval. Since Timberlake Re's capital and surplus fell below \$35.0 million, it has been required, since the second quarter of 2011, to request approval on a quarterly rather than annual basis and provide additional scenario testing results. Approval to pay interest on the surplus note was granted through September 28, 2012. As of June 30, 2012, Timberlake Re's surplus totaled \$29.0 million. Management expects capital and surplus to remain below \$35.0 million through 2012. Reserve decreases and statutory profits are expected to increase capital and surplus above \$35.0 million by year-end 2014.

In 2010, Manor Re obtained \$300.0 million of collateral financing through 2020 from an international bank which enabled Manor Re to deposit assets in trust to support statutory reserve credit for an affiliated reinsurance transaction. The bank has recourse to RGA should Manor Re fail to make payments or otherwise not perform its obligations under this financing. Interest on the collateral financing accrues at an annual rate of 3-month LIBOR plus a base rate margin, payable quarterly.

## **Asset / Liability Management**

The Company actively manages its cash and invested assets using an approach that is intended to balance quality, diversification, asset/liability matching, liquidity and investment return. The goals of the investment process are to optimize after-tax, risk-adjusted investment income and after-tax, risk-adjusted total return while managing the assets and liabilities on a cash flow and duration basis.

The Company has established target asset portfolios for each major insurance product, which represent the investment strategies intended to profitably fund its liabilities within acceptable risk parameters. These strategies include objectives and limits for effective duration, yield curve sensitivity and convexity, liquidity, asset sector concentration and credit quality.

The Company's liquidity position (cash and cash equivalents and short-term investments) was \$1,007.3 million and \$1,051.4 million at June 30, 2012 and December 31, 2011, respectively. Cash and cash equivalents includes cash collateral received from derivative counterparties of \$226.4 million and \$241.5 million as of June 30, 2012 and December 31, 2011, respectively. This unrestricted cash collateral is included in cash and cash equivalents and the obligation to return it is included in other liabilities in the Company's condensed consolidated balance sheets. Liquidity needs are determined from valuation analyses conducted by operational units and are driven by product portfolios. Periodic evaluations of demand liabilities and short-term liquid assets are designed to adjust specific portfolios, as well as their durations and maturities, in response to anticipated liquidity needs.

The Company periodically sells investment securities under agreements to repurchase the same securities. These arrangements are used for purposes of short-term financing. There were no securities subject to these agreements outstanding at June 30, 2012 or December 31, 2011. The book value of securities subject to these agreements, if any, is included in fixed maturity securities while the repurchase obligations would be reported in other liabilities in the condensed consolidated balance sheets. The Company also occasionally enters into arrangements to purchase securities under agreements to resell the same securities. Amounts outstanding, if any, are reported in cash and cash equivalents on the Company's condensed consolidated balance sheets. These agreements are primarily used as yield enhancement alternatives to other cash equivalent investments. There were no amounts outstanding at June 30, 2012 or December 31, 2011. The Company sometimes participates in a securities borrowing program whereby securities, which are not reflected on the Company's condensed consolidated balance sheets, are borrowed from a third party. The Company is required to maintain a minimum of 100% of the market value of the borrowed securities as collateral. The Company had borrowed securities with an amortized cost and estimated fair value of \$237.5 million and \$150.0 million as of June 30, 2012 and December 31, 2011. The borrowed securities are used to provide collateral under an affiliated reinsurance transaction.

RGA Reinsurance is a member of the Federal Home Loan Bank of Des Moines ( FHLB ) and holds \$18.9 million of common stock in the FHLB, which is included in other invested assets on the Company's condensed consolidated balance sheets. RGA Reinsurance occasionally enters into traditional funding agreements with the FHLB, and had no outstanding traditional funding agreements with the FHLB at June 30, 2012 and December 31, 2011. The Company's had no traditional funding agreements during the first six months of 2012. The Company's average outstanding balance of traditional funding agreements was \$80.9 million and \$46.8 million during the second quarter and first six months of 2011. Interest on traditional funding agreements with the FHLB is reflected in interest expense on the Company's condensed consolidated statements of income.

In addition, RGA Reinsurance has also entered into funding agreements with the FHLB under guaranteed investment contracts whereby RGA Reinsurance has issued the funding agreements in exchange for cash and for which the FHLB has been granted a blanket lien on RGA Reinsurance's commercial and residential mortgage-backed securities and commercial mortgage loans used to collateralize RGA Reinsurance's obligations under the funding agreements. RGA Reinsurance maintains control over these pledged assets, and may use, commingle, encumber or dispose of any portion of the collateral as long as there is no event of default and the remaining qualified collateral is sufficient to satisfy the collateral maintenance level. The funding agreements and the related security agreements represented by this blanket lien provide that upon any



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event of default by RGA Reinsurance, the FHLB's recovery is limited to the amount of RGA Reinsurance's liability under the outstanding funding agreements. The amount of the Company's liability for the funding agreements with the FHLB under guaranteed investment contracts was \$200.0 million and \$197.7 million at June 30, 2012 and December 31, 2011, respectively, which is included in interest sensitive contract liabilities. The advances on these agreements are collateralized primarily by commercial and residential mortgage-backed securities and commercial mortgage loans.

The Company's asset-intensive products are primarily supported by investments in fixed maturity securities reflected on the Company's balance sheet and under funds withheld arrangements with the ceding company. Investment guidelines are established to structure the investment portfolio based upon the type, duration and behavior of products in the liability portfolio so as to achieve targeted levels of profitability. The Company manages the asset-intensive business to provide a targeted spread between the interest rate earned on investments and the interest rate credited to the underlying interest-sensitive contract liabilities. The Company periodically reviews models projecting different interest rate scenarios and their effect on profitability. Certain of these asset-intensive agreements, primarily in the U.S. operating segment, are generally funded by fixed maturity securities that are withheld by the ceding company.

**Investments**

The Company had total cash and invested assets of \$32.5 billion and \$25.9 billion at June 30, 2012 and December 31, 2011, respectively, as illustrated below (dollars in thousands):

|   | June 30, 2012        | December 31, 2011    |
|---|----------------------|----------------------|
| Fixed maturity securities, available-for-sale | \$ 17,244,192        | \$ 16,200,950        |
| Mortgage loans on real estate                 | 1,157,049            | 991,731              |
| Policy loans                                  | 1,250,238            | 1,260,400            |
| Funds withheld at interest                    | 5,457,888            | 5,410,424            |
| Short-term investments                        | 49,981               | 88,566               |
| Investment receivable                         | 5,406,898            | -                    |
| Other invested assets                         | 940,605              | 1,012,541            |
| Cash and cash equivalents                     | 957,341              | 962,870              |
| <b>Total cash and invested assets</b>         | <b>\$ 32,464,192</b> | <b>\$ 25,927,482</b> |

The following table presents consolidated average invested assets at amortized cost, net investment income and investment yield, excluding funds withheld at interest and the investment receivable associated with the annuity coinsurance transaction executed in the second quarter of 2012. Funds withheld at interest assets and investment receivable are primarily associated with the reinsurance of annuity contracts on which the Company earns a spread. Fluctuations in the yield on funds withheld assets and investment receivable are substantially offset by a corresponding adjustment to the interest credited on the liabilities (dollars in thousands).

|  | Three months ended June 30, |               |                         | Six months ended June 30, |               |                         |
|--|-----------------------------|---------------|-------------------------|---------------------------|---------------|-------------------------|
|  | 2012                        | 2011          | Increase/<br>(Decrease) | 2012                      | 2011          | Increase/<br>(Decrease) |
| Average invested assets at amortized cost                                    | \$ 18,584,971               | \$ 17,446,168 | 6.5%                    | \$ 18,351,827             | \$ 16,992,394 | 8.0%                    |
| Net investment income  | 230,383                     | 228,728       | 0.7%                    | 457,753                   | 448,636       | 2.0%                    |
| Investment yield (ratio of net investment income to average invested assets) | 5.05%                       | 5.35%         | (30) bps                | 5.05%                     | 5.35%         | (30) bps                |

The investment yield including the previously mentioned investment receivable would be 4.54% and 4.66% for the second quarter and first six months of 2012, respectively. The current low U.S. interest rate environment is negatively affecting the Company's earnings. Investment yield decreased for the three months ended June 30, 2012 due primarily to slightly lower yields on several asset classes including fixed maturity securities, mortgage loans and policy loans. The lower yields are due primarily to a lower interest rate environment which decreases the yield on new investment purchases. All investments held by RGA and its subsidiaries are monitored for conformance with 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, to provide adequate liquidity for expected reinsurance obligations, and to balance income and total return objectives.

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while maintaining prudent asset management. The Company's duration needs differ between operating segments. Based on Canadian reserve requirements, the Canadian liabilities are matched with long-duration Canadian assets and 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. See Note 4 Investments in the Notes to Condensed Consolidated Financial Statements of the DAC Current Report for additional information regarding the Company's investments.

**Table of Contents***Fixed Maturity and Equity Securities Available-for-Sale*

See Fixed Maturity and Equity Securities Available-for-Sale in Note 4 Investments in the Notes to Consolidated Financial Statements for tables that provide the amortized cost, unrealized gains and losses, estimated fair value of fixed maturity and equity securities, and other-than-temporary impairments in AOCI by sector as of June 30, 2012 and December 31, 2011.

The Company's fixed maturity securities are invested primarily in corporate bonds, mortgage- and asset-backed securities, and U.S. and Canadian government securities. As of June 30, 2012 and December 31, 2011, approximately 95.6% and 95.5%, respectively, of the Company's consolidated investment portfolio of fixed maturity securities were investment grade.

Important factors in the selection of investments include diversification, quality, yield, total rate of return potential and call protection. The relative importance of these factors is determined by market conditions and the underlying product or portfolio characteristics. Cash equivalents are primarily invested in high-grade money market instruments. The largest asset class in which fixed maturity securities were invested was corporate securities, which represented approximately 48.7% and 46.0% of total fixed maturity securities as of June 30, 2012 and December 31, 2011, respectively. See Corporate Fixed Maturity Securities in Note 4 Investments in the Notes to Condensed Consolidated Financial Statements for tables showing the major industry types, which comprise the corporate fixed maturity holdings at June 30, 2012 and December 31, 2011.

The creditworthiness of Greece, Ireland, Italy, Portugal and Spain, commonly referred to as Europe's peripheral region, is under ongoing stress and uncertainty due to high debt levels and economic weakness. The Company did not have exposure to sovereign fixed maturity securities, which includes global government agencies, from Europe's peripheral region as of June 30, 2012 and December 31, 2011. In addition, the Company did not purchase or sell credit protection, through credit default swaps, referenced to sovereign entities of Europe's peripheral region. The tables below show the Company's exposure to sovereign fixed maturity securities originated in countries other than Europe's peripheral region, included in Other foreign government, supranational and foreign government-sponsored enterprises, in Note 4 Investments in the Notes to Condensed Consolidated Financial Statements, as of June 30, 2012 and December 31, 2011 (dollars in thousands):

| <b>June 30, 2012:</b> |                     |                      |                |
|-----------------------|---------------------|----------------------|----------------|
|                       | Amortized Cost      | Estimated Fair Value | % of Total     |
| Australia             | \$ 475,097          | \$ 490,913           | 37.2 %         |
| Japan                 | 214,420             | 220,390              | 16.7           |
| United Kingdom        | 124,547             | 136,672              | 10.3           |
| South Africa          | 66,353              | 68,691               | 5.2            |
| New Zealand           | 52,684              | 53,231               | 4.0            |
| Cayman Islands        | 48,133              | 53,013               | 4.0            |
| Germany               | 40,406              | 42,863               | 3.2            |
| Other                 | 236,277             | 256,300              | 19.4           |
| <b>Total</b>          | <b>\$ 1,257,917</b> | <b>\$ 1,322,073</b>  | <b>100.0 %</b> |

| <b>December 31, 2011:</b> |                     |                      |                |
|---------------------------|---------------------|----------------------|----------------|
|                           | Amortized Cost      | Estimated Fair Value | % of Total     |
| Australia                 | \$ 437,713          | \$ 446,694           | 39.1 %         |
| Japan                     | 214,994             | 219,276              | 19.2           |
| United Kingdom            | 118,618             | 130,106              | 11.4           |
| Germany                   | 72,926              | 75,741               | 6.6            |
| New Zealand               | 51,547              | 51,544               | 4.5            |
| South Africa              | 37,624              | 38,528               | 3.4            |
| South Korea               | 30,592              | 32,025               | 2.8            |
| Other                     | 139,927             | 148,792              | 13.0           |
| <b>Total</b>              | <b>\$ 1,103,941</b> | <b>\$ 1,142,706</b>  | <b>100.0 %</b> |





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The tables below show the Company's exposure to non-sovereign fixed maturity securities and equity securities, based on the security's country of issuance, from Europe's peripheral region as of June 30, 2012 and December 31, 2011 (dollars in thousands):

**June 30, 2012:**

|                                | Amortized Cost | Estimated Fair Value | % of Total |
|--------------------------------|----------------|----------------------|------------|
| <b>Financial institutions:</b> |                |                      |            |
| Ireland                        | \$ 3,477       | \$ 3,864             | 6.1 %      |
| Spain                          | 23,486         | 20,865               | 32.9       |
| Total financial institutions   | 26,963         | 24,729               | 39.0       |
| <b>Other:</b>                  |                |                      |            |
| Ireland                        | 12,476         | 13,042               | 20.6       |
| Italy                          | 3,544          | 3,438                | 5.4        |
| Spain                          | 24,420         | 22,148               | 35.0       |
| Total other                    | 40,440         | 38,628               | 61.0       |
| Total                          | \$ 67,403      | \$ 63,357            | 100.0 %    |

**December 31, 2011:**

|                                | Amortized Cost | Estimated Fair Value | % of Total |
|--------------------------------|----------------|----------------------|------------|
| <b>Financial institutions:</b> |                |                      |            |
| Ireland                        | \$ 4,084       | \$ 4,397             | 5.9 %      |
| Spain                          | 25,565         | 20,378               | 27.6       |
| Total financial institutions   | 29,649         | 24,775               | 33.5       |
| <b>Other:</b>                  |                |                      |            |
| Ireland                        | 12,474         | 13,149               | 17.8       |
| Italy                          | 2,898          | 2,808                | 3.8        |
| Spain                          | 34,459         | 33,137               | 44.9       |
| Total other                    | 49,831         | 49,094               | 66.5       |
| Total                          | \$ 79,480      | \$ 73,869            | 100.0 %    |

The Company references rating agency designations in some of its investment disclosures. These designations are based on the ratings from nationally recognized rating organizations, primarily those assigned by S&P. In instances where a S&P rating is not available the Company will reference the rating provided by Moody's and in the absence of both the Company will assign equivalent ratings based on information from the NAIC. The NAIC assigns securities quality ratings and uniform valuations called "NAIC Designations" which are used by insurers when preparing their statutory filings. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations assigned by the NAIC range from class 1 to class 6, with designations in classes 1 and 2 generally considered investment grade (BBB or higher rating agency designation). NAIC designations in classes 3 through 6 are generally considered below investment grade (BB or lower rating agency designation).

The quality of the Company's available-for-sale fixed maturity securities portfolio, as measured at fair value and by the percentage of fixed maturity securities invested in various ratings categories, relative to the entire available-for-sale fixed maturity security portfolio, at June 30, 2012 and December 31, 2011 was as follows (dollars in thousands):

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| Rating Agency    |                    | June 30, 2012  |                      |            | December 31, 2011 |                      |            |
|------------------|--------------------|----------------|----------------------|------------|-------------------|----------------------|------------|
| NAIC Designation | Designation        | Amortized Cost | Estimated Fair Value | % of Total | Amortized Cost    | Estimated Fair Value | % of Total |
| 1                | AAA/AA/A           | \$ 10,477,317  | \$ 12,506,331        | 72.5 %     | \$ 10,087,612     | \$ 11,943,633        | 73.7 %     |
| 2                | BBB                | 3,667,640      | 3,974,486            | 23.1       | 3,283,937         | 3,522,411            | 21.8       |
| 3                | BB                 | 421,128        | 428,875              | 2.5        | 446,610           | 436,001              | 2.7        |
| 4                | B                  | 269,970        | 248,850              | 1.4        | 244,645           | 210,222              | 1.3        |
| 5                | CCC and lower      | 89,665         | 64,812               | 0.4        | 95,128            | 71,410               | 0.4        |
| 6                | In or near default | 31,445         | 20,838               | 0.1        | 24,948            | 17,273               | 0.1        |
| Total            |                    | \$ 14,957,165  | \$ 17,244,192        | 100.0 %    | \$ 14,182,880     | \$ 16,200,950        | 100.0 %    |

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The Company's fixed maturity portfolio includes structured securities. The following table shows the types of structured securities the Company held at June 30, 2012 and December 31, 2011 (dollars in thousands):

|   | June 30, 2012       |                      | December 31, 2011   |                      |
|---|---------------------|----------------------|---------------------|----------------------|
|   | Amortized Cost      | Estimated Fair Value | Amortized Cost      | Estimated Fair Value |
| <b>Residential mortgage-backed securities:</b>      |                     |                      |                     |                      |
| Agency  | \$ 511,985          | \$ 571,821           | \$ 561,156          | \$ 619,010           |
| Non-agency  | 495,808             | 506,741              | 606,109             | 608,224              |
| <b>Total residential mortgage-backed securities</b> | <b>1,007,793</b>    | <b>1,078,562</b>     | <b>1,167,265</b>    | <b>1,227,234</b>     |
| <b>Commercial mortgage-backed securities</b>        | <b>1,308,668</b>    | <b>1,348,047</b>     | <b>1,233,958</b>    | <b>1,242,219</b>     |
| <b>Asset-backed securities</b>                      | <b>469,616</b>      | <b>441,051</b>       | <b>443,974</b>      | <b>401,991</b>       |
| <b>Total</b>  | <b>\$ 2,786,077</b> | <b>\$ 2,867,660</b>  | <b>\$ 2,845,197</b> | <b>\$ 2,871,444</b>  |

The residential mortgage-backed securities include agency-issued pass-through securities and collateralized mortgage obligations. A majority of the agency-issued pass-through securities are guaranteed or otherwise supported by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, or the Government National Mortgage Association. The weighted average credit rating was AA+ as of June 30, 2012 and AA as of December 31, 2011. The principal risks inherent in holding mortgage-backed securities are prepayment and extension risks, which will affect the timing of when cash will be received and are dependent on the level of mortgage interest rates. Prepayment risk is the unexpected increase in principal payments, primarily as a result of owner refinancing. Extension risk relates to the unexpected slowdown in principal payments. In addition, mortgage-backed securities face default risk should the borrower be unable to pay the contractual interest or principal on their obligation. The Company monitors its mortgage-backed securities to mitigate exposure to the cash flow uncertainties associated with these risks.

As of June 30, 2012 and December 31, 2011, the Company had exposure to commercial mortgage-backed securities with amortized costs totaling \$1,641.3 million and \$1,595.1 million, and estimated fair values of \$1,697.4 million and \$1,615.9 million, respectively. Those amounts include exposure to commercial mortgage-backed securities held directly in the Company's investment portfolios within fixed maturity securities, as well as securities held by ceding companies that support the Company's funds withheld at interest investment. The securities are generally highly rated with weighted average S&P credit ratings of approximately A+ at both June 30, 2012 and December 31, 2011. Approximately 34.6% and 40.2%, based on estimated fair value, were classified in the AAA category at June 30, 2012 and December 31, 2011, respectively. The Company recorded \$12.1 million of other-than-temporary impairments in its direct investments in commercial mortgage-backed securities for the first six months ended June 30, 2012. The Company recorded \$2.3 million and \$2.7 million of other-than-temporary impairments in its direct investments in commercial mortgage-backed securities for the second quarter and first six months ended June 30, 2011, respectively. The following tables summarize the commercial mortgage-backed securities by rating and underwriting year at June 30, 2012 and December 31, 2011 (dollars in thousands):

| Underwriting Year     | AAA               |                      | AA                |                      | A                 |                      |
|-----------------------|-------------------|----------------------|-------------------|----------------------|-------------------|----------------------|
|                       | Amortized Cost    | Estimated Fair Value | Amortized Cost    | Estimated Fair Value | Amortized Cost    | Estimated Fair Value |
| <b>June 30, 2012:</b> |                   |                      |                   |                      |                   |                      |
| 2005 & Prior          | \$ 70,446         | \$ 76,457            | \$ 153,178        | \$ 162,467           | \$ 84,719         | \$ 83,838            |
| 2006                  | 240,958           | 264,432              | 61,474            | 67,147               | 63,307            | 66,402               |
| 2007                  | 166,347           | 181,013              | 13,093            | 15,362               | 105,024           | 114,127              |
| 2008                  | 8,757             | 8,750                | 43,657            | 56,075               | 23,613            | 27,928               |
| 2009                  | 1,636             | 1,721                | 17,268            | 19,393               | 3,436             | 5,192                |
| 2010                  | 27,960            | 29,298               | 46,949            | 52,726               | 13,248            | 14,154               |
| 2011                  | 21,139            | 21,244               | 16,050            | 18,173               | 7,475             | 7,938                |
| 2012                  | 5,132             | 5,179                | 17,298            | 17,466               | 1,499             | 1,501                |
| <b>Total</b>          | <b>\$ 542,375</b> | <b>\$ 588,094</b>    | <b>\$ 368,967</b> | <b>\$ 408,809</b>    | <b>\$ 302,321</b> | <b>\$ 321,080</b>    |

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| Underwriting Year | BBB               |                      | Below Investment Grade |                      | Total               |                      |
|-------------------|-------------------|----------------------|------------------------|----------------------|---------------------|----------------------|
|                   | Amortized Cost    | Estimated Fair Value | Amortized Cost         | Estimated Fair Value | Amortized Cost      | Estimated Fair Value |
| 2005 & Prior      | \$ 56,847         | \$ 55,405            | \$ 28,855              | \$ 21,646            | \$ 394,045          | \$ 399,813           |
| 2006              | 44,298            | 39,512               | 47,361                 | 41,039               | 457,398             | 478,532              |
| 2007              | 103,035           | 112,915              | 114,312                | 81,467               | 501,811             | 504,884              |
| 2008              | --                | --                   | 22,011                 | 15,389               | 98,038              | 108,142              |
| 2009              | 3,767             | 4,759                | --                     | --                   | 26,107              | 31,065               |
| 2010              | --                | --                   | --                     | --                   | 88,157              | 96,178               |
| 2011              | --                | --                   | --                     | --                   | 44,664              | 47,355               |
| 2012              | --                | --                   | 7,117                  | 7,286                | 31,046              | 31,432               |
| <b>Total</b>      | <b>\$ 207,947</b> | <b>\$ 212,591</b>    | <b>\$ 219,656</b>      | <b>\$ 166,827</b>    | <b>\$ 1,641,266</b> | <b>\$ 1,697,401</b>  |

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| December 31, 2011: | AAA            |                      | AA             |                      | A              |                      |
|--------------------|----------------|----------------------|----------------|----------------------|----------------|----------------------|
|                    | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Underwriting Year  |                |                      |                |                      |                |                      |
| 2005 & Prior       | \$ 92,275      | \$ 98,213            | \$ 130,890     | \$ 143,609           | \$ 32,504      | \$ 31,187            |
| 2006               | 260,765        | 277,959              | 52,883         | 59,727               | 52,805         | 55,074               |
| 2007               | 201,228        | 214,510              | 23,565         | 18,700               | 116,898        | 122,945              |
| 2008               | 8,975          | 9,053                | 48,818         | 59,536               | 17,012         | 19,237               |
| 2009               | 1,664          | 1,709                | 12,367         | 13,684               | 7,060          | 9,515                |
| 2010               | 27,946         | 28,872               | 49,323         | 53,480               | 19,434         | 20,727               |
| 2011               | 20,047         | 20,002               | 11,146         | 12,079               | 7,563          | 7,594                |
| Total              | \$ 612,900     | \$ 650,318           | \$ 328,992     | \$ 360,815           | \$ 253,276     | \$ 266,279           |

| Underwriting Year | BBB            |                      | Below Investment Grade |                      | Total          |                      |
|-------------------|----------------|----------------------|------------------------|----------------------|----------------|----------------------|
|                   | Amortized Cost | Estimated Fair Value | Amortized Cost         | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| 2005 & Prior      | \$ 24,750      | \$ 24,295            | \$ 52,475              | \$ 40,753            | \$ 332,894     | \$ 338,057           |
| 2006              | 27,995         | 26,563               | 53,205                 | 43,559               | 447,653        | 462,882              |
| 2007              | 102,604        | 108,047              | 113,946                | 77,718               | 558,241        | 541,920              |
| 2008              | --             | --                   | 24,916                 | 17,554               | 99,721         | 105,380              |
| 2009              | --             | --                   | --                     | --                   | 21,091         | 24,908               |
| 2010              | --             | --                   | --                     | --                   | 96,703         | 103,079              |
| 2011              | --             | --                   | --                     | --                   | 38,756         | 39,675               |
| Total             | \$ 155,349     | \$ 158,905           | \$ 244,542             | \$ 179,584           | \$ 1,595,059   | \$ 1,615,901         |

Asset-backed securities include credit card and automobile receivables, sub-prime mortgage-backed securities, home equity loans, manufactured housing bonds and collateralized debt obligations. The Company's asset-backed securities are diversified by issuer and contain both floating and fixed rate securities and had a weighted average credit rating of AA- at June 30, 2012 and December 31, 2011. The Company owns floating rate securities that represent approximately 14.7% and 15.2% of the total fixed maturity securities at June 30, 2012 and December 31, 2011, respectively. These investments have a higher degree of income variability than the other fixed income holdings in the portfolio due to the floating rate nature of the interest payments. The Company holds these investments to match specific floating rate liabilities primarily reflected in the consolidated balance sheets as collateral finance facility. In addition to the risks associated with floating rate securities, principal risks in holding asset-backed securities are structural, credit and capital market risks. Structural risks include the securities' cash flow priority in the capital structure and the inherent prepayment sensitivity of the underlying collateral. Credit risks include the adequacy and ability to realize proceeds from the collateral. Credit risks are mitigated by credit enhancements which include excess spread, over-collateralization and subordination. Capital market risks include general level of interest rates and the liquidity for these securities in the marketplace.

As of June 30, 2012 and December 31, 2011, the Company held investments in securities with sub-prime mortgage exposure with amortized costs totaling \$128.8 million and \$136.7 million, and estimated fair values of \$98.6 million and \$102.7 million, respectively. Those amounts include exposure to sub-prime mortgages through securities held directly in the Company's investment portfolios within asset-backed securities, as well as securities backing the Company's funds withheld at interest investment. The weighted average S&P credit ratings on these securities was approximately BB+ and BBB- at June 30, 2012 and December 31, 2011, respectively. At new issue, these securities had been highly rated; however, in recent years have been downgraded by rating agencies. Additionally, the Company has largely avoided directly investing in securities originated since the second half of 2005, which management believes was a period of lessened underwriting quality. Limited growth in this sector is attributable to new purchases in the funds withheld segregated portfolios. While ratings and vintage year are important factors to consider, the tranche seniority and evaluation of forecasted future losses within a tranche is critical to the valuation of these types of securities. The Company did not record any other-than-temporary impairments in its sub-prime portfolio during the second quarter and first six months of 2012. The Company recorded \$0.2 million and \$0.7 million in other-than-temporary impairments in its sub-prime portfolio during the second quarter and first six months of 2011, respectively.

Alternative residential mortgage loans ( Alt-A ) are a classification of mortgage loans where the risk profile of the borrower falls between prime and sub-prime. At June 30, 2012 and December 31, 2011, the Company's Alt-A securities had an amortized cost of \$124.5 million and \$140.5 million, respectively. As of June 30, 2012 and December 31, 2011, 24.3% and 43.8%, respectively, of the Alt-A securities were rated AA- or better. This amount includes securities directly held by the Company and securities held by ceding companies that support the Company's funds withheld at interest investment. The Company recorded \$0.2 million in other-than-temporary impairments in the second quarter of 2012, in its Alt-A securities portfolio due primarily to the increased likelihood that some or all of the remaining scheduled principal and interest payments on certain securities will not be received. The Company did not record any other-than-temporary impairments in the second quarter of 2011 in

its Alt-A portfolio.

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The Company does not invest in the common equity securities of Fannie Mae and Freddie Mac, both government sponsored entities; however, as of June 30, 2012 and December 31, 2011, the Company held in its general portfolio \$59.7 million and \$51.0 million, respectively, at amortized cost with direct exposure in the form of senior unsecured agency and preferred securities. Additionally, as of June 30, 2012 and December 31, 2011, the portfolios held by the Company's ceding companies that support its funds withheld asset contain approximately \$329.3 million and \$454.6 million, respectively, in amortized cost of unsecured agency bond holdings and no equity exposure. As of June 30, 2012 and December 31, 2011, indirect exposure in the form of secured, structured mortgaged securities issued by Fannie Mae and Freddie Mac totaled approximately \$736.8 million and \$723.7 million, respectively, in amortized cost across the Company's general and funds withheld portfolios. Including the funds withheld portfolios, the Company's direct holdings in the form of preferred securities had a total amortized cost of \$0.7 million at December 31, 2011.

The Company monitors its fixed maturity and equity securities to determine impairments in value and evaluates factors such as financial condition of the issuer, payment performance, the length of time and the extent to which the market value has been below amortized cost, compliance with covenants, general market and industry sector conditions, current intent and ability to hold securities, and various other subjective factors. The Company recorded \$4.0 million and \$19.7 million in other-than-temporary impairments in its fixed maturity and equity securities, including \$0.2 million and \$13.0 million of other-than-temporary impairment losses on Subprime / Alt-A / Other structured securities, in the second quarter and first six months of 2012, respectively, primarily due to a decline in value of structured securities with exposure to mortgages and general credit deterioration in select corporate and foreign securities. The Company recorded \$9.0 million and \$10.5 million in other-than-temporary impairments in its fixed maturity and equity securities, including \$5.3 million and \$6.3 million of other-than-temporary impairment losses on Subprime / Alt-A / Other structured securities, in the second quarter and first six months of 2011, respectively, primarily due to a decline in value of structured securities with exposure to mortgages and general credit deterioration in the select corporate and foreign securities. The table below summarizes other-than-temporary impairments for the second quarter of 2012 and 2011 (dollars in thousands).

| Asset Class  | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|--|--------------------------------|------------------|------------------------------|------------------|
|  | 2012                           | 2011             | 2012                         | 2011             |
| Subprime / Alt-A / Other structured securities                 | \$ 220                         | \$ 5,290         | \$ 13,010                    | \$ 6,332         |
| Corporate / Other fixed maturity securities                    | 1,577                          | --               | 3,615                        | 514              |
| Equity securities  | 2,186                          | 3,680            | 3,025                        | 3,680            |
| Other impairments, including change in mortgage loan provision | (1,762)                        | 3,186            | 4,081                        | 2,610            |
| <b>Total</b>   | <b>\$ 2,221</b>                | <b>\$ 12,156</b> | <b>\$ 23,731</b>             | <b>\$ 13,136</b> |

At June 30, 2012 and December 31, 2011, the Company had \$196.3 million and \$292.5 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,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
| <b>Sector:</b>  |                  |                      |
| Corporate securities  | 34.7 %           | 46.5 %               |
| Residential mortgage-backed securities  | 4.1              | 5.6                  |
| Asset-backed securities   | 21.0             | 18.4                 |
| Commercial mortgage-backed securities   | 34.6             | 27.2                 |
| State and political subdivisions  | 4.3              | 1.1                  |
| Other foreign government supranational and foreign government-sponsored enterprises | 1.3              | 1.2                  |
| <b>Total</b>  | <b>100.0 %</b>   | <b>100.0 %</b>       |
| <b>Industry:</b>  |                  |                      |
| Finance   | 23.7 %           | 36.0 %               |
| Asset-backed  | 21.0             | 18.4                 |
| Industrial  | 7.8              | 8.2                  |



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|                 |         |         |
|-----------------|---------|---------|
| Mortgage-backed | 38.7    | 32.8    |
| Government      | 5.6     | 2.4     |
| Utility         | 3.2     | 2.2     |
| Total           | 100.0 % | 100.0 % |

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See *Unrealized Losses for Fixed Maturity and Equity Securities Available-for-Sale* in Note 4 *Investments* in the Notes to Condensed Consolidated Financial Statements for a table that presents the total gross unrealized losses for fixed maturity and equity securities at June 30, 2012 and December 31, 2011, respectively, where the estimated fair value had declined and remained below amortized cost by less than 20% or more than 20%.

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 Company believes that due to fluctuating market conditions and an extended period of economic uncertainty, the extent and duration of a decline in value have become less indicative of when there has been credit deterioration with respect to a fixed maturity security since it may not have an impact on the ability of the issuer to service all scheduled payments and the Company's evaluation of the recoverability of all contractual cash flows or the ability to recover an amount at least equal to amortized cost. In the Company's impairment review process, the duration and severity of an unrealized loss position for equity securities are given greater weight and consideration given the lack of contractual cash flows or deferability features.

See *Unrealized Losses for Fixed Maturity and Equity Securities Available-for-Sale* in Note 4 *Investments* in the Notes to Condensed Consolidated Financial Statements for tables that present the estimated fair values and gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, for fixed maturity and equity securities that have estimated fair values below amortized cost as of June 30, 2012 and December 31, 2011.

As of June 30, 2012, 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, unforeseen facts and circumstances may cause the Company to sell fixed maturity securities in the ordinary course of managing its portfolio to meet diversification, credit quality, asset-liability management and liquidity guidelines.

As of June 30, 2012, 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, unforeseen facts and circumstances may cause the Company to sell equity securities in the ordinary course of managing its portfolio to meet diversification, credit quality and liquidity guidelines.

As of June 30, 2012 and December 31, 2011, respectively, the Company classified approximately 7.6% and 8.5% of its fixed maturity securities in the Level 3 category (refer to Note 6 *Fair Value of Assets and Liabilities* in the Notes to Condensed Consolidated Financial Statements for additional information). These securities primarily consist of private placement corporate securities, below investment grade commercial and residential mortgage-backed securities and sub-prime asset-backed securities with inactive trading markets.

### *Mortgage Loans on Real Estate*

Mortgage loans represented approximately 3.6% and 3.8% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively. The Company's mortgage loan portfolio consists principally of investments in U.S.-based commercial offices, light industrial properties and retail locations. The mortgage loan portfolio is diversified by geographic region and property type.

Valuation allowances on mortgage loans are established based upon losses expected by management to be realized in connection with future dispositions or settlement of mortgage loans, including foreclosures. The valuation allowances are established after management considers, among other things, the value of underlying collateral and payment capabilities of debtors. Any subsequent adjustments to the valuation allowances will be treated as investment gains or losses.

See *Mortgage Loans on Real Estate* in Note 4 *Investments* in the Notes to Condensed Consolidated Financial Statements for information regarding for information regarding valuation allowances and impairments.

### *Policy Loans*

Policy loans comprised approximately 3.9% and 4.9% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively, substantially all of which are associated with one client. These policy loans present no credit risk because the amount of the loan cannot exceed the obligation due the ceding company upon the death of the insured or surrender of the underlying policy. The provisions of the treaties in force and the underlying policies determine the policy loan interest rates. Because policy loans represent premature distributions of policy liabilities, they have the effect of reducing future disintermediation risk. In addition, the Company earns a spread between the interest rate

earned on policy loans and the interest rate credited to corresponding liabilities.

**Table of Contents***Funds Withheld at Interest*

Funds withheld at interest comprised approximately 16.8% and 20.9% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively. For reinsurance agreements written on a modified coinsurance basis and certain agreements written on a coinsurance basis, assets equal to the net statutory reserves are withheld and legally owned and managed by the ceding company, and are reflected as funds withheld at interest on the Company's consolidated balance sheets. In the event of a ceding company's insolvency, the Company would need to assert a claim on the assets supporting its reserve liabilities. However, the risk of loss to the Company is mitigated by its ability to offset amounts it owes the ceding company for claims or allowances with amounts owed by the ceding company. Interest accrues to these assets at rates defined by the treaty terms. Additionally, under certain treaties the Company is subject to the investment performance on the withheld assets, although it does not directly control them. These assets are primarily fixed maturity investment securities and pose risks similar to the fixed maturity securities the Company owns. To mitigate the risk, the Company helps set the investment guidelines followed by the ceding company and monitors compliance. Ceding companies with funds withheld at interest had an average rating of *A* at June 30, 2012 and December 31, 2011. Certain ceding companies maintain segregated portfolios for the benefit of the Company.

*Investment Receivable*

During the second quarter of 2012, the Company added a large fixed deferred annuity reinsurance transaction in its U.S. Asset Intensive sub-segment. This transaction increased the Company's invested asset base by approximately \$5.4 billion which is reflected on the condensed consolidated balance sheet as an investment receivable. Investment receivable represented approximately 16.7% of the Company's cash and invested assets as of June 30, 2012 which represents cash, cash equivalents and invested assets, valued as of the effective date of the transaction, and the related accrued investment income expected to be received. The Company recorded these assets as a receivable since they were not received until July 31, 2012 and August 3, 2012, see Note 13 *Subsequent Event* in the Notes to Condensed Consolidated Financial Statements for more information.

*Other Invested Assets*

Other invested assets include equity securities, limited partnership interests, joint ventures, structured loans and derivative contracts. Other invested assets represented approximately 2.9% and 3.9% of the Company's cash and invested assets as of June 30, 2012 and December 31, 2011, respectively. See *Other Invested Assets* in Note 4 *Investments* in the Notes to Consolidated Financial Statements for a table that presents the carrying value of the Company's other invested assets by type as of June 30, 2012 and December 31, 2011.

The Company recorded \$2.2 million and \$3.0 million of other-than-temporary impairments on equity securities in the second quarter and first six months of 2012. The Company recorded \$3.7 million of other-than-temporary impairments on other invested assets in the second quarter and first six months of 2011. The Company may be exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments. Generally, the credit exposure of the Company's derivative contracts is limited to the fair value at the reporting date plus or minus any collateral pledged to or from the Company. The Company had no credit exposure related to its derivative contracts, excluding futures, at June 30, 2012 as the net amount of collateral pledged to the Company from counterparties exceeded the fair value of the derivative contracts. The Company had credit exposure related to its derivative contracts, excluding futures, of \$12.0 million at December 31, 2011.

**Contractual Obligations**

From December 31, 2011 to June 30, 2012, the Company's obligation related to interest-sensitive contract liabilities increased by \$6,647.1 million due to a large deferred annuity reinsurance transaction executed during the second quarter of 2012. In addition, since December 31, 2011, the Company has revised the estimated principal payments of its collateral financing obligation. The revised estimated principal payments increased (decreased) the contractual obligations by approximately \$(44.5) million, \$(30.2) million, \$33.9 million and \$39.3 million for the periods of less than 1 year, 1-3 years, 4-5 years, and after 5 years, respectively. There were no other material changes in the Company's contractual obligations from those reported in the DAC Current Report.

**Enterprise Risk Management**

RGA maintains an Enterprise Risk Management (ERM) program to identify, assess, mitigate, monitor, and report material risks facing the enterprise. This includes development and implementation of mitigation strategies to reduce exposures to these risks to acceptable levels. Risk management is an integral part of the Company's culture and is interwoven in day to day activities. It includes guidelines, risk appetites, risk limits, and other controls in areas such as pricing, underwriting, currency, administration, investments, asset liability management, counterparty exposure, financing, regulatory change, business continuity planning, human resources, liquidity, sovereign risks and information technology development.



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The Chief Risk Officer ( CRO ), aided by Business Unit Chief Risk Officers, Risk Management Officers and a dedicated ERM function, is responsible for ensuring, on an ongoing basis, that objectives of the ERM framework are met; this includes ensuring proper risk controls are in place, that risks are effectively identified and managed, and that key risks to which the Company is exposed to are disclosed to appropriate stakeholders. For each Business Unit and key risk, a Risk Management Officer is assigned. In addition to this network of Risk Management Officers, the Company also has risk focused committees such as the Business Continuity and Information Governance Steering Committee, Consolidated Investment Committee, Derivatives Risk Oversight Committee, Asset and Liability Management Committee, Collateral and Liquidity Committee, and the Currency Risk Management Committee. These committees are comprised of various risk experts and have overlapping membership, enabling consistent and holistic management of risks. These committees report directly or indirectly to the Risk Management Steering Committee. The Risk Management Steering Committee, which includes senior management executives, including the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer ( COO ) and the CRO, is the primary risk management oversight for the Company.

The Risk Management Steering Committee, through the CRO, reports regularly to the Finance, Investment and Risk Management ( FIRM ) Committee, a sub-committee of the Board of Directors responsible, among other duties, for overseeing the management of RGA's ERM programs and policies. The Board has other committees, such as the Audit Committee, whose responsibilities include aspects of risk management. The CRO reports to the COO and has direct access to the Board of the Company through the FIRM Committee.

The Company has devoted significant resources to develop its ERM program, and expects to do so in the future. Nonetheless, the Company's policies and procedures to identify, manage and monitor risks may not be fully effective. Many of the Company's methods for managing risk are based on historical information, which may not be a good predictor of future risk exposures, such as the risk of a pandemic causing a large number of deaths. Management of operational, legal and regulatory risk rely on policies and procedures which may not be fully effective.

The Company categorizes its main risks as follows:

- Insurance Risk
- Liquidity Risk
- Market Risk
- Credit Risk
- Operational Risk

Specific risk assessments and descriptions can be found below and in Item 1A Risk Factors of the 2011 Annual Report and the DAC Current Report.

### ***Insurance Risk***

The risk of loss due to experience deviating adversely from expectations for mortality, morbidity, and policyholder behavior or lost future profits due to treaty recapture by clients. This category is further divided into mortality, morbidity, policyholder behavior, and client recapture. The Company uses multiple approaches to managing insurance risk: pricing appropriately for the risks assumed, transferring undesired risks, and managing the retained exposure prudently. These strategies are explained below.

### **Pricing**

Pricing is a vital component of effective insurance risk management. Proper pricing ensures that the Company is compensated commensurately for the risks it assumes and that it does not overpay for the risks it transfers to third parties, but cannot guarantee that experience will not deviate adversely from expectations. Pricing tools and assumptions, adjusted as necessary, are useful in assessing the risk for in force business. Misestimation of any key risk can threaten the long term viability of the enterprise. Thus a lot of effort goes into ensuring the appropriateness of pricing assumptions. Some of the safeguards the Company uses to ensure proper pricing are: experience studies, strict underwriting, sensitivity and scenario testing, pricing guidelines and controls, authority limits and internal and external pricing reviews. In addition, the Corporate ERM provides additional pricing oversight by performing periodic pricing audits. If actual mortality or morbidity experience is materially adverse, some reinsurance treaties allow for increases to future premium rates. Other treaties include experience refund provisions, which may also help reduce the Company's insurance risk.

### **Risk Transfer**

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To minimize volatility in financial results and reduce the impact of large losses, the Company transfers some of its insurance risk to third parties using vehicles such as retrocession and catastrophe coverage.

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### *Retrocession*

In the normal course of business, the Company seeks to limit its exposure to loss on any single insured and to recover a portion of claims paid by ceding reinsurance to other insurance enterprises (or retrocessionaires) under excess coverage and coinsurance contracts. In individual life markets, the Company retains a maximum of \$8.0 million of coverage per individual life. In certain limited situations the Company has retained more than \$8.0 million per individual life. The Company enters into agreements with other reinsurers to mitigate the residual risk related to the over-retained policies. Additionally, due to some lower face amount reinsurance coverages provided by the Company in addition to individual life, such as group life, disability and health, under certain circumstances, the Company could potentially incur claims totaling more than \$8.0 million per individual life.

### *Catastrophe Coverage*

The Company accesses the markets each year for annual catastrophic coverages and reviews current coverage and pricing of current and alternate designs. Purchases vary from year to year based on the Company's perceived value of such coverages. The current policy covers events involving 10 or more insured deaths from a single occurrence and covers the Company for claims up to \$100 million after a \$50 million deductible.

### **Mitigation of Retained Exposure**

The Company retains most of the inbound insurance risk. The Company manages the retained exposure proactively using various mitigating factors such as diversification and limits. Diversification is the primary mitigating factor of short term volatility risk, but it also mitigates adverse impacts of changes in long term trends and catastrophic events. The Company's insured populations are dispersed globally, diversifying the insurance exposure because factors that cause actual experience to deviate materially from expectations do not affect all areas uniformly and synchronously or in close sequence. A variety of limits mitigate retained insurance risk. Examples of these limits include geographic exposure limits, which set the maximum amount of business that can be written in a given locale, and jumbo limits, which prevent excessive coverage on a given individual.

In the event that mortality or morbidity experience develops in excess of expectations, some reinsurance treaties allow for increases to future premium rates. Other treaties include experience refund provisions, which may also help reduce RGA's mortality risk.

### ***Liquidity Risk***

Liquidity risk is the risk that cash resources are insufficient to meet the Company's cash demands without incurring unacceptable costs.

Liquidity demands come primarily from payment of claims, expenses and investment purchases, all of which are known or can be reasonably forecasted. Contingent liquidity demands exist and require the Company to inventory and estimate likely and potential liquidity demands stemming from stress scenarios.

The Company maintains cash, cash equivalents, credit facilities, and short-term liquid investments to support its current and future anticipated liquidity requirements. RGA may also borrow via the reverse repo market, and holds a large pool of unrestricted, FHLB-eligible collateral that may be pledged to support any FHLB advances needed to provide additional liquidity.

### ***Market Risk***

Market risk is the risk that net asset and liability values or revenue will be affected adversely by changes in market conditions such as market prices, exchange rates, and nominal interest rates. The Company is primarily exposed to interest rate, equity and currency risks.

### **Interest Rate Risk**

Interest rate risk is the potential for loss, on a net asset and liability basis, due to changes in interest rates, including both normal rate changes and credit spread changes. This risk arises from many of the Company's primary activities, as the Company invests substantial funds in interest-sensitive assets and also has certain interest-sensitive contract liabilities. The Company manages interest rate risk to maximize the return on the Company's capital effectively and to preserve the value created by its business operations. As such, certain management monitoring processes are designed to minimize the effect of sudden and/or sustained changes in interest rates on fair value, cash flows, and net interest income. The Company manages its exposure to interest rates principally by matching floating rate liabilities with corresponding floating rate



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assets and by matching fixed rate liabilities with corresponding fixed rate assets. On a limited basis, the Company uses equity options to minimize its exposure to movements in equity markets that have a direct correlation with certain of its reinsurance products.

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The Company's exposure to interest rate price risk and interest rate cash flow risk is reviewed on a quarterly basis. Interest rate price risk exposure is measured using interest rate sensitivity analysis to determine the change in fair value of the Company's financial instruments in the event of a hypothetical change in interest rates. Interest rate cash flow risk exposure is measured using interest rate sensitivity analysis to determine the Company's variability in cash flows in the event of a hypothetical change in interest rates.

In order to reduce the exposure of changes in fair values from interest rate fluctuations, the Company has developed strategies to manage the interest rate sensitivity of its asset base. From time to time, the Company has utilized the swap market to manage the volatility of cash flows to interest rate fluctuations.

## **Foreign Currency Risk**

The Company is subject to foreign currency translation, transaction, and net income exposure. The Company manages its exposure to currency principally by matching invested assets with the underlying liabilities to the extent possible. The Company has in place net investment hedges for a portion of its investments in its Canadian and Australian operations to reduce excess exposure to these currencies. Translation differences resulting from translating foreign subsidiary balances to U.S. dollars are reflected in stockholders' equity on the condensed consolidated balance sheets.

The Company generally does not hedge the foreign currency exposure of its subsidiaries transacting business in currencies other than their functional currency (transaction exposure). However, the Company has entered into certain interest rate swaps in which the cash flows are denominated in different currencies, commonly referred to as cross currency swaps. Those interest rate swaps have been designated as cash flow hedges. The majority of the Company's foreign currency transactions are denominated in Australian dollars, British pounds, Canadian dollars, Euros, Japanese yen, Korean won, and the South African rand.

## **Inflation Risk**

The primary direct effect on the Company of inflation is the increase in operating expenses. A large portion of the Company's operating expenses consists of salaries, which are subject to wage increases at least partly affected by the rate of inflation. The rate of inflation also has an indirect effect on the Company. To the extent that a government's policies to control the level of inflation result in changes in interest rates, the Company's investment income is affected.

The Company has one treaty with benefits indexed to the cost of living. These benefits are hedged with a combination of CPI swaps and indexed government bonds.

## **Equity Risk**

Equity risk is the risk that net asset and liability (e.g. variable annuities or other equity linked exposures) values or revenues will be affected adversely by changes in equity markets. The Company assumes equity risk from embedded derivatives in alternative investments, fixed indexed annuities and variable annuities.

## ***Alternative Investments***

Alternative Investments are investments in non-traditional asset classes that are most commonly backing capital and surplus and not liabilities. The Company generally restricts the alternative investments portfolio to non-liability supporting assets: that is, free surplus. For (re)insurance companies, alternative investments generally encompass: hedge funds, owned commercial real estate, emerging markets debt, distressed debt, commodities, infrastructure, tax credits, and equities, both public and private. The Company mitigates its exposure to alternative investments by limiting the size of the alternative investments holding.

## ***Fixed Indexed Annuities***

Credits for fixed indexed annuities are affected by changes in equity markets. Thus the fair value of the benefit is a function of primarily index returns and volatility. The Company hedges some of the underlying equity exposure.

## ***Variable Annuities***

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The Company reinsures variable annuities including those with guaranteed minimum death benefits ( GMDB ), guaranteed minimum income benefits ( GMIB ), guaranteed minimum accumulation benefits ( GMAB ) and guaranteed minimum withdrawal benefits ( GMWB ). Strong equity markets, increases in interest rates and decreases in volatility will generally decrease the fair value of the liabilities underlying the benefits. Conversely, a decrease in the equity markets along with a decrease in interest rates and an increase in volatility will generally result in an increase in the fair value of the liabilities underlying the benefits, which has the effect of increasing reserves and lowering earnings. The Company maintains a customized dynamic hedging program that is designed to mitigate the risks associated with income volatility around the change in reserves on guaranteed benefits. However, the hedge positions may not fully offset the changes in the carrying value of the guarantees due to, among other things, time lags, high levels of volatility in the equity and derivative markets, extreme swings in interest rates, unexpected contract holder behavior, and divergence between the performance of the

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underlying funds and hedging indices. These factors, individually or collectively, may have a material adverse effect on the Company's net income, financial condition or liquidity. The table below provides a summary of variable annuity account values and the fair value of the guaranteed benefits as of June 30, 2012 and December 31, 2011.

| (dollars in millions)                 | June 30, 2012 | December 31, 2011 |
|---------------------------------------|---------------|-------------------|
| No guarantee minimum benefits         | \$ 944        | \$ 986            |
| GMDB only                             | 79            | 85                |
| GMIB only                             | 6             | 6                 |
| GMAB only                             | 54            | 55                |
| GMWB only                             | 1,620         | 1,538             |
| GMDB / WB                             | 451           | 498               |
| Other                                 | 30            | 31                |
| Total variable annuity account values | \$ 3,184      | \$ 3,199          |

|   |        |        |
|---|--------|--------|
| Fair value of liabilities associated with living benefit riders | \$ 205 | \$ 277 |
|---|--------|--------|

There has been no significant change in the Company's quantitative or qualitative aspects of market risk during the quarter ended June 30, 2012 from that disclosed in the DAC Current Report.

***Credit Risk***

Credit risk is the risk of loss due to counterparty (obligor, client, retrocessionaire, or partner) credit deterioration or unwillingness to meet its obligations. Credit risk has two forms: investment credit risk (asset default and credit migration) and insurance counterparty risk.

**Investment Credit Risk**

Investment credit risk, which includes default risk, is risk of loss due to credit quality deterioration of an individual financial investment, derivative or non-derivative contract or instrument. Credit quality deterioration may or may not be accompanied by a ratings downgrade. Generally, the investment credit exposure is limited to the fair value, net of any collateral received, at the reporting date.

The creditworthiness of Europe's peripheral region is under ongoing stress and uncertainty due to high debt levels and economic weakness. The Company does not have exposure to sovereign fixed maturity securities, which includes global government agencies, from Europe's peripheral region. The Company does have exposure to sovereign fixed maturity securities originated in countries other than Europe's peripheral region and to non-sovereign fixed maturity and equity securities issued from Europe's peripheral region. See Investments above for additional information on the Company's exposure related to investment securities.

The Company manages investment credit risk using per-issuer investments limits. In addition to per-issuer limits, the Company also limits the total amounts of investments per rating category. An automated compliance system checks for compliance for all investment positions and sends warning messages when there is a breach. 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. Because 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. The Collateral and Liquidity Committee sets rules, approves and oversees all deals requiring collateral. See Credit Risk in Note 5 Derivative Instruments in the Notes to Condensed Consolidated Financial Statements for additional information on credit risk related to derivatives.

**Insurance Counterparty Risk**

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Insurance counterparty risk is the potential for the Company to incur losses due to a client, retrocessionaire, or partner becoming distressed or insolvent. This includes run-on-the-bank risk and collection risk.

### *Run-on-the-Bank*

The risk that a client's in force block incurs substantial surrenders and/or lapses due to credit impairment, reputation damage or other market changes affecting the counterparty. Severely higher than expected surrenders and/or lapses could result in inadequate in force business to recover cash paid out for acquisition costs.

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### *Collection Risk*

For clients and retrocessionaires, this includes their inability to satisfy a reinsurance agreement because the right of offset is disallowed by the receivership court; the reinsurance contract is rejected by the receiver, resulting in a premature termination of the contract; and/or the security supporting the transaction becomes unavailable to RGA.

The Company manages insurance counterparty risk by limiting the total exposure to a single counterparty and by only initiating contracts with creditworthy counterparties. In addition, some of the counterparties have set up trusts and letters of credit, reducing the Company's exposure to these counterparties.

Generally, RGA's insurance subsidiaries retrocede amounts in excess of their retention to RGA Reinsurance, Parkway Re, RGA Barbados, RGA Americas, Rockwood Re, Manor Re, RGA Worldwide or RGA Atlantic. External retrocessions are arranged through the Company's retrocession pools for amounts in excess of its retention. As of June 30, 2012, all retrocession pool members in this excess retention pool reviewed by the A.M. Best Company were rated A- or better. A rating of A- is the fourth highest rating out of fifteen possible ratings. For a majority of the retrocessionaires that were not rated, letters of credit or trust assets have been given as additional security. In addition, the Company performs annual financial and in force reviews of its retrocessionaires to evaluate financial stability and performance.

The Company has never experienced a material default in connection with retrocession arrangements, nor has it experienced any material difficulty in collecting claims recoverable from retrocessionaires; however, no assurance can be given as to the future performance of such retrocessionaires or as to the recoverability of any such claims.

### **Aggregate Counterparty Limits**

In addition to investment credit limits and insurance counterparty limits, there are aggregate counterparty risk limits which include counterparty exposures from reinsurance, financing and investment activities at an aggregated level to control total exposure to a single counterparty. Counterparty risk aggregation is important because it enables the Company to capture risk exposures at a comprehensive level and under more extreme circumstances compared to analyzing the components individually.

### ***Operational Risk***

Operational risk is the risk of loss due to inadequate or failed internal processes, people or systems, or external events. These risks are sometimes residual risks after insurance, market and credit risks have been identified. Operational risk is further divided into: Process, Legal/Regulatory, Financial, and Intangibles. In order to effectively manage operational risks, management primarily relies on:

### **Risk Culture**

Risk management is embedded in RGA's business processes in accordance with RGA's risk philosophy. As the cornerstone of the ERM framework, risk culture plays a preeminent role in the effective management of risks assumed by RGA. At the heart of RGA's risk culture is prudent risk management. Senior management sets the tone for RGA risk culture, inculcating positive risk attitudes so as to entrench sound risk management practices into day-to-day activities.

### **Structural Controls**

Structural controls provide additional safeguards against undesired risk exposures. Examples of structural controls include: pricing and underwriting reviews, standard treaty language which limits or excludes rating triggers and recapture language which minimizes the likelihood and impact of client recaptures.

### **Risk Monitoring and Reporting**

Proactive risk monitoring and reporting enable early detection and mitigation of emerging risks. For example, there is elevated regulatory activity in the wake of the global financial crisis and RGA is actively monitoring regulatory proposals in order to respond optimally. Risk escalation channels coupled with open communication lines enhance the mitigants explained above.

### **New Accounting Standards**

See Note 12 New Accounting Standards in the Notes to Condensed Consolidated Financial Statements.

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**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

See Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk which is included herein.

**ITEM 4. Controls and Procedures**

The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that these disclosure controls and procedures were effective.

There was no change in the Company's internal control over financial reporting as defined in Exchange Act Rule 13a-15(f) during the quarter ended June 30, 2012, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting, except as noted below.

Effective January 1, 2012 the Company upgraded its accounts payable, general ledger and financial reporting technologies to better support its global financial structure. The Company has updated its internal control over financial reporting as necessary to accommodate the modifications to its business processes and related internal control over financial reporting. These system changes, along with the internal control over financial reporting affected by the implementation, were appropriately tested for design effectiveness. While there may be additional changes in related internal control over financial reporting as the Company continues its system transition efforts and alignment of existing business processes in 2012, existing controls and controls affected by the system transition efforts were evaluated as being appropriate and effective.



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**PART II - OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

The Company is subject to litigation in the normal course of its business. The Company currently has no material litigation. A legal reserve is established when the Company is notified of an arbitration demand or litigation or is notified that an arbitration demand or litigation is imminent, it is probable that the Company will incur a loss as a result and the amount of the probable loss is reasonably capable of being estimated.

**ITEM 1A. Risk Factors**

There have been no material changes from the risk factors previously disclosed in the 2011 Annual Report and the DAC Current Report.

**ITEM 6. Exhibits**

See index to exhibits.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Reinsurance Group of America, Incorporated

Date: August 7, 2012

By: /s/ A. Greig Woodring  
A. Greig Woodring  
President & Chief Executive Officer

(Principal Executive Officer)

Date: August 7, 2012

By: /s/ Jack B. Lay  
Jack B. Lay  
Senior Executive Vice President & Chief Financial Officer

(Principal Financial and Accounting Officer)

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## Exhibit

| Number  | Description  |
|---------|--|
| 3.1     | Amended and Restated Articles of Incorporation, incorporated by reference to Exhibit 3.1 of Current Report on Form 8-K filed November 25, 2008.  |
| 3.2     | Amended and Restated Bylaws, incorporated by reference to Exhibit 3.2 of Current Report on Form 8-K filed November 25, 2008.   |
| 10.1    | Consulting Services Agreement, dated May 31, 2012, between Graham Watson and the Company, incorporated by reference to Exhibit 10.1 of Current Report on Form 8-K filed June 6, 2012.*   |
| 10.2    | Memorandum of Agreement, dated May 31, 2012, among Graham Watson, RGA Reinsurance Company and RGA International Corporation, incorporated by reference to Exhibit 10.2 of Current Report on Form 8-K filed June 6, 2012.*  |
| 31.1    | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 31.2    | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.   |
| 32.1    | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2    | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101     | Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at December 31, 2011 and June 30, 2012, (ii) Condensed Consolidated Statements of Income for the three and six months ended June 30, 2011 and 2012, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2012, and (iv) Notes to Condensed Consolidated Financial Statements for the six months ended June 30, 2012. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Exchange Act, and shall not be deemed filed or part of any registration statement or prospectus for purposes of Section 11 or 12 under the Securities Act or the Exchange Act, or otherwise subject to liability under those sections, except as shall be expressly set forth by specific reference in such filing. |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |

\* Represents a management contract or compensatory plan or arrangement

