REINSURANCE GROUP OF AMERICA INC
Form 10-Q
May 05, 2014
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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 March 31, 2014
	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	43-1627032
(State or other jurisdiction of incorporation or organization)	(IRS employer identification number)

1370 Timberlake Manor Parkway
Chesterfield, Missouri 63017
(Address of principal executive offices)
(636) 736-7000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes X No

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

As of April 30, 2014, 69,077,582 shares of the registrant's common stock were outstanding.

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PART I - FINANCIAL INFORMATION

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

	March 31, 2014	December 31, 2013
	(Dollars in thousands, except share data)	
Assets		
Fixed maturity securities:		
Available-for-sale at fair value (amortized cost of $20,497,524 and $20,270,734)	$ 22,157,182	$ 21,474,136
Mortgage loans on real estate (net of allowances of $8,466 and $10,106)	2,526,228	2,486,680
Policy loans	1,296,897	1,244,469
Funds withheld at interest	5,814,231	5,771,467
Short-term investments	118,789	139,395
Other invested assets	1,234,779	1,324,960
Total investments	33,148,106	32,441,107
Cash and cash equivalents	1,127,132	923,647
Accrued investment income	233,816	267,908
Premiums receivable and other reinsurance balances	1,454,959	1,439,528
Reinsurance ceded receivables	594,794	594,515
Deferred policy acquisition costs	3,450,523	3,517,796
Other assets	532,251	489,972
Total assets	$ 40,541,581	$ 39,674,473
Liabilities and Stockholders' Equity		
Future policy benefits	$ 11,887,951	$ 11,866,776
Interest-sensitive contract liabilities	12,809,003	12,947,557
Other policy claims and benefits	3,899,004	3,571,761
Other reinsurance balances	283,249	275,138
Deferred income taxes	2,023,588	1,837,577
Other liabilities	638,967	541,035
Short-term debt	50,000	—
Long-term debt	2,214,526	2,214,350
Collateral finance facility	484,747	484,752
Total liabilities	34,291,035	33,738,946
Commitments and contingent liabilities (See Note 8)		
Stockholders' Equity:		
Preferred stock - par value $.01 per share, 10,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock - par value $.01 per share, 140,000,000 shares authorized, 79,137,758 shares issued at March 31, 2014 and December 31, 2013	791	791
Additional paid-in-capital	1,782,838	1,777,906
Retained earnings	3,772,776	3,659,938
Treasury stock, at cost - 9,623,749 and 8,369,540 shares	(585,358)	(508,715)
Accumulated other comprehensive income	1,279,499	1,005,607
Total stockholders' equity	6,250,546	5,935,527

Total liabilities and stockholders' equity	$ 40,541,581	$ 39,674,473

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

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

	Three months ended March 31, 2014	2013
Revenues:	(Dollars in thousands, except per share data)	
Net premiums	$ 2,100,637	$ 1,979,693
Investment income, net of related expenses	404,375	425,131
Investment related gains (losses), net:		
Other-than-temporary impairments on fixed maturity securities	(303)	(202)
Other-than-temporary impairments on fixed maturity securities transferred to (from) accumulated other comprehensive income	—	—
Other investment related gains (losses), net	84,874	94,573
Total investment related gains (losses), net	84,571	94,371
Other revenues	67,590	101,907
Total revenues	2,657,173	2,601,102
Benefits and Expenses:		
Claims and other policy benefits	1,843,677	1,688,910
Interest credited	110,594	125,483
Policy acquisition costs and other insurance expenses	354,873	357,357
Other operating expenses	110,936	119,501
Interest expense	35,084	28,486
Collateral finance facility expense	2,569	2,538
Total benefits and expenses	2,457,733	2,322,275
Income before income taxes	199,440	278,827
Provision for income taxes	62,776	93,292
Net income	$ 136,664	$ 185,535
Earnings per share:		
Basic earnings per share	$ 1.94	$ 2.51
Diluted earnings per share	$ 1.92	$ 2.49
Dividends declared per share	$ 0.30	$ 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
(Unaudited)

	Three months ended March 31,	
	2014	2013
Comprehensive income	(Dollars in thousands)	
Net income	$136,664	$185,535
Other comprehensive income (loss), net of tax:		
Change in foreign currency translation adjustments	(42,683)	(14,105)
Change in net unrealized gains and losses on investments	315,384	(119,333)
Change in other-than-temporary impairment losses on fixed maturity securities	450	451
Changes in pension and other postretirement plan adjustments	741	825
Total other comprehensive income (loss), net of tax	273,892	(132,162)
Total comprehensive income	$410,556	$53,373

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

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

	Three months ended March 31, 2014	2013
	(Dollars in thousands)	
Cash Flows from Operating Activities:		
Net income	$136,664	$185,535
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in operating assets and liabilities:		
Accrued investment income	34,480	(30,083)
Premiums receivable and other reinsurance balances	(15,627)	72,864
Deferred policy acquisition costs	64,559	42,741
Reinsurance ceded receivable balances	4,254	28,131
Future policy benefits, other policy claims and benefits, and other reinsurance balances	392,876	275,091
Deferred income taxes	41,472	16,343
Other assets and other liabilities, net	(29,340)	(12,317)
Amortization of net investment premiums, discounts and other	(25,357)	(22,497)
Investment related gains, net	(84,571)	(94,371)
Gain on repurchase of collateral finance facility securities	—	(46,506)
Excess tax benefits from share-based payment arrangement	(668)	(143)
Other, net	22,486	80,142
Net cash provided by operating activities	541,228	494,930
Cash Flows from Investing Activities:		
Sales of fixed maturity securities available-for-sale	584,491	795,575
Maturities of fixed maturity securities available-for-sale	111,854	36,028
Purchases of fixed maturity securities available-for-sale	(917,715)	(1,277,240)
Cash invested in mortgage loans	(135,802)	(79,361)
Cash invested in policy loans	(52,913)	—
Cash invested in funds withheld at interest	(21,466)	(29,829)
Principal payments on mortgage loans on real estate	105,622	52,157
Principal payments on policy loans	485	32,378
Change in short-term investments	20,740	101,722
Change in other invested assets	160,427	(16,805)
Net cash used in investing activities	(144,277)	(385,375)
Cash Flows from Financing Activities:		
Dividends to stockholders	(21,244)	(17,753)
Repurchase and repayment of collateral finance facility securities	—	(112,000)
Net change in short-term debt	50,000	—
Purchases of treasury stock	(86,837)	(47,640)
Excess tax benefits from share-based payment arrangement	668	143
Exercise of stock options, net	6,364	1,071
Change in cash collateral for derivatives and other arrangements	29,680	11,532
Deposits on universal life and other investment type policies and contracts	36,257	17,241
Withdrawals on universal life and other investment type policies and contracts	(215,660)	(204,196)
Net cash used in financing activities	(200,772)	(351,602)
Effect of exchange rate changes on cash	7,306	(16,004)
Change in cash and cash equivalents	203,485	(258,051)

Cash and cash equivalents, beginning of period	923,647	1,259,892
Cash and cash equivalents, end of period	$1,127,132	$1,001,841
Supplementary information:		
Cash paid for interest	$25,434	$16,552
Cash paid for income taxes, net of refunds	$8,611	$9,125

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

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

1. Business 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, these financial statements 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 months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. There were no subsequent events that would require disclosure or adjustments to the accompanying condensed consolidated financial statements through the date the financial statements were issued. These unaudited condensed consolidated financial statements 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 2013 Annual Report on Form 10-K ("2013 Annual Report") filed with the Securities and Exchange Commission ("SEC") on February 27, 2014.

Effective January 1, 2014, the Company realigned certain operations and management responsibilities to better fit within its geographic-based segments. Operations in Mexico and Latin America have been moved from Europe & South Africa to the U.S. segment, which has been renamed U.S. and Latin America. Operations in India have been moved from Europe & South Africa to the Asia Pacific segment. The Europe & South Africa segment has been renamed Europe, Middle East and Africa. Prior-period figures have been adjusted to conform to the new segment reporting structure.

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 March 31,	
	2014	2013
Earnings:		
Net income (numerator for basic and diluted calculations)	$136,664	$185,535
Shares:		
Weighted average outstanding shares (denominator for basic calculation)	70,574	73,838
Equivalent shares from outstanding stock options	690	551
Denominator for diluted calculation	71,264	74,389
Earnings per share:		
Basic	$1.94	$2.51
Diluted	$1.92	$2.49

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 March 31, 2014, 0.3 million stock options and approximately 0.9 million performance contingent shares were excluded from the calculation. For the three months ended March 31, 2013, approximately 1.5 million stock options and approximately 0.9 million performance contingent shares were excluded from the calculation.

Year-to-date amounts for equivalent shares from outstanding stock options and performance contingent shares are the weighted average of the individual quarterly amounts.

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3. Accumulated Other Comprehensive Income

The balance of and changes in each component of accumulated other comprehensive income (loss) ("AOCI") for the three months ended March 31, 2014 and 2013 are as follows (dollars in thousands):

	Accumulated Other Comprehensive Income (Loss), Net of Income Tax			
	Accumulated Currency Translation Adjustments	Unrealized Appreciation (Depreciation) of Investments[1]	Pension and Postretirement Benefits	Total
Balance, December 31, 2013	$207,083	$ 820,245	$(21,721)	$1,005,607
Other comprehensive income (loss) before reclassifications	(42,683)	319,758	161	277,236
Amounts reclassified to (from) AOCI	—	(3,924)	580	(3,344)
Net current-period other comprehensive income (loss)	(42,683)	315,834	741	273,892
Balance, March 31, 2014	$164,400	$ 1,136,079	$(20,980)	$1,279,499

	Accumulated Other Comprehensive Income (Loss), Net of Income Tax			
	Accumulated Currency Translation Adjustments	Unrealized Appreciation (Depreciation) of Investments[1]	Pension and Postretirement Benefits	Total
Balance, December 31, 2012	$267,475	$ 1,877,657	$(36,230)	$2,108,902
Other comprehensive income (loss) before reclassifications	(14,105)	(112,711)	99	(126,717)
Amounts reclassified to (from) AOCI	—	(6,171)	726	(5,445)
Net current-period other comprehensive income (loss)	(14,105)	(118,882)	825	(132,162)
Balance, March 31, 2013	$253,370	$ 1,758,775	$(35,405)	$1,976,740

(1) Includes cash flow hedges. See Note 5 - "Derivative Instruments" for additional information on cash flow hedges.

The following table presents the amounts of AOCI reclassifications for the three months ended March 31, 2014 and 2013 (dollars in thousands):

	Amount Reclassified from AOCI		
	Three months ended March 31,		
Details about AOCI Components	2014	2013	Affected Line Item in Statement of Income
Unrealized gains and losses on available-for-sale securities	$1,189	$10,348	Investment related gains (losses), net
Gains and losses on cash flow hedge - interest rate swap	218	305	Investment income
Deferred policy acquisition costs attributed to unrealized gains and losses[1]	4,421	(1,548)	
	5,828	9,105	Total before tax

	(1,904)	(2,934)	Tax expense
	$3,924	$6,171	Net of tax
Amortization of unrealized pension and postretirement benefits:			
Prior service cost(2)	$(2)	$(94)	
Actuarial gains/(losses)(2)	(890)	(1,023)	
	(892)	(1,117)	Total before tax
	312	391	Tax benefit
	$(580)	$(726)	Net of tax
Total reclassifications for the period	$3,344	$5,445	Net of tax

(1) This AOCI component is included in the computation of the deferred policy acquisition cost. See Note 8 – “Deferred Policy Acquisition Costs” of the 2013 Annual Report for additional details.

(2) These AOCI components are included in the computation of the net periodic pension cost. See Note 10 – “Employee Benefit Plans” for additional details.

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4. Investments

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 March 31, 2014 and December 31, 2013 (dollars in thousands):

March 31, 2014:	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	% of Total		Other-than-temporary impairments in AOCI
Available-for-sale:							
Corporate securities	$11,858,578	$762,137	$102,415	$12,518,300	56.4	%	$—
Canadian and Canadian provincial governments	2,655,865	802,236	7,937	3,450,164	15.6		—
Residential mortgage-backed securities	969,944	45,270	13,343	1,001,871	4.5		(300)
Asset-backed securities	933,130	23,247	11,798	944,579	4.3		(2,259)
Commercial mortgage-backed securities	1,367,205	95,154	11,856	1,450,503	6.5		(1,609)
U.S. government and agencies	447,071	18,158	2,967	462,262	2.1		—
State and political subdivisions	368,465	31,367	9,200	390,632	1.8		—
Other foreign government, supranational and foreign government-sponsored enterprises	1,897,266	57,073	15,468	1,938,871	8.8		—
Total fixed maturity securities	$20,497,524	$1,834,642	$174,984	$22,157,182	100.0	%	$(4,168)
Non-redeemable preferred stock	$84,156	$7,273	$2,662	$88,767	31.5	%	
Other equity securities	191,988	2,921	1,661	193,248	68.5		
Total equity securities	$276,144	$10,194	$4,323	$282,015	100.0	%	

December 31, 2013:	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value	% of Total		Other-than-temporary impairments in AOCI
Available-for-sale:							
Corporate securities	$11,697,394	$616,147	$202,786	$12,110,755	56.4	%	$—
Canadian and Canadian provincial governments	2,728,111	669,762	16,848	3,381,025	15.7		—
Residential mortgage-backed securities	970,434	38,126	18,917	989,643	4.6		(300)
Asset-backed securities	891,751	18,893	15,812	894,832	4.2		(2,259)
Commercial mortgage-backed securities	1,314,782	91,651	17,487	1,388,946	6.5		(1,609)
U.S. government and agencies	489,631	16,468	4,748	501,351	2.3		—
State and political subdivisions	313,252	21,907	14,339	320,820	1.5		—
Other foreign government, supranational and foreign government-sponsored enterprises	1,865,379	45,347	23,962	1,886,764	8.8		—
Total fixed maturity securities	$20,270,734	$1,518,301	$314,899	$21,474,136	100.0	%	$(4,168)
Non-redeemable preferred stock	$81,993	$5,342	$5,481	$81,854	20.2	%	

Other equity securities	327,479	618	4,220	323,877	79.8	
Total equity securities	$409,472	$5,960	$9,701	$405,731	100.0	%

The Company enters into various collateral arrangements that require both the pledging and acceptance of fixed maturity securities as collateral. The Company pledged fixed maturity securities as collateral to derivative and reinsurance counterparties with an amortized cost of $60.8 million and $57.2 million, and an estimated fair value of $62.6 million and $58.0 million, as of March 31, 2014 and December 31, 2013 respectively. The pledged fixed maturity securities are included in fixed maturity securities, available-for-sale in the condensed consolidated balance sheets. Securities with an amortized cost of $8,051.4 million and $7,842.9 million, and an estimated fair value of $8,505.1 million and $8,125.4 million, as of March 31, 2014 and December 31, 2013, respectively, were held in trust to satisfy collateral requirements under certain third-party reinsurance treaties.

The Company received fixed maturity securities as collateral from derivative and reinsurance counterparties with an estimated fair value of $107.2 million and $94.1 million, as of March 31, 2014 and December 31, 2013, respectively. The collateral is held in separate custodial accounts and is not recorded on the Company’s condensed consolidated balance sheets. Subject to certain constraints, the Company is permitted by contract to sell or re-pledge this collateral; however, as of March 31, 2014 and December 31, 2013, none of the collateral had been sold or re-pledged.

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As of March 31, 2014, the Company held securities with a fair value of $1,245.7 million that were guaranteed or issued by the Canadian province of Ontario and $1,419.0 million that were guaranteed or issued by the Canadian province of Quebec, both of which exceeded 10% of total stockholders' equity. As of December 31, 2013, the Company held securities with a fair value of $1,222.3 million that were guaranteed or issued by the Canadian province of Ontario and $1,389.1 million that were guaranteed or issued 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 March 31, 2014 are shown by contractual maturity in the table below (dollars in thousands). 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. Asset and mortgage-backed securities are shown separately in the table below, as they are not due at a single maturity date.

	Amortized Cost	Fair Value
Available-for-sale:		
Due in one year or less	$616,796	$624,013
Due after one year through five years	3,673,274	3,873,527
Due after five years through ten years	7,148,863	7,474,062
Due after ten years	5,788,312	6,788,627
Asset and mortgage-backed securities	3,270,279	3,396,953
Total	$20,497,524	$22,157,182

Corporate Fixed Maturity Securities

The tables below show the major industry types of the Company's corporate fixed maturity holdings as of March 31, 2014 and December 31, 2013 (dollars in thousands):

March 31, 2014:	Amortized Cost	Estimated Fair Value	% of Total	
Finance	$ 3,993,669	$4,204,783	33.6	%
Industrial	5,967,291	6,295,510	50.3	
Utility	1,886,833	2,007,246	16.0	
Other	10,785	10,761	0.1	
Total	$ 11,858,578	$12,518,300	100.0	%

December 31, 2013:	Amortized Cost	Estimated Fair Value	% of Total	
Finance	$ 3,838,716	$3,983,623	32.9	%
Industrial	5,943,353	6,138,150	50.7	
Utility	1,904,100	1,978,218	16.3	
Other	11,225	10,764	0.1	
Total	$ 11,697,394	$12,110,755	100.0	%

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Other-Than-Temporary Impairments - Fixed Maturity and Equity Securities

As discussed in Note 2 – “Summary of Significant Accounting Policies” of the 2013 Annual 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):

	Three months ended March 31,	
	2014	2013
Balance, beginning of period	$11,696	$16,675
Credit loss OTTI previously recognized on securities which matured, paid down, prepaid or were sold during the period	—	(1,902)
Balance, end of period	$11,696	$14,773

Purchased Credit Impaired Fixed Maturity Securities Available-for-Sale

Securities acquired with evidence of credit quality deterioration since origination and for which it is probable at the acquisition date that the Company will be unable to collect all contractually required payments are classified as purchased credit impaired securities. For each security, the excess of the cash flows expected to be collected as of the acquisition date over its acquisition date fair value is referred to as the accretable yield and is recognized as net investment income on an effective yield basis. At the date of acquisition, the timing and amount of the cash flows expected to be collected was determined based on a best estimate using key assumptions, such as interest rates, default rates and prepayment speeds. If subsequently, based on current information and events, it is probable that there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected to be collected, the accretable yield is adjusted prospectively. The excess of the contractually required payments (including interest) as of the acquisition date over the cash flows expected to be collected as of the acquisition date is referred to as the nonaccretable difference, and this amount is not expected to be realized as net investment income. Decreases in cash flows expected to be collected can result in OTTI.

The following tables present information on the Company’s purchased credit impaired securities, which are included in fixed maturity securities available-for-sale (dollars in thousands):

	March 31, 2014	December 31, 2013
Outstanding principal and interest balance[1]	$208,044	$192,644
Carrying value, including accrued interest[2]	165,740	148,822

(1) Represents the contractually required payments which is the sum of contractual principal, whether or not currently due, and accrued interest.

(2) Estimated fair value plus accrued interest.

The following table presents information about purchased credit impaired investments acquired during the periods, as of the acquisition dates (dollars in thousands):

	Three months ended March 31,	
	2014	2013
Contractually required payments (including interest)	$31,672	$91,863
Cash flows expected to be collected[1]	25,722	72,940
Fair value of investments acquired	18,151	50,874

(1) Represents undiscounted principal and interest cash flow expectations at the date of acquisition.

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The following table presents activity for the accretable yield on purchased credit impaired securities for the three months ended March 31, 2014 and 2013 (dollars in thousands):

	Three months ended March 31,	
	2014	2013
Balance, beginning of period	$69,469	$39,239
Investments purchased	7,571	22,066
Accretion	(2,139)	(1,943)
Disposals	(379)	—
Reclassification from nonaccretable difference	(1,155)	553
Balance, end of period	$73,367	$59,915

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

The following table presents the total gross unrealized losses for the 1,046 and 1,396 fixed maturity and equity securities as of March 31, 2014 and December 31, 2013, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (dollars in thousands):

	March 31, 2014		December 31, 2013	
	Gross Unrealized Losses	% of Total	Gross Unrealized Losses	% of Total
Less than 20%	$161,371	90.0 %	$296,731	91.4 %
20% or more for less than six months	163	0.1	6,444	2.0
20% or more for six months or greater	17,773	9.9	21,425	6.6
Total	$179,307	100.0 %	$324,600	100.0 %

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. 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 1,046 and 1,396 fixed maturity and equity securities that have estimated fair values below amortized cost as of March 31, 2014 and December 31, 2013, respectively (dollars in thousands). These investments are presented by class and grade of security, as well as the length of time the related fair value has remained below amortized cost.

	Less than 12 months		12 months or greater		Total	
March 31, 2014:	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Investment grade securities:						
Corporate securities	$2,057,301	$64,535	$311,738	$31,273	$2,369,039	$95,808
Canadian and Canadian provincial governments	114,845	6,334	12,421	1,603	127,266	7,937
Residential mortgage-backed securities	190,212	9,802	32,621	3,294	222,833	13,096
Asset-backed securities	214,774	3,140	79,532	7,023	294,306	10,163
Commercial mortgage-backed securities	106,146	1,295	26,181	5,443	132,327	6,738
U.S. government and agencies	75,193	2,777	4,104	190	79,297	2,967
State and political subdivisions	103,058	5,440	8,158	3,760	111,216	9,200
Other foreign government, supranational and foreign government-sponsored enterprises	502,280	10,605	68,811	4,829	571,091	15,434
Total investment grade securities	3,363,809	103,928	543,566	57,415	3,907,375	161,343
Non-investment grade securities:						
Corporate securities	191,113	3,886	43,178	2,721	234,291	6,607
Residential mortgage-backed securities	26,209	197	1,776	50	27,985	247
Asset-backed securities	1,694	10	8,483	1,625	10,177	1,635
Commercial mortgage-backed securities	—	—	5,969	5,118	5,969	5,118
Other foreign government, supranational and foreign government-sponsored enterprises	2,440	34	—	—	2,440	34
Total non-investment grade securities	221,456	4,127	59,406	9,514	280,862	13,641
Total fixed maturity securities	$3,585,265	$108,055	$602,972	$66,929	$4,188,237	$174,984
Non-redeemable preferred stock	$20,765	$2,660	$1	$2	$20,766	$2,662
Other equity securities	—	—	32,833	1,661	32,833	1,661
Total equity securities	$20,765	$2,660	$32,834	$1,663	$53,599	$4,323

	Less than 12 months		12 months or greater		Total	
December 31, 2013:	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Investment grade securities:						
Corporate securities	$3,141,179	$148,895	$301,303	$40,548	$3,442,482	$189,443
Canadian and Canadian provincial governments	188,491	14,419	12,029	2,429	200,520	16,848
Residential mortgage-backed securities	283,967	15,900	23,068	1,688	307,035	17,588
Asset-backed securities	255,656	4,916	56,668	4,983	312,324	9,899
Commercial mortgage-backed securities	219,110	3,725	20,068	5,745	239,178	9,470
U.S. government and agencies	133,697	4,469	4,406	279	138,103	4,748
State and political subdivisions	120,193	9,723	15,202	4,616	135,395	14,339
Other foreign government, supranational and foreign government-sponsored enterprises	665,313	21,075	36,212	2,847	701,525	23,922
Total investment grade securities	5,007,606	223,122	468,956	63,135	5,476,562	286,257

Non-investment grade securities:						
Corporate securities	283,603	9,451	38,256	3,892	321,859	13,343
Residential mortgage-backed securities	62,146	1,075	3,945	254	66,091	1,329
Asset-backed securities	28,670	415	32,392	5,498	61,062	5,913
Commercial mortgage-backed securities	15,762	81	10,980	7,936	26,742	8,017
Other foreign government, supranational and foreign government-sponsored enterprises	9,403	40	—	—	9,403	40
Total non-investment grade securities	399,584	11,062	85,573	17,580	485,157	28,642
Total fixed maturity securities	$5,407,190	$234,184	$554,529	$80,715	$5,961,719	$314,899
Non-redeemable preferred stock	$51,386	$5,479	$1	$2	$51,387	$5,481
Other equity securities	218,834	1,748	32,550	2,472	251,384	4,220
Total equity securities	$270,220	$7,227	$32,551	$2,474	$302,771	$9,701

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As of March 31, 2014, 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. As of March 31, 2014, 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 fixed maturity and equity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality, asset-liability management and liquidity guidelines.

Unrealized losses on non-investment grade securities as of March 31, 2014 are primarily related to high-yield corporate securities and commercial mortgage-backed securities. Unrealized losses decreased across all security types as interest rates decreased during the first three months of 2014.

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 March 31,	
	2014	2013
Fixed maturity securities available-for-sale	$243,962	$239,244
Mortgage loans on real estate	33,092	28,243
Policy loans	13,438	17,910
Funds withheld at interest	112,739	137,259
Short-term investments	965	813
Other invested assets	14,501	13,922
Investment income	418,697	437,391
Investment expense	(14,322)	(12,260)
Investment income, net of related expenses	$404,375	$425,131

Investment Related Gains (Losses), Net

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

	Three months ended March 31,	
	2014	2013
Fixed maturities and equity securities available for sale:		
Other-than-temporary impairment losses on fixed maturities	$(303)	$(202)
Portion of loss recognized in accumulated other comprehensive income (before taxes)	—	—
Net other-than-temporary impairment losses on fixed maturity securities recognized in earnings	(303)	(202)
Impairment losses on equity securities	—	—
Gain on investment activity	8,067	21,680
Loss on investment activity	(6,583)	(11,212)
Other impairment losses and change in mortgage loan provision	1,664	(1,626)
Derivatives and other, net	81,726	85,731
Total investment related gains (losses), net	$84,571	$94,371

During the three months ended March 31, 2014 and 2013, the Company sold fixed maturity and equity securities with fair values of $235.1 million and $204.3 million at losses of $6.6 million and $11.2 million, respectively. The Company generally does not engage in short-term buying and selling of securities.

Securities Borrowing and Other

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 fair value of the borrowed securities as collateral, which consists of rights to reinsurance treaty cash flows. The Company had borrowed securities with an amortized cost of $184.5 million and $93.0 million, and an estimated fair value of $183.4 million and $93.0 million, as of March 31, 2014 and December 31, 2013, respectively. The borrowed securities are used to provide collateral under an affiliated reinsurance transaction.

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The Company also participates in a repurchase/reverse repurchase program in which securities, reflected as investments on the Company's condensed consolidated balance sheets, are pledged to a third party. In return, the Company receives securities from the third party with an estimated fair value equal to a minimum of 100% of the securities pledged. The securities received are not reflected on the Company's condensed consolidated balance sheets. As of March 31, 2014 the Company had pledged securities with an amortized cost of $300.5 million and an estimated fair value of $312.8 million, in return the Company received securities with an estimated fair value of $349.7 million. As of December 31, 2013 the Company had pledged securities with an amortized cost of $300.3 million and an estimated fair value of $310.8 million, in return the Company received securities with an estimated fair value of $344.2 million.

Mortgage Loans on Real Estate

Mortgage loans represented approximately 7.6% and 7.7% of the Company's total investments as of March 31, 2014 and December 31, 2013. 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. The distribution of mortgage loans, gross of valuation allowances, by property type is as follows as of March 31, 2014 and December 31, 2013 (dollars in thousands):

	March 31, 2014			December 31, 2013		
	Recorded Investment	% of Total		Recorded Investment	% of Total	
Apartment	$346,918	13.7	%	$289,394	11.6	%
Retail	720,921	28.4		748,731	30.0	
Office building	917,985	36.2		917,284	36.7	
Industrial	412,322	16.3		439,890	17.6	
Other commercial	136,548	5.4		101,487	4.1	
Total	$2,534,694	100.0	%	$2,496,786	100.0	%

As of March 31, 2014 and December 31, 2013, the Company's mortgage loans, gross of valuation allowances, were distributed throughout the United States as follows (dollars in thousands):

	March 31, 2014			December 31, 2013		
	Recorded Investment	% of Total		Recorded Investment	% of Total	
Pacific	$678,578	26.8	%	$671,822	26.9	%
South Atlantic	521,853	20.6		543,658	21.8	
Mountain	374,874	14.8		334,446	13.4	
Middle Atlantic	251,235	10.0		266,802	10.7	
West North Central	160,561	6.3		138,442	5.5	
East North Central	243,936	9.6		236,766	9.5	
West South Central	167,894	6.6		168,246	6.7	
East South Central	59,384	2.3		59,625	2.4	
New England	76,379	3.0		76,979	3.1	
Total	$2,534,694	100.0	%	$2,496,786	100.0	%

The maturities of the mortgage loans, gross of valuation allowances, as of March 31, 2014 and December 31, 2013 are as follows (dollars in thousands):

	March 31, 2014			December 31, 2013		
	Recorded Investment	% of Total		Recorded Investment	% of Total	
Due within five years	$968,162	38.2	%	$987,109	39.5	%
Due after five years through ten years	998,196	39.4		984,289	39.4	

Due after ten years	568,336	22.4	525,388	21.1
Total	$2,534,694	100.0 %	$2,496,786	100.0 %

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Information regarding the Company’s credit quality indicators, as determined by the Company's internal evaluation methodology for its recorded investment in mortgage loans, gross of valuation allowances, as of March 31, 2014 and December 31, 2013 is as follows (dollars in thousands):

	March 31, 2014			December 31, 2013		
Internal credit quality grade:	Recorded Investment	% of Total		Recorded Investment	% of Total	
High investment grade	$1,266,653	50.0	%	$1,437,244	57.5	%
Investment grade	1,023,250	40.4		827,993	33.2	
Average	183,250	7.2		155,914	6.2	
Watch list	32,936	1.3		49,404	2.0	
In or near default	28,605	1.1		26,231	1.1	
Total	$2,534,694	100.0	%	$2,496,786	100.0	%

The age analysis of the Company’s past due recorded investment in mortgage loans, gross of valuation allowances, as of March 31, 2014 and December 31, 2013 is as follows (dollars in thousands):

	March 31, 2014	December 31, 2013
31-60 days past due	$—	$—
61-90 days past due	—	—
Greater than 90 days	7,087	—
Total past due	7,087	—
Current	2,527,607	2,496,786
Total	$2,534,694	$2,496,786

The following table presents the recorded investment in mortgage loans, by method of measuring impairment, and the related valuation allowances as of March 31, 2014 and December 31, 2013 (dollars in thousands):

	March 31, 2014	December 31, 2013
Mortgage loans:		
Individually measured for impairment	$32,344	$37,841
Collectively measured for impairment	2,502,350	2,458,945
Mortgage loans, gross of valuation allowances	2,534,694	2,496,786
Valuation allowances:		
Individually measured for impairment	1,677	3,211
Collectively measured for impairment	6,789	6,895
Total valuation allowances	8,466	10,106
Mortgage loans, net of valuation allowances	$2,526,228	$2,486,680

Information regarding the Company’s loan valuation allowances for mortgage loans for the three months ended March 31, 2014 and 2013 is as follows (dollars in thousands):

	Three months ended March 31,	
	2014	2013
Balance, beginning of period	$10,106	$11,580
Recoveries	24	—

Charge-offs	—	(852)
Provision (release)	(1,664)	(804)
Balance, end of period	$8,466	$9,924

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Information regarding the portion of the Company's mortgage loans that were impaired as of March 31, 2014 and December 31, 2013 is as follows (dollars in thousands):

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Carrying Value
March 31, 2014:				
Impaired mortgage loans with no valuation allowance recorded	$20,610	$20,007	$—	$20,007
Impaired mortgage loans with valuation allowance recorded	12,308	12,337	1,677	10,660
Total impaired mortgage loans	$32,918	$32,344	$1,677	$30,667
December 31, 2013:				
Impaired mortgage loans with no valuation allowance recorded	$21,698	$21,100	$—	$21,100
Impaired mortgage loans with valuation allowance recorded	16,772	16,741	3,211	13,530
Total impaired mortgage loans	$38,470	$37,841	$3,211	$34,630

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 March 31,			
	2014		2013	
	Average Investment(1)	Interest Income	Average Investment(1)	Interest Income
Impaired mortgage loans with no valuation allowance recorded	$14,539	$318	$13,378	$135
Impaired mortgage loans with valuation allowance recorded	20,554	193	27,184	240
Total	$35,093	$511	$40,562	$375

(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 three months ended March 31, 2014 and 2013. The Company had $7.1 million of mortgage loans, gross of valuation allowances, that were on nonaccrual status at March 31, 2014. The Company had no mortgage loans that were on a nonaccrual status at December 31, 2013.

Policy Loans

Policy loans comprised approximately 3.9% and 3.8% of the Company's total investments as of both March 31, 2014 and December 31, 2013, 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 to 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. As 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.

Funds Withheld at Interest

Funds withheld at interest comprised approximately 17.5% and 17.8% of the Company's total investments as of March 31, 2014 and December 31, 2013, respectively. Of the $5.8 billion funds withheld at interest balance, net of embedded derivatives, as of March 31, 2014, $4.1 billion of the balance is associated with one client. For reinsurance agreements written on a modified coinsurance basis and certain agreements written on a coinsurance funds withheld 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 condensed 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 to the Company from the ceding company. 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 this risk, the Company helps set the investment guidelines followed by the ceding company and monitors compliance.

Other Invested Assets

Other invested assets include equity securities, limited partnership interests, real estate joint ventures, structured loans, derivative contracts, fair value option ("FVO") contractholder-directed unit-linked investments, Federal Home Loan Bank of Des Moines ("FHLB") common stock (included in other), and real estate held-for-investment (included in other). The fair value option was elected for contractholder-directed investments supporting unit-linked variable annuity type liabilities which do not qualify for

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presentation and reporting as separate accounts. Other invested assets represented approximately 3.7% and 4.1% of the Company's total investments as of both March 31, 2014 and December 31, 2013. Carrying values of these assets as of March 31, 2014 and December 31, 2013 are as follows (dollars in thousands):

	March 31, 2014	December 31, 2013
Equity securities	$282,015	$405,731
Limited partnerships and real estate joint ventures	403,874	411,456
Structured loans	209,590	223,549
Derivatives	121,173	75,227
FVO contractholder-directed unit-linked investments	147,342	138,892
Other	70,785	70,105
Total other invested assets	$1,234,779	$1,324,960

5. Derivative Instruments

Derivatives, except embedded derivatives, are carried on the Company's condensed consolidated balance sheets in other invested assets or other liabilities, at fair value. Embedded derivative liabilities on modified coinsurance or funds withheld arrangements are included on the condensed consolidated balance sheets with the host contract in funds withheld at interest, at fair value. Embedded derivative liabilities on indexed annuity and variable annuity products are included on the condensed consolidated balance sheets with the host contract in interest-sensitive contract liabilities, at fair value. The following table presents the notional amounts and gross fair value of derivative instruments prior to taking into account the netting effects of master netting agreements as of March 31, 2014 and December 31, 2013 (dollars in thousands):

	March 31, 2014			December 31, 2013		
	Notional	Carrying Value/Fair Value		Notional	Carrying Value/Fair Value	
	Amount	Assets	Liabilities	Amount	Assets	Liabilities
Derivatives not designated as hedging instruments:						
Interest rate swaps	$1,330,276	$46,649	$10,978	$1,592,943	$32,555	$21,873
Interest rate options	240,000	3,836	—	240,000	2,554	—
Financial futures	143,629	—	—	123,780	—	—
Foreign currency forwards	68,885	—	10,067	79,618	—	12,772
Consumer price index swaps	62,254	13	83	59,922	—	309
Credit default swaps	663,700	8,639	1,425	682,700	10,438	2,156
Equity options	821,432	30,866	—	757,352	33,902	—
Synthetic guaranteed investment contracts	4,993,100	—	—	4,629,859	—	—
Embedded derivatives in:						
Modified coinsurance or funds withheld arrangements	—	—	99,029	—	—	176,270
Indexed annuity products	—	—	858,270	—	—	838,670
Variable annuity products	—	—	53,717	—	—	30,055
Total non-hedging derivatives	8,323,276	90,003	1,033,569	8,166,174	79,449	1,082,105
Derivatives designated as hedging instruments:						
Interest rate swaps	51,043	—	4,055	49,131	—	4,606
Foreign currency swaps	682,206	44,213	—	728,674	21,903	620
Total hedging derivatives	733,249	44,213	4,055	777,805	21,903	5,226
Total derivatives	$9,056,525	$134,216	$1,037,624	$8,943,979	$101,352	$1,087,331

Netting Arrangements

Certain of the Company’s derivatives are subject to enforceable master netting arrangements and reported as a net asset or liability in the condensed consolidated balance sheets. The Company nets all derivatives that are subject to such arrangements.

The Company has elected to include all derivatives, except embedded derivatives, in the tables below, irrespective of whether they are subject to an enforceable master netting arrangement or a similar agreement. See Note 4 – "Investments" for information regarding the Company’s securities borrowing and repurchase/reverse repurchase programs. See “Embedded Derivatives” below for information regarding the Company’s bifurcated embedded derivatives.

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The following table provides information relating to the Company's derivative instruments as of March 31, 2014 and December 31, 2013 (dollars in thousands):

				Gross Amounts Not Offset in the Balance Sheet		
	Gross Amounts Recognized	Gross Amounts Offset in the Balance Sheet	Net Amounts Presented in the Balance Sheet	Financial Instruments	Cash Collateral Pledged/ Received	Net Amount
March 31, 2014:						
Derivative assets	$ 134,216	$ (13,043)	$ 121,173	$(20,985)	$ (84,252)	$15,936
Derivative liabilities	26,608	(13,043)	13,565	(17,423)	(8,450)	(12,308)
December 31, 2013:						
Derivative assets	$ 101,352	$ (26,125)	$ 75,227	$(11,095)	$ (51,006)	$13,126
Derivative liabilities	42,336	(26,125)	16,211	(18,081)	(8,033)	(9,903)

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 March 31, 2014 and December 31, 2013, the Company held interest rate swaps that were designated and qualified as cash flow hedges of interest rate risk, held foreign currency swaps that were designated and qualified as hedges of a portion of its net investment in its foreign operations and had derivative instruments that were not designated as hedging instruments. See Note 2 – "Summary of Significant Accounting Policies" of the Company's 2013 Annual 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.

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 March 31, 2014 and 2013 (dollars in thousands):

	Three months ended March 31,	
	2014	2013
Accumulated other comprehensive income (loss), balance beginning of period	$(4,578)	$403
Gains (losses) deferred in other comprehensive income (loss) on the effective portion of cash flow hedges	776	1,863
Amounts reclassified to investment income	(218)	(305)
Accumulated other comprehensive income (loss), balance end of period	$(4,020)	$1,961

As of March 31, 2014, 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 $0.6 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 months ended March 31, 2014 and 2013.

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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 months ended March 31, 2014 and 2013 (dollars in thousands):

Derivatives in Cash Flow Hedging Relationships	Amount of Gains (Losses) Deferred in AOCI on Derivatives (Effective Portion)	Amount and Location of Gains (Losses) Reclassified from AOCI into Income (Loss) (Effective Portion)		Amount and Location of Gains (Losses) Recognized in Income (Loss) on Derivatives (Ineffective Portion and Amounts Excluded from Effectiveness Testing)	
		Investment Related Gains (Losses)	Investment Income	Investment Related Gains (Losses)	Investment Income
For the three months ended March 31, 2014:					
Interest rate swaps	$ 776	$ —	$ 218	$ (6)	$ —
For the three months ended March 31, 2013:					
Interest rate swaps	$ 1,863	$ —	$ 305	$ (17)	$ —

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 months ended March 31, 2014 and 2013 (dollars in thousands):

	Derivative Gains (Losses) Deferred in AOCI	
	For the three months ended March 31,	
Type of NIFO Hedge [1] [2]	2014	2013
Foreign currency swaps	$ 23,080	$ 10,922

(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 recorded in AOCI related to these hedges was $47.0 million and $23.9 million at March 31, 2014 and December 31, 2013, 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. The Company recognized investment related gains (losses) of $19.8 million and $(60.4) million for the three months ended March 31, 2014 and 2013, respectively, related to derivatives (not including embedded derivatives) that do not qualify or have not been qualified for hedge accounting.

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A summary of the effect of non-hedging derivatives, including embedded derivatives, on the Company's income statement for the three months ended March 31, 2014 and 2013 is as follows (dollars in thousands):

Type of Non-hedging Derivative	Income Statement Location of Gain (Loss)	Gain (Loss) for the three months ended March 31, 2014	Gain (Loss) for the three months ended March 31, 2013
Interest rate swaps	Investment related gains (losses), net	$ 29,653	$ (22,265)
Interest rate options	Investment related gains (losses), net	1,282	1,982
Financial futures	Investment related gains (losses), net	(1,584)	(6,881)
Foreign currency forwards	Investment related gains (losses), net	1,154	(5,659)
CPI swaps	Investment related gains (losses), net	352	(871)
Credit default swaps	Investment related gains (losses), net	(2,114)	3,904
Equity options	Investment related gains (losses), net	(8,966)	(30,623)
Embedded derivatives in:			
Modified coinsurance or funds withheld arrangements	Investment related gains (losses), net	77,241	90,257
Indexed annuity products	Interest credited	(23,840)	(32,996)
Variable annuity products	Investment related gains (losses), net	(23,661)	51,314
Total non-hedging derivatives		$ 49,517	$ 48,162

Types of Derivatives Used by the Company

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.

Interest Rate Options

Interest rate options, commonly referred to as swaptions, are used by the Company primarily to hedge living benefit guarantees embedded in certain variable annuity products. A swaption, used to hedge against adverse changes in interest rates, is an option to enter into a swap with a forward starting effective date. The Company pays an upfront premium for the right to exercise this option in the future.

Financial Futures

Exchange-traded futures are used primarily to economically hedge liabilities embedded in certain variable annuity products. With exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the value of which is determined by the relevant 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 futures with regulated futures commission merchants that are members of the exchange.

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.

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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 termination of the currency swap by each party. The Company uses foreign currency swaps to hedge a portion of its net investment in certain foreign operations against adverse movements in exchange rates.

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 of a referencing entity, the Company is typically required to pay the protection holder the full notional value less a recovery amount determined at auction.

The following table presents the estimated fair value, maximum amount of future payments and weighted average years to maturity of credit default swaps sold by the Company at March 31, 2014 and December 31, 2013 (dollars in thousands):

	March 31, 2014			December 31, 2013		
Rating Agency Designation of Referenced Credit Obligations(1)	Estimated Fair Value of Credit Default Swaps	Maximum Amount of Future Payments under Credit Default Swaps(2)	Weighted Average Years to Maturity(3)	Estimated Fair Value of Credit Default Swaps	Maximum Amount of Future Payments under Credit Default Swaps(2)	Weighted Average Years to Maturity(3)
AAA/AA-/A+/A/A-						
Single name credit default swaps	$1,059	$ 112,500	5.0	$614	$ 117,500	5.1
Credit default swaps referencing indices	—	—	—	—	—	—
Subtotal	1,059	112,500	5.0	614	117,500	5.1
BBB+/BBB/BBB-						
Single name credit default swaps	608	127,200	5.0	656	142,200	4.9
Credit default swaps referencing indices	6,291	406,000	5.2	7,295	405,000	5.0
Subtotal	6,899	533,200	5.2	7,951	547,200	5.0
Total	$7,958	$ 645,700	5.1	$8,565	$ 664,700	4.4

(1) The rating agency designations are based on ratings from Standard and Poor's ("S&P").

(2) Assumes the value of the referenced credit obligations is zero.

(3) The weighted average years to maturity of the credit default swaps is calculated based on weighted average notional amounts.

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 Guaranteed Investment Contracts

The Company sells fee-based synthetic guaranteed investment contracts 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 reported as derivatives, recorded at fair value and classified as interest rate derivatives.

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Embedded Derivatives

The Company has certain embedded derivatives which are required to be separated from their host contracts and reported as derivatives. Host contracts include reinsurance treaties structured on a modified coinsurance (“modco”) or funds withheld basis. Changes in fair values of embedded derivatives on modco or funds withheld treaties are net of a decrease in investment related gains (losses), net of $0.9 million and $1.7 million for the three months ended March 31, 2014 and 2013, respectively, associated with the Company’s own credit risk. Changes in fair values of embedded derivatives on variable annuity contracts are net of a decrease in investment related gains (losses), net of $0.5 million and $11.9 million for the three months ended March 31, 2014 and 2013, respectively, 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 March 31, 2014 and 2013 are reflected in the following table (dollars in thousands):

	Three months ended March 31, 2014	2013
Embedded derivatives in modco or funds withheld arrangements included in investment related gains	$77,241	$90,257
After the associated amortization of DAC and taxes, the related amounts included in net income	18,079	21,624
Embedded derivatives in variable annuity contracts included in investment related gains	(23,661)	51,314
After the associated amortization of DAC and taxes, the related amounts included in net income	(13,669)	12,192
Amounts related to embedded derivatives in equity-indexed annuities included in benefits and expenses	(23,840)	(32,996)
After the associated amortization of DAC and taxes, the related amounts included in net income	(18,375)	(29,550)

Credit Risk

The Company manages its credit risk related to over-the-counter ("OTC") derivatives by entering into transactions with creditworthy counterparties, maintaining collateral arrangements and through the use of master netting agreements that provide for a single net payment to be made by one counterparty to another at each due date and upon termination.

The credit exposure of the Company's OTC derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master netting agreements that provide for a netting of payments and receipts with a single counterparty, and (ii) enter into agreements that allow the use of credit support annexes, which are bilateral rating-sensitive agreements that require collateral postings at established threshold levels. Certain of the Company's OTC derivatives are cleared derivatives, which are bilateral transactions between the Company and a counterparty where the transactions are cleared through a clearinghouse, such that each derivative counterparty is only exposed to the default of the clearinghouse. These cleared transactions require initial and daily variation margin collateral postings and include certain interest rate swaps and credit default swaps entered into on or after June 10, 2013, related to new guidelines implemented under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Also, the Company enters into exchange-traded futures through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of non-performance by counterparties to such financial 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 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. 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.

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 March 31, 2014 and December 31, 2013 are reflected in the following table (dollars in thousands):

	March 31, 2014	December 31, 2013
Estimated fair value of derivatives in net asset position	$107,608	$59,016
Cash provided as collateral(1)	8,450	8,033
Securities pledged to counterparties as collateral(2)	17,423	18,081
Cash pledged from counterparties as collateral(3)	(84,252)	(51,006)
Securities pledged from counterparties as collateral(4)	(20,985)	(11,095)
Initial margin for cleared derivatives	(12,927)	(13,350)
Net credit exposure	$15,317	$9,679
Margin account related to exchange-traded futures(5)	$3,904	$2,566

(1) Consists of receivable from counterparty, included in other assets.
(2) Included in other invested assets, primarily consists of U.S. Treasury securities.
(3) Included in cash and cash equivalents, with obligation to return cash collateral recorded in other liabilities.
(4) Consists of U.S. Treasury securities.
(5) Included in cash and cash equivalents.

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 - Unadjusted quoted prices in active markets for identical assets or liabilities. Active markets are defined as having the following characteristics for the measured asset/liability: (i) many transactions, (ii) current prices, (iii) price quotes not varying substantially among market makers, (iv) narrow bid/ask spreads and (v) most information publicly available. The Company's Level 1 assets 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 servicers 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 and bank loans), asset-backed securities (including collateralized debt obligations and those with exposure to subprime mortgages), and to a lesser extent, certain residential and commercial mortgage-backed securities,

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among others. 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 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).

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Assets and Liabilities by Hierarchy Level

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2014 and December 31, 2013 are summarized below (dollars in thousands):

March 31, 2014:		Fair Value Measurements Using:		
	Total	Level 1	Level 2	Level 3
Assets:				
Fixed maturity securities – available-for-sale:				
Corporate securities	$12,518,300	$71,152	$11,155,447	$1,291,701
Canadian and Canadian provincial governments	3,450,164	—	3,450,164	—
Residential mortgage-backed securities	1,001,871	—	823,944	177,927
Asset-backed securities	944,579	—	441,904	502,675
Commercial mortgage-backed securities	1,450,503	—	1,360,130	90,373
U.S. government and agencies securities	462,262	360,017	64,214	38,031
State and political subdivision securities	390,632	—	346,799	43,833
Other foreign government supranational and foreign government-sponsored enterprises	1,938,871	298,309	1,629,405	11,157
Total fixed maturity securities – available-for-sale	22,157,182	729,478	19,272,007	2,155,697
Funds withheld at interest – embedded derivatives	(99,029)	—	—	(99,029)
Cash equivalents	532,957	532,957	—	—
Short-term investments	85,292	78,710	6,582	—
Other invested assets:				
Non-redeemable preferred stock	88,767	87,382	1,385	—
Other equity securities	193,248	193,248	—	—
Derivatives:				
Interest rate swaps	34,911	—	34,911	—
Financial futures	3,836	—	3,836	—
Foreign currency forwards	—	—	—	—
CPI swaps	(70)	—	(70)	—
Credit default swaps	7,421	—	7,421	—
Equity options	30,862	—	30,862	—
Foreign currency swaps	44,213	—	44,213	—
FVO contractholder-directed unit-linked investments	147,342	140,659	6,683	—
Collateral	—	—	—	—
Other	7,193	7,193	—	—
Total other invested assets	557,723	428,482	129,241	—
Total	$23,234,125	$1,769,627	$19,407,830	$2,056,668
Liabilities:				
Interest sensitive contract liabilities – embedded derivatives	$911,987	$—	$—	$911,987
Other liabilities:				
Derivatives:				
Interest rate swaps	3,295	—	3,295	—
Foreign currency forwards	10,067	—	10,067	—
Credit default swaps	207	—	207	—
Equity options	(4)	—	(4)	—

Foreign currency swaps	—	—	—	—
Total	$925,552	$—	$13,565	$911,987

December 31, 2013:		Fair Value Measurements Using:		
	Total	Level 1	Level 2	Level 3
Assets:				
Fixed maturity securities – available-for-sale:				
Corporate securities	$12,110,755	$68,934	$10,696,532	$1,345,289
Canadian and Canadian provincial governments	3,381,025	—	3,381,025	—
Residential mortgage-backed securities	989,643	—	836,138	153,505
Asset-backed securities	894,832	—	422,984	471,848
Commercial mortgage-backed securities	1,388,946	—	1,287,161	101,785
U.S. government and agencies securities	501,351	396,092	64,340	40,919
State and political subdivision securities	320,820	—	277,044	43,776
Other foreign government, supranational and foreign government-sponsored enterprises	1,886,764	304,487	1,544,280	37,997
Total fixed maturity securities – available-for-sale	21,474,136	769,513	18,509,504	2,195,119
Funds withheld at interest – embedded derivatives	(176,270)	—	—	(176,270)
Cash equivalents	371,345	371,345	—	—
Short-term investments	111,572	105,649	5,923	—
Other invested assets:				
Non-redeemable preferred stock	81,854	74,220	2,672	4,962
Other equity securities	323,877	323,877	—	—
Derivatives:				
Interest rate swaps	9,904	—	9,904	—
Foreign currency forwards	2,554	—	2,554	—
CPI swaps	(309)	—	(309)	—
Credit default swaps	7,926	—	7,926	—
Equity options	33,869	—	33,869	—
Collateral	21,283	—	21,283	—
FVO contractholder-directed unit-linked investments	138,892	132,643	6,249	—
Other	9,142	9,142	—	—
Total other invested assets	628,992	539,882	84,148	4,962
Total	$22,409,775	$1,786,389	$18,599,575	$2,023,811
Liabilities:				
Interest sensitive contract liabilities – embedded derivatives	$868,725	$—	$—	$868,725
Other liabilities:				
Derivatives:				
Interest rate swaps	3,828	—	3,828	—
Foreign currency forwards	12,772	—	12,772	—
Credit default swaps	(356)	—	(356)	—
Foreign currency swaps	(33)	—	(33)	—
Total	$884,936	$—	$16,211	$868,725

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 condensed consolidated 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.

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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, comparison of a sample of executed prices of securities sold to the fair value estimates, comparison of fair value estimates to management's knowledge 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.

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, market comparable 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 March 31, 2014 and 2013, 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 basis are summarized below.

Fixed Maturity Securities – The fair values of the Company's publicly-traded 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 reasonableness, 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 that 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 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.

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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 3. 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.

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 discounted cash flow model, 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 reasonableness 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. The valuation also requires certain significant inputs, which are generally not observable and accordingly, the valuation is considered Level 3 in the fair value hierarchy, see "Level 3 Measurements and Transfers" below for a description.

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. The valuation also requires certain significant inputs, which are generally not observable and accordingly, the valuation is considered Level 3 in the fair value hierarchy, see "Level 3 Measurements and Transfers" below for a description.

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. However, certain short-term investments may incorporate significant unobservable inputs resulting in a Level 3 classification. 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 exchange-traded funds and preferred stock of publicly and privately traded companies. The fair values of publicly traded equity securities are primarily based on quoted market prices in active markets and are classified within Level 1 in the fair value hierarchy. The fair values of preferred equity securities, for which quoted market prices are not readily available, are based on prices obtained from independent pricing services and these securities are generally classified within Level 2 in the fair value hierarchy. Non-binding broker quotes for equity securities are generally based on significant unobservable inputs and are

reflected as Level 3 in the fair value hierarchy.
FVO Contractholder-Directed Unit-Linked Investments - FVO contractholder-directed investments supporting unit-linked variable annuity type liabilities primarily consist of exchange-traded funds and, to a lesser extent, fixed maturity securities and cash and cash equivalents. The fair values of the exchange-traded securities are primarily based on quoted market prices in active markets and are classified within Level 1 of the hierarchy. The fair value of the fixed maturity contractholder-directed securities is determined on a basis consistent with the methodologies described above for fixed maturity securities and are classified within Level 2 of the hierarchy.

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Derivative Assets and Derivative Liabilities – All of the derivative instruments utilized by the Company are classified within Level 2 on the fair value hierarchy. These derivatives are principally valued using an income approach. Valuations of interest rate contracts 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, 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 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.

Level 3 Measurements and Transfers

As of March 31, 2014 and December 31, 2013, respectively, the Company classified approximately 9.7% and 10.2% of its fixed maturity securities in the Level 3 category. These securities primarily consist of private placement corporate securities and bank loans with inactive trading markets. Additionally, the Company has included asset-backed securities with subprime 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 unobservable 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 investments are probability of default, liquidity premium and subordination premium. 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 and subordination premium. For securities with a fair value derived using the market comparable pricing valuation technique, liquidity premium is the only significant unobservable input.

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 projections based on short-term 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.

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The following table presents quantitative information about significant unobservable inputs used in Level 3 fair value measurements that are developed by the Company, which does not include unobservable Level 3 asset and liability measurements provided by third parties, as of March 31, 2014 and December 31, 2013 (dollars in thousands):

March 31, 2014:	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Assets:				
State and political subdivision securities	$21,689	Market comparable securities	Liquidity premium	1 %
Corporate securities	267,015	Market comparable securities	Liquidity premium	0-2% (1%)
U.S. government and agencies	34,693	Market comparable securities	Liquidity premium	0-1% (1%)
Funds withheld at interest- embedded derivatives	(99,029)	Total return swap	Mortality	0-100% (2%)
			Lapse	0-35% (7%)
			Withdrawal	0-5% (3%)
			Own Credit	0-1% (1%)
			Crediting rate	2-4% (3%)
Liabilities:				
Interest sensitive contract liabilities- embedded derivatives- indexed annuities	858,270	Discounted cash flow	Mortality	0-100% (2%)
			Lapse	0-35% (7%)
			Withdrawal	0-5% (3%)
			Option budget projection	2-4% (3%)
Interest sensitive contract liabilities- embedded derivatives- variable annuities	53,717	Discounted cash flow	Mortality	0-100% (2%)
			Lapse	0-25% (7%)
			Withdrawal	0-7% (3%)
			Own Credit	0-1% (1%)
			Long-term volatility	0-27% (10%)

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December 31, 2013:	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Assets:				
State and political subdivision securities	$29,024			