ALLSTATE CORP
Form 10-Q
October 31, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

OR

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

SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___ to ___

Commission file number 1-11840

THE ALLSTATE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-3871531**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

(847) 402-5000

(Registrant s telephone number, including area code)

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

Yes X No ___

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

Yes X No ___

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

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

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

Yes ___ No X

As of October 17, 2012, the registrant had 418,222,228 common shares, $.01 par value, outstanding.

THE ALLSTATE CORPORATION

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September 30, 2012

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

($ in millions, except per share data)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
	(unaudited)		(unaudited)	
Revenues				
Property-liability insurance premiums	$ 6,697	$ 6,432	$ 19,993	$ 19,337
Life and annuity premiums and contract charges	563	552	1,675	1,668
Net investment income	940	994	2,977	2,996
Realized capital gains and losses:				
Total other-than-temporary impairment losses	(39)	(197)	(195)	(435)
Portion of loss recognized in other comprehensive income	(7)	(6)	16	(37)
Net other-than-temporary impairment losses recognized in earnings	(46)	(203)	(179)	(472)
Sales and other realized capital gains and losses	(26)	467	302	889
Total realized capital gains and losses	(72)	264	123	417
	8,128	8,242	24,768	24,418
Costs and expenses				
Property-liability insurance claims and claims expense	4,293	5,132	13,442	15,963
Life and annuity contract benefits	453	455	1,354	1,331
Interest credited to contractholder funds	215	405	959	1,240
Amortization of deferred policy acquisition costs	1,016	1,046	2,937	2,990
Operating costs and expenses	1,010	888	3,023	2,656
Restructuring and related charges	9	8	25	28
Interest expense	93	92	281	275
	7,089	8,026	22,021	24,483
Gain (loss) on disposition of operations	9	3	15	(10)
Income (loss) from operations before income tax expense (benefit)	1,048	219	2,762	(75)
Income tax expense (benefit)	325	44	850	(150)
Net income	$ 723	$ 175	$ 1,912	$ 75
Earnings per share:				
Net income per share - Basic	$ 1.49	$ 0.34	$ 3.89	$ 0.14
Weighted average shares - Basic	485.9	512.0	491.5	520.4
Net income per share - Diluted	$ 1.48	$ 0.34	$ 3.86	$ 0.14
Weighted average shares - Diluted	489.9	514.2	494.7	522.9

Cash dividends declared per share	$	0.22	$	0.21	$	0.66	$	0.63

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

($ in millions)	**Three Months Ended September 30,**		**Nine Months Ended September 30,**	
	2012	**2011**	**2012**	**2011**
	(unaudited)		**(unaudited)**	
Net income	$ 723	$ 175	$ 1,912	$ 75
Other comprehensive income (loss), after-tax				
Changes in:				
Unrealized net capital gains and losses	810	(410)	1,480	117
Unrealized foreign currency translation adjustments	12	(33)	14	(19)
Unrecognized pension and other postretirement benefit cost	20	21	64	53
Other comprehensive income (loss), after-tax	842	(422)	1,558	151
Comprehensive income (loss)	$ 1,565	$ (247)	$ 3,470	$ 226

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

($ in millions, except par value data)	**September 30, 2012 (unaudited)**	**December 31, 2011**
Assets		
Investments		
Fixed income securities, at fair value (amortized cost $72,432 and $73,379)	$ 77,729	$ 76,113
Equity securities, at fair value (cost $3,429 and $4,203)	3,876	4,363
Mortgage loans	6,904	7,139
Limited partnership interests	4,974	4,697
Short-term, at fair value (amortized cost $2,825 and $1,291)	2,825	1,291
Other	2,208	2,015
Total investments	98,516	95,618
Cash	642	776
Premium installment receivables, net	5,108	4,920
Deferred policy acquisition costs	3,578	3,871
Reinsurance recoverables, net	7,278	7,251
Accrued investment income	835	826
Deferred income taxes	--	722
Property and equipment, net	928	914
Goodwill	1,242	1,242
Other assets	2,041	2,069
Separate Accounts	6,820	6,984
Total assets	$ 126,988	$ 125,193
Liabilities		
Reserve for property-liability insurance claims and claims expense	$ 20,197	$ 20,375
Reserve for life-contingent contract benefits	14,900	14,406
Contractholder funds	40,110	42,332
Unearned premiums	10,494	10,057
Claim payments outstanding	763	827
Deferred income taxes	689	--
Other liabilities and accrued expenses	6,121	5,978
Long-term debt	6,057	5,908
Separate Accounts	6,820	6,984
Total liabilities	106,151	106,867
Commitments and Contingent Liabilities (Note 10)		
Equity		
Preferred stock, $1 par value, 25 million shares authorized, none issued	--	--
Common stock, $.01 par value, 2.0 billion shares authorized and 900 million issued, 483 million and 501 million shares outstanding	9	9
Additional capital paid-in	3,154	3,189
Retained income	33,496	31,909
Deferred ESOP expense	(41)	(43)
Treasury stock, at cost (417 million and 399 million shares)	(17,368)	(16,795)
Accumulated other comprehensive income:		
Unrealized net capital gains and losses:		
Unrealized net capital losses on fixed income securities with OTTI	(42)	(174)
Other unrealized net capital gains and losses	3,765	2,041
Unrealized adjustment to DAC, DSI and insurance reserves	(843)	(467)
Total unrealized net capital gains and losses	2,880	1,400
Unrealized foreign currency translation adjustments	70	56
Unrecognized pension and other postretirement benefit cost	(1,363)	(1,427)
Total accumulated other comprehensive income	1,587	29
Total shareholders equity	20,837	18,298
Noncontrolling interest	--	28
Total equity	20,837	18,326
Total liabilities and equity	$ 126,988	$ 125,193

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

($ in millions)	Nine Months Ended September 30, 2012	2011
	(unaudited)	
Cash flows from operating activities		
Net income	$ 1,912	$ 75
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other non-cash items	293	149
Realized capital gains and losses	(123)	(417)
(Gain) loss on disposition of operations	(15)	10
Interest credited to contractholder funds	959	1,240
Changes in:		
Policy benefits and other insurance reserves	(769)	546
Unearned premiums	421	220
Deferred policy acquisition costs	13	129
Premium installment receivables, net	(178)	(158)
Reinsurance recoverables, net	(139)	(275)
Income taxes	669	(183)
Other operating assets and liabilities	(425)	335
Net cash provided by operating activities	2,618	1,671
Cash flows from investing activities		
Proceeds from sales		
Fixed income securities	13,952	23,916
Equity securities	1,345	1,116
Limited partnership interests	1,067	762
Mortgage loans	11	74
Other investments	104	149
Investment collections		
Fixed income securities	3,892	3,864
Mortgage loans	682	491
Other investments	70	105
Investment purchases		
Fixed income securities	(16,809)	(21,900)
Equity securities	(385)	(1,066)
Limited partnership interests	(1,232)	(1,159)
Mortgage loans	(472)	(896)
Other investments	(275)	(199)
Change in short-term investments, net	(1,284)	64
Change in other investments, net	(6)	(357)
Purchases of property and equipment, net	(176)	(160)
Disposition of operations	13	1
Net cash provided by investing activities	497	4,805
Cash flows from financing activities		
Proceeds from issuance of long-term debt	493	--
Repayment of long-term debt	(351)	(1)
Contractholder fund deposits	1,571	1,606
Contractholder fund withdrawals	(3,938)	(6,439)
Dividends paid	(322)	(327)
Treasury stock purchases	(729)	(858)
Shares reissued under equity incentive plans, net	60	18
Excess tax benefits on share-based payment arrangements	7	(4)
Other	(40)	(7)
Net cash used in financing activities	(3,249)	(6,012)
Net (decrease) increase in cash	(134)	464
Cash at beginning of period	776	562
Cash at end of period	$ 642	$ 1,026

See notes to condensed consolidated financial statements.

THE ALLSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Basis of presentation

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

The condensed consolidated financial statements and notes as of September 30, 2012 and for the three-month and nine-month periods ended September 30, 2012 and 2011 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring accruals), which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011 and Current Report on Form 8-K filed May 2, 2012. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

To conform to the current year presentation, certain amounts in the prior year condensed consolidated financial statements and notes have been reclassified.

Adopted accounting standards

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued guidance modifying the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal insurance contracts. The guidance specifies that the costs must be directly related to the successful acquisition of insurance contracts. The guidance also specifies that advertising costs should be included as deferred acquisition costs (DAC) only when the direct-response advertising accounting criteria are met. The Company adopted the new guidance on a retrospective basis as of January 1, 2012. The cumulative effect of the adoption to shareholders equity as of January 1, 2011 was a decrease of $399 million, net of taxes. The impacts of the retrospective adjustments on previously issued financial statements are summarized in the following table.

($ in millions, except per share data)	Three months ended September 30, 2011		Nine months ended September 30, 2011	
	Previously Reported	As Adjusted	Previously Reported	As Adjusted
Amortization of DAC	$ 1,122	$ 1,046	$ 3,191	$ 2,990
Operating costs and expenses	825	888	2,465	2,656
Gain (loss) on disposition of operations	--	3	(17)	(10)
Income tax expense (benefit)	38	44	(156)	(150)
Net income	165	175	64	75
Net income per share - Basic	0.32	0.34	0.12	0.14
Net income per share - Diluted	0.32	0.34	0.12	0.14

	As of December 31, 2011	
	Previously Reported	As Adjusted
DAC	4,443	3,871
Deferred income taxes	520	722
Reserve for life-contingent contract benefits	14,449	14,406
Other liabilities and accrued expenses	5,929	5,978
Retained income	32,321	31,909
Unrealized adjustment to DAC, DSI and insurance reserves	(504)	(467)
Unrealized foreign currency translation adjustments	57	56

In future periods, operating costs and expenses will increase since a lower amount of acquisition costs will be capitalized, which will be partially offset by a decrease in amortization of DAC due to the retrospective reduction of the DAC balance. The effect of the adoption on net income and related per share amounts for interim periods after adoption is not determinable since calculations under the historic DAC accounting policy were not continued after adoption.

Criteria for Determining Effective Control for Repurchase Agreements

In April 2011, the FASB issued guidance modifying the assessment criteria of effective control for repurchase agreements. The new guidance removes the criteria requiring an entity to have the ability to repurchase or redeem financial assets on substantially the agreed terms and the collateral maintenance guidance related to that criteria. The guidance is to be applied prospectively to transactions or modifications of existing transactions that occur during reporting periods beginning on or after December 15, 2011. The adoption of this guidance as of January 1, 2012 had no impact on the Company s results of operations or financial position.

Amendments to Fair Value Measurement and Disclosure Requirements

In May 2011, the FASB issued guidance that clarifies the application of existing fair value measurement and disclosure requirements and amends certain fair value measurement principles, requirements and disclosures. Changes were made to improve consistency in global application. The guidance is to be applied prospectively for reporting periods beginning after December 15, 2011. The adoption of this guidance as of January 1, 2012 had no impact on the Company s results of operations or financial position.

Presentation of Comprehensive Income

In June and December 2011, the FASB issued guidance amending the presentation of comprehensive income and its components. Under the new guidance, a reporting entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements. The Company adopted the new guidance in the first quarter of 2012. The new guidance affects presentation only and therefore had no impact on the Company s results of operations or financial position.

Intangibles Goodwill and Other

In September 2011, the FASB issued guidance providing the option to first assess qualitative factors, such as macroeconomic conditions and industry and market considerations, to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If impairment is indicated by the qualitative assessment, then it is necessary to perform the two-step goodwill impairment test. If the option is not elected, the guidance requiring the two-step goodwill impairment test is unchanged. The adoption of this guidance as of January 1, 2012 had no impact on the Company s results of operations or financial position.

Pending accounting standard

Disclosures about Offsetting Assets and Liabilities for Financial Instruments and Derivative Instruments

In December 2011, the FASB issued guidance requiring expanded disclosures, including both gross and net information, for financial instruments and derivative instruments that are either offset in the reporting entity s financial statements or those that are subject to an enforceable master netting arrangement or similar agreement. The guidance is effective for reporting periods beginning on or after January 1, 2013 and is to be applied retrospectively. The new guidance affects disclosures only and will have no impact on the Company s results of operations or financial position.

2. Earnings per share

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

The computation of basic and diluted earnings per share is presented in the following table.

($ in millions, except per share data)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Numerator:				
Net income	$ 723	$ 175	$ 1,912	$ 75
Denominator:				
Weighted average common shares outstanding	485.9	512.0	491.5	520.4
Effect of dilutive potential common stock:				
Stock options	2.7	1.6	2.2	2.0
Restricted stock units and performance share awards (non-participating)	1.3	0.6	1.0	0.5
Weighted average common and dilutive potential common shares outstanding	489.9	514.2	494.7	522.9
Earnings per share - Basic	$ 1.49	$ 0.34	$ 3.89	$ 0.14
Earnings per share - Diluted	$ 1.48	$ 0.34	$ 3.86	$ 0.14

The effect of dilutive potential common shares does not include the effect of options with an anti-dilutive effect on earnings per share because their exercise prices exceed the average market price of Allstate common shares during the period or for which the unrecognized compensation cost would have an anti-dilutive effect. Options to purchase 17.8 million and 27.6 million Allstate common shares, with exercise prices ranging from $31.41 to $62.84 and $24.70 to $62.84, were outstanding for the three-month periods ended September 30, 2012 and 2011, respectively, but were not included in the computation of diluted earnings per share in those periods. Options to purchase 22.1 million and 27.6 million Allstate common shares, with exercise prices ranging from $26.56 to $62.84 and $25.91 to $62.84, were outstanding for the nine-month periods ended September 30, 2012 and 2011, respectively, but were not included in the computation of diluted earnings per share in those periods.

3. Supplemental Cash Flow Information

Non-cash modifications of certain mortgage loans, fixed income securities, limited partnership interests and other investments, as well as mergers completed with equity securities, totaled $170 million and $564 million for the nine months ended September 30, 2012 and 2011, respectively. Non-cash financing activities include $39 million related to the issuance of Allstate shares for vested restricted stock units for the nine months ended September 30, 2012.

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

($ in millions)	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net change in proceeds managed		
Net change in short-term investments	$ (297)	$ (301)

Operating cash flow used	(297)	(301)
Net change in cash	(6)	1
Net change in proceeds managed	$ (303)	$ (300)
Net change in liabilities		
Liabilities for collateral, beginning of year	$ (462)	$ (484)
Liabilities for collateral, end of period	(765)	(784)
Operating cash flow provided	$ 303	$ 300

4. Investments

Fair values

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

($ in millions)	Amortized cost	Gross unrealized Gains	Losses	Fair value
September 30, 2012				
U.S. government and agencies	$ 4,401	$ 371	$ --	$ 4,772
Municipal	13,048	1,083	(161)	13,970
Corporate	44,344	3,956	(146)	48,154
Foreign government	2,015	240	--	2,255
Residential mortgage-backed securities (RMBS)	3,344	150	(146)	3,348
Commercial mortgage-backed securities (CMBS)	1,555	66	(91)	1,530
Asset-backed securities (ABS)	3,703	112	(142)	3,673
Redeemable preferred stock	22	5	--	27
Total fixed income securities	$ 72,432	$ 5,983	$ (686)	$ 77,729
December 31, 2011				
U.S. government and agencies	$ 5,966	$ 349	$ --	$ 6,315
Municipal	13,634	863	(256)	14,241
Corporate	41,217	2,743	(379)	43,581
Foreign government	1,866	216	(1)	2,081
RMBS	4,532	110	(521)	4,121
CMBS	1,962	48	(226)	1,784
ABS	4,180	73	(287)	3,966
Redeemable preferred stock	22	2	--	24
Total fixed income securities	$ 73,379	$ 4,404	$ (1,670)	$ 76,113

Scheduled maturities

The scheduled maturities for fixed income securities are as follows as of September 30, 2012:

($ in millions)	Amortized cost	Fair value
Due in one year or less	$ 4,017	$ 4,072
Due after one year through five years	20,943	22,124
Due after five years through ten years	24,287	26,615

Due after ten years		16,138		17,897
		65,385		70,708
RMBS and ABS		7,047		7,021
Total	$	72,432	$	77,729

Actual maturities may differ from those scheduled as a result of prepayments by the issuers. Because of the potential for prepayment on RMBS and ABS, they are not categorized by contractual maturity. CMBS are categorized by contractual maturity because they generally are not subject to prepayment risk.

Net investment income

Net investment income is as follows:

($ in millions)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Fixed income securities	$ 817	$ 862	$ 2,441	$ 2,661
Equity securities	29	23	74	76
Mortgage loans	92	91	277	267
Limited partnership interests (1)	22	33	238	61
Short-term investments	2	2	4	5
Other	33	27	97	64
Investment income, before expense	995	1,038	3,131	3,134
Investment expense	(55)	(44)	(154)	(138)
Net investment income	$ 940	$ 994	$ 2,977	$ 2,996

(1) Income from limited partnership interests accounted for under the equity method of accounting (EMA) is reported in net investment income in 2012 and realized capital gains and losses in 2011.

Realized capital gains and losses

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

($ in millions)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Fixed income securities	$ (50)	$ 603	$ (73)	$ 615
Equity securities	(15)	(77)	157	60
Mortgage loans	(3)	(28)	5	(37)
Limited partnership interests (1)	--	8	13	129
Derivatives	(2)	(234)	26	(354)
Other	(2)	(8)	(5)	4
Realized capital gains and losses	$ (72)	$ 264	$ 123	$ 417

(1) Income from EMA limited partnerships is reported in net investment income in 2012 and realized capital gains and losses in 2011.

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

($ in millions)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Impairment write-downs	$ (43)	$ (190)	$ (131)	$ (374)
Change in intent write-downs	(3)	(13)	(48)	(98)
Net other-than-temporary impairment losses recognized in earnings	(46)	(203)	(179)	(472)
Sales	(24)	692	275	1,116
Valuation of derivative instruments	--	(254)	1	(282)
Settlements of derivative instruments	(2)	20	26	(72)
EMA limited partnership income	--	9	--	127
Realized capital gains and losses	$ (72)	$ 264	$ 123	$ 417

Gross gains of $109 million and $709 million and gross losses of $154 million and $32 million were realized on sales of fixed income securities during the three months ended September 30, 2012 and 2011, respectively. Gross gains of $296 million and $1.10 billion and gross losses of $291 million and $218 million were realized on sales of fixed income securities during the nine months ended September 30, 2012 and 2011, respectively.

Other-than-temporary impairment losses by asset type are as follows:

($ in millions)	Three months ended September 30, 2012			Nine months ended September 30, 2012		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	$ (2)	$ (3)	$ (5)	$ (28)	$ 14	$ (14)
Corporate	(1)	(1)	(2)	(19)	(2)	(21)
RMBS	(4)	(6)	(10)	(59)	(2)	(61)
CMBS	(4)	3	(1)	(19)	6	(13)
Total fixed income securities	(11)	(7)	(18)	(125)	16	(109)
Equity securities	(22)	--	(22)	(58)	--	(58)
Mortgage loans	(1)	--	(1)	3	--	3
Limited partnership interests	(2)	--	(2)	(5)	--	(5)
Other	(3)	--	(3)	(10)	--	(10)
Other-than-temporary impairment losses	$ (39)	$ (7)	$ (46)	$ (195)	$ 16	$ (179)

	Three months ended September 30, 2011			Nine months ended September 30, 2011		
	Gross	Included in OCI	Net	Gross	Included in OCI	Net
Fixed income securities:						
Municipal	$ (8)	$ --	$ (8)	$ (50)	$ (3)	$ (53)
Corporate	(14)	--	(14)	(19)	1	(18)
Foreign government	--	--	--	(1)	--	(1)
RMBS	(57)	(3)	(60)	(164)	(28)	(192)
CMBS	(1)	(3)	(4)	(27)	(10)	(37)
ABS	--	--	--	(7)	3	(4)
Total fixed income securities	(80)	(6)	(86)	(268)	(37)	(305)
Equity securities	(81)	--	(81)	(114)	--	(114)
Mortgage loans	(29)	--	(29)	(42)	--	(42)
Limited partnership interests	(2)	--	(2)	(4)	--	(4)
Other	(5)	--	(5)	(7)	--	(7)
Other-than-temporary impairment losses	$ (197)	$ (6)	$ (203)	$ (435)	$ (37)	$ (472)

The total amount of other-than-temporary impairment losses included in accumulated other comprehensive income at the time of impairment for fixed income securities, which were not included in earnings, are presented in the following table. The amount excludes $220 million and $172 million as of September 30, 2012 and December 31, 2011, respectively, of net unrealized gains related to changes in valuation of the fixed income securities subsequent to the impairment measurement date.

($ in millions)	September 30, 2012	December 31, 2011
Municipal	$ (25)	$ (11)
Corporate	(1)	(35)
RMBS	(223)	(353)
CMBS	(22)	(19)
ABS	(14)	(21)
Total	$ (285)	$ (439)

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

($ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Beginning balance	$ (781)	$ (912)	$ (944)	$ (1,046)
Additional credit loss for securities previously other-than-temporarily impaired	(15)	(56)	(49)	(133)
Additional credit loss for securities not previously other-than-temporarily impaired	(3)	(25)	(24)	(82)
Reduction in credit loss for securities disposed or collected	128	66	339	313
Reduction in credit loss for securities the Company has made the decision to sell or more likely than not will be required to sell	--	--	7	15
Change in credit loss due to accretion of increase in cash flows	1	4	1	10
Ending balance	$ (670)	$ (923)	$ (670)	$ (923)

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

Unrealized net capital gains and losses

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

($ in millions)	**Fair**	**Gross unrealized**		**Unrealized net**
September 30, 2012	**value**	**Gains**	**Losses**	**gains (losses)**
Fixed income securities	$ 77,729	$ 5,983	$ (686)	$ 5,297
Equity securities	3,876	509	(62)	447
Short-term investments	2,825	--	--	--
Derivative instruments (1)	(14)	2	(21)	(19)
EMA limited partnerships (2)				6
Unrealized net capital gains and losses, pre-tax				5,731
Amounts recognized for:				
Insurance reserves (3)				(876)
DAC and DSI (4)				(420)
Amounts recognized				(1,296)
Deferred income taxes				(1,555)
Unrealized net capital gains and losses, after-tax				$ 2,880

(1) Included in the fair value of derivative instruments are $(6) million classified as assets and $8 million classified as liabilities.

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

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

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

	Fair	**Gross unrealized**		**Unrealized net**
December 31, 2011	**value**	**Gains**	**Losses**	**gains (losses)**
Fixed income securities	$ 76,113	$ 4,404	$ (1,670)	$ 2,734
Equity securities	4,363	369	(209)	160
Short-term investments	1,291	--	--	--
Derivative instruments (1)	(12)	3	(20)	(17)
EMA limited partnerships				2
Unrealized net capital gains and losses, pre-tax				2,879
Amounts recognized for:				
Insurance reserves				(594)
DAC and DSI				(124)
Amounts recognized				(718)
Deferred income taxes				(761)
Unrealized net capital gains and losses, after-tax				$ 1,400

(1) Included in the fair value of derivative instruments are $(5) million classified as assets and $7 million classified as liabilities.

Change in unrealized net capital gains and losses

The change in unrealized net capital gains and losses for the nine months ended September 30, 2012 is as follows:

($ in millions)		
Fixed income securities	$	2,563
Equity securities		287
Derivative instruments		(2)
EMA limited partnerships		4
Total		2,852
Amounts recognized for:		
Insurance reserves		(282)
DAC and DSI		(296)
Amounts recognized		(578)
Deferred income taxes		(794)
Increase in unrealized net capital gains and losses	$	1,480

Portfolio monitoring

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

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

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

For equity securities, the Company considers various factors, including whether it has the intent and ability to hold the equity security for a period of time sufficient to recover its cost basis. Where the Company lacks the intent and ability to hold to recovery, or believes the recovery period is extended, the equity security s decline in fair value is considered other than temporary and is recorded in earnings. For equity securities managed by a third party, the Company has contractually retained its decision making authority as it pertains to selling equity securities that are in an unrealized loss position.

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

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

($ in millions)	Less than 12 months			12 months or more			Total
	Number of issues	Fair value	Unrealized losses	Number of issues	Fair value	Unrealized losses	Total unrealized losses
September 30, 2012							
Fixed income securities							
U.S. government and agencies	4	$ 225	$ --	--	$ --	$ --	$ --
Municipal	35	215	(9)	117	1,052	(152)	(161)
Corporate	79	919	(30)	82	977	(116)	(146)
Foreign government	7	17	--	1	1	--	--
RMBS	269	51	(3)	236	735	(143)	(146)
CMBS	4	21	--	50	449	(91)	(91)
ABS	19	249	(4)	83	859	(138)	(142)
Redeemable preferred stock	1	--	--	--	--	--	--
Total fixed income securities	418	1,697	(46)	569	4,073	(640)	(686)
Equity securities	892	663	(43)	136	80	(19)	(62)
Total fixed income and equity securities	1,310	$ 2,360	$ (89)	705	$ 4,153	$ (659)	$ (748)
Investment grade fixed income securities	364	$ 1,275	$ (30)	346	$ 2,584	$ (293)	$ (323)
Below investment grade fixed income securities	54	422	(16)	223	1,489	(347)	(363)
Total fixed income securities	418	$ 1,697	$ (46)	569	$ 4,073	$ (640)	$ (686)
December 31, 2011							
Fixed income securities							
U.S. government and agencies	4	$ 61	$ --	--	$ --	$ --	$ --
Municipal	29	135	(11)	303	1,886	(245)	(256)
Corporate	307	3,439	(113)	105	1,273	(266)	(379)
Foreign government	11	85	(1)	1	1	--	(1)
RMBS	321	373	(11)	294	1,182	(510)	(521)
CMBS	47	378	(49)	68	489	(177)	(226)
ABS	89	960	(17)	108	1,020	(270)	(287)
Redeemable preferred stock	1	--	--	--	--	--	--
Total fixed income securities	809	5,431	(202)	879	5,851	(1,468)	(1,670)
Equity securities	1,397	2,120	(203)	32	30	(6)	(209)
Total fixed income and equity securities	2,206	$ 7,551	$ (405)	911	$ 5,881	$ (1,474)	$ (1,879)
Investment grade fixed income securities	665	$ 4,480	$ (145)	555	$ 3,773	$ (700)	$ (845)
Below investment grade fixed income securities	144	951	(57)	324	2,078	(768)	(825)
Total fixed income securities	809	$ 5,431	$ (202)	879	$ 5,851	$ (1,468)	$ (1,670)

As of September 30, 2012, $373 million of unrealized losses are related to securities with an unrealized loss position less than 20% of amortized cost or cost, the degree of which suggests that these securities do not pose a high risk of being other-than-temporarily impaired. Of the $373 million, $228 million are related to unrealized losses on investment grade fixed income securities. Investment grade is defined as a security having a rating of Aaa, Aa, A or Baa from Moody s, a rating of AAA, AA, A or BBB from Standard & Poor s (S&P), Fitch, Dominion or

Realpoint, a rating of aaa, aa, a or bbb from A.M. Best, or a comparable internal rating if an externally provided rating is not available. Unrealized losses on investment grade securities are principally related to widening credit spreads or rising interest rates since the time of initial purchase.

As of September 30, 2012, the remaining $375 million of unrealized losses are related to securities in unrealized loss positions greater than or equal to 20% of amortized cost or cost. Investment grade fixed income securities comprising $95 million of these unrealized losses were evaluated based on factors such as discounted cash flows and the financial condition and near-term and long-term prospects of the issue or issuer and were determined to have adequate resources to fulfill contractual obligations. Of the $375 million, $250 million are related to below investment grade fixed income securities and $30 million are related to equity securities. Of these amounts, $215 million are related to below investment grade fixed income securities that had been in an unrealized loss position greater than or equal to 20% of amortized cost for a period of twelve or more consecutive months as of September 30, 2012. Unrealized losses on below investment grade securities are principally related to RMBS, CMBS and ABS and were the result of wider credit spreads resulting from higher risk premiums since the time of initial purchase. These wider spreads are largely due to the risk associated with the underlying collateral supporting certain RMBS, CMBS and ABS securities.

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

As of September 30, 2012, the Company has not made the decision to sell and it is not more likely than not the Company will be required to sell fixed income securities with unrealized losses before recovery of the amortized cost basis. As of September 30, 2012, the Company had the intent and ability to hold equity securities with unrealized losses for a period of time sufficient for them to recover.

Limited partnerships

As of September 30, 2012 and December 31, 2011, the carrying value of equity method limited partnerships totaled $3.52 billion and $3.13 billion, respectively. The Company recognizes an impairment loss for equity method limited partnerships when evidence demonstrates that the loss is other than temporary. Evidence of a loss in value that is other than temporary may include the absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain a level of earnings that would justify the carrying amount of the investment. The Company had no write-downs related to equity method limited partnerships for the three or nine months ended September 30, 2012 and 2011.

As of September 30, 2012 and December 31, 2011, the carrying value for cost method limited partnerships was $1.46 billion and $1.57 billion, respectively. To determine if an other-than-temporary impairment has occurred, the Company evaluates whether an impairment indicator has occurred in the period that may have a significant adverse effect on the carrying value of the investment. Impairment indicators may include: significantly reduced valuations of the investments held by the limited partnerships; actual recent cash flows received being significantly less than expected cash flows; reduced valuations based on financing completed at a lower value; completed sale of a material underlying investment at a price significantly lower than expected; or any other adverse events since the last financial statements received that might affect the fair value of the investee s capital. Additionally, the Company s portfolio monitoring process includes a quarterly review of all cost method limited partnerships to identify instances where the net asset value is below established thresholds for certain periods of time, as well as investments that are performing below expectations, for further impairment consideration. If a cost method limited partnership is other-than-temporarily impaired, the carrying value is written down to fair value, generally estimated to be equivalent to the reported net asset value of the underlying funds. The Company had write-downs related to cost method limited partnerships of $2 million and $2 million for the three months ended September 30, 2012 and 2011, respectively, and $5 million and $4 million for the nine months ended September 30, 2012 and 2011, respectively.

Mortgage loans

Mortgage loans are evaluated for impairment on a specific loan basis through a quarterly credit monitoring process and review of key credit quality indicators. Mortgage loans are considered impaired when it is probable that the Company will not collect the contractual principal and interest. Valuation allowances are established for impaired loans to reduce the carrying value to the fair value of the collateral less costs to sell or the present value of the loan s expected future repayment cash flows discounted at the loan s original effective interest rate. Impaired mortgage loans may not have a valuation allowance when the fair value of the collateral less costs to sell is higher than the carrying value. Valuation allowances are adjusted for subsequent changes in the fair value of the collateral less costs to sell. Mortgage loans are charged off against their corresponding valuation allowances when there is no reasonable expectation of recovery. The impairment evaluation is non-statistical in respect to the aggregate portfolio but considers facts and circumstances attributable to each loan. It is not considered probable that additional impairment losses, beyond those identified on a specific loan basis, have been incurred as of September 30, 2012.

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

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

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

($ in millions)		**September 30, 2012**				**December 31, 2011**	
Debt service coverage ratio distribution	**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**		**Fixed rate mortgage loans**	**Variable rate mortgage loans**	**Total**
Below 1.0	$ 296	$ --	$ 296		$ 345	$ --	$ 345
1.0 - 1.25	1,276	21	1,297		1,527	44	1,571
1.26 - 1.50	1,615	22	1,637		1,573	24	1,597
Above 1.50	3,322	172	3,494		3,214	168	3,382
Total non-impaired mortgage loans	$ 6,509	$ 215	$ 6,724		$ 6,659	$ 236	$ 6,895

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

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

($ in millions)	**September 30, 2012**	**December 31, 2011**
Impaired mortgage loans with a valuation allowance	$ 172	$ 244
Impaired mortgage loans without a valuation allowance	8	--
Total impaired mortgage loans	$ 180	$ 244
Valuation allowance on impaired mortgage loans	$ 47	$ 63

The average balance of impaired loans was $214 million and $201 million for the nine months ended September 30, 2012 and 2011, respectively.

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

($ in millions)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Beginning balance	$ 48	$ 68	$ 63	$ 84
Net increase (decrease) in valuation allowance	1	29	(3)	42
Charge offs	(2)	(27)	(13)	(56)
Ending balance	$ 47	$ 70	$ 47	$ 70

The carrying value of past due mortgage loans is as follows:

($ in millions)	September 30, 2012	December 31, 2011
Less than 90 days past due	$ 9	$ --
90 days or greater past due	7	43
Total past due	16	43
Current loans	6,888	7,096
Total mortgage loans	$ 6,904	$ 7,139

5. Fair Value of Assets and Liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The hierarchy for inputs used in determining fair value maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Assets and liabilities recorded on the Condensed Consolidated Statements of Financial Position at fair value are categorized in the fair value hierarchy based on the observability of inputs to the valuation techniques as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

Level 1 measurements

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

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

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

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

Level 2 measurements

- Fixed income securities:

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

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

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

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

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

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

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

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

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

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

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

Level 3 measurements

- Fixed income securities:

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

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

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

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

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

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

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

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

The following table summarizes the Company s assets and liabilities measured at fair value on a recurring and non-recurring basis as of September 30, 2012:

($ in millions)	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Counterparty and cash collateral netting**	**Balance as of September 30, 2012**
Assets					
Fixed income securities:					
U.S. government and agencies	$ 2,866	$ 1,898	$ 8		$ 4,772
Municipal	--	12,808	1,162		13,970
Corporate	--	46,611	1,543		48,154
Foreign government	--	2,255	--		2,255
RMBS	--	3,345	3		3,348
CMBS	--	1,480	50		1,530
ABS	--	3,451	222		3,673
Redeemable preferred stock	--	26	1		27
Total fixed income securities	2,866	71,874	2,989		77,729
Equity securities	2,806	887	183		3,876
Short-term investments	788	2,037	--		2,825
Other investments:					
Free-standing derivatives	--	333	2	$ (84)	251
Separate account assets	6,820	--	--		6,820
Other assets	1	--	1		2
Total recurring basis assets	13,281	75,131	3,175	(84)	91,503
Non-recurring basis (1)	--	--	22		22
Total assets at fair value	$ 13,281	$ 75,131	$ 3,197	$ (84)	$ 91,525
% of total assets at fair value	14.5%	82.1%	3.5%	(0.1)%	100.0%
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (551)		$ (551)
Other liabilities:					

Free-standing derivatives		(1)		(150)		(32)	$	43		(140)
Total liabilities at fair value	$	(1)	$	(150)	$	(583)	$	43	$	(691)
% of total liabilities at fair value		0.1%		21.7%		84.4%		(6.2)%		100.0%

(1) Includes $9 million of mortgage loans, $6 million of limited partnership interests and $7 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table summarizes quantitative information about the significant unobservable inputs used in Level 3 fair value measurements as of September 30, 2012.

($ in millions)	Fair value		Valuation technique	Unobservable input	Range	Weighted average
ARS backed by student loans	$	573	Discounted cash flow model	Anticipated date liquidity will return to the market	18 - 60 months	32 - 44 months
Derivatives embedded in life and annuity contracts Equity-indexed and forward starting options	$	(413)	Stochastic cash flow model	Projected option cost	1.0 - 2.0 %	1.95 %

If the anticipated date liquidity will return to the market is sooner (later), it would result in a higher (lower) fair value. If the projected option cost increased (decreased), it would result in a higher (lower) liability fair value.

As of September 30, 2012, Level 3 fair value measurements include $1.73 billion of fixed income securities valued based on non-binding broker quotes where the inputs have not been corroborated to be market observable and $405 million of municipal fixed income securities that are not rated by third party credit rating agencies. The Company does not develop the unobservable inputs used in measuring fair value; therefore, these are not included in the table above. However, an increase (decrease) in credit spreads for fixed income securities valued based on non-binding broker quotes would result in a lower (higher) fair value, and an increase (decrease) in the credit rating of municipal bonds that are not rated by third party credit rating agencies would result in a higher (lower) fair value.

The following table summarizes the Company s assets and liabilities measured at fair value on a recurring and non-recurring basis as of December 31, 2011:

($ in millions)	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Counterparty and cash collateral netting	Balance as of December 31, 2011
Assets					
Fixed income securities:					
U.S. government and agencies	$ 4,707	$ 1,608	$ --		$ 6,315
Municipal	--	12,909	1,332		14,241
Corporate	--	42,176	1,405		43,581
Foreign government	--	2,081	--		2,081
RMBS	--	4,070	51		4,121
CMBS	--	1,724	60		1,784
ABS	--	3,669	297		3,966
Redeemable preferred stock	--	23	1		24
Total fixed income securities	4,707	68,260	3,146		76,113
Equity securities	3,433	887	43		4,363
Short-term investments	188	1,103	--		1,291
Other investments:					
Free-standing derivatives	--	281	1	$ (114)	168
Separate account assets	6,984	--	--		6,984
Other assets	1	--	1		2
Total recurring basis assets	15,313	70,531	3,191	(114)	88,921
Non-recurring basis (1)	--	--	35		35
Total assets at fair value	$ 15,313	$ 70,531	$ 3,226	$ (114)	$ 88,956
% of total assets at fair value	17.2 %	79.3 %	3.6 %	(0.1) %	100.0 %
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (723)		$ (723)
Other liabilities:					
Free-standing derivatives	(1)	(112)	(96)	$ 77	(132)
Total liabilities at fair value	$ (1)	$ (112)	$ (819)	$ 77	$ (855)
% of total liabilities at fair value	0.1 %	13.1 %	95.8 %	(9.0) %	100.0 %

(1) Includes $19 million of mortgage loans and $16 million of other investments written-down to fair value in connection with recognizing other-than-temporary impairments.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2012.

($ in millions)	Balance as of June 30, 2012	Total gains (losses) included in: Net income (1)	OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
U.S. government and agencies	$ 8	$ --	$ --	$ --	$ --
Municipal	1,144	(4)	14	53	--
Corporate	1,524	10	39	74	--
RMBS	4	--	--	--	--
CMBS	47	(1)	1	--	--
ABS	334	(9)	34	43	(26)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	3,062	(4)	88	170	(26)
Equity securities	192	(3)	--	--	--
Other investments:					
Free-standing derivatives, net	(71)	11	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 3,184	$ 4	$ 88	$ 170	$ (26)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (707)	$ 160	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (707)	$ 160	$ --	$ --	$ --

	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2012
Assets					
Fixed income securities:					
U.S. government and agencies	$ --	$ --	$ --	$ --	$ 8
Municipal	4	(49)	--	--	1,162
Corporate	62	(120)	--	(46)	1,543
RMBS	--	--	--	(1)	3
CMBS	3	--	--	--	50
ABS	--	(151)	--	(3)	222
Redeemable preferred stock	--	--	--	--	1
Total fixed income securities	69	(320)	--	(50)	2,989
Equity securities	2	(8)	--	--	183
Other investments:					
Free-standing derivatives, net	21	--	--	9	(30)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 92	$ (328)	$ --	$ (41)	$ 3,143
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (24)	$ 20	$ (551)
Total recurring Level 3 liabilities	$ --	$ --	$ (24)	$ 20	$ (551)

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(1) The effect to net income totals $164 million and is reported in the Condensed Consolidated Statements of Operations as follows: $(4) million in realized capital gains and losses, $7 million in net investment income, $143 million in interest credited to contractholder funds and $18 million in life and annuity contract benefits.

(2) Comprises $2 million of assets and $32 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the nine months ended September 30, 2012.

($ in millions)	Balance as of December 31, 2011	Total gains (losses) included in: Net income (1)	OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
U.S. government and agencies	$ --	$ --	$ --	$ 8	$ --
Municipal	1,332	(10)	31	53	(26)
Corporate	1,405	16	62	210	(38)
RMBS	51	--	--	--	(47)
CMBS	60	(3)	9	--	(5)
ABS	297	20	46	43	(77)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	3,146	23	148	314	(193)
Equity securities	43	(7)	6	--	--
Other investments:					
Free-standing derivatives, net	(95)	25	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 3,095	$ 41	$ 154	$ 314	$ (193)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (723)	$ 151	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (723)	$ 151	$ --	$ --	$ --

	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2012
Assets					
Fixed income securities:					
U.S. government and agencies	$ --	$ --	$ --	$ --	$ 8
Municipal	46	(254)	--	(10)	1,162
Corporate	193	(219)	--	(86)	1,543
RMBS	--	--	--	(1)	3
CMBS	5	(1)	--	(15)	50
ABS	74	(162)	--	(19)	222
Redeemable preferred stock	1	(1)	--	--	1
Total fixed income securities	319	(637)	--	(131)	2,989
Equity securities	164	(23)	--	--	183
Other investments:					
Free-standing derivatives, net	27	--	--	13	(30)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 510	$ (660)	$ --	$ (118)	$ 3,143
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (53)	$ 74	$ (551)
Total recurring Level 3 liabilities	$ --	$ --	$ (53)	$ 74	$ (551)

(1) The effect to net income totals $192 million and is reported in the Condensed Consolidated Statements of Operations as follows: $19 million in realized capital gains and losses, $22 million in net investment income, $119 million in interest credited to contractholder funds and $32 million in life and annuity contract

benefits.

(2) Comprises $2 million of assets and $32 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the three months ended September 30, 2011.

($ in millions)	Balance as of June 30, 2011	Total gains (losses) included in: Net income (1)	Total gains (losses) included in: OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
Municipal	$ 1,554	$ (10)	$ 1	$ --	$ (22)
Corporate	1,720	(4)	(23)	3	(107)
RMBS	1,194	--	2	--	(1,100)
CMBS	938	(1)	(5)	20	(877)
ABS	2,167	(36)	(75)	--	(329)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	7,574	(51)	(100)	23	(2,435)
Equity securities	42	--	--	--	--
Other investments:					
Free-standing derivatives, net	(56)	(57)	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 7,561	$ (108)	$ (100)	$ 23	$ (2,435)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (629)	$ 2	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (629)	$ 2	$ --	$ --	$ --

	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2011
Assets					
Fixed income securities:					
Municipal	$ --	$ (70)	$ --	$ --	$ 1,453
Corporate	245	(59)	--	(45)	1,730
RMBS	--	--	--	(4)	92
CMBS	2	--	--	(1)	76
ABS	165	(1)	--	(90)	1,801
Redeemable preferred stock	--	--	--	--	1
Total fixed income securities	412	(130)	--	(140)	5,153
Equity securities	--	--	--	--	42
Other investments:					
Free-standing derivatives, net	5	--	--	(2)	(110)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 417	$ (130)	$ --	$ (142)	$ 5,086
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (15)	$ 45	$ (597)
Total recurring Level 3 liabilities	$ --	$ --	$ (15)	$ 45	$ (597)

(1) The effect to net income totals $(106) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(119) million in realized capital gains and losses, $14 million in net investment income, $54 million in interest credited to contractholder funds and $(55) million in life and annuity contract benefits.

(2) Comprises $1 million of assets and $111 million of liabilities.

The following table presents the rollforward of Level 3 assets and liabilities held at fair value on a recurring basis during the nine months ended September 30, 2011.

($ in millions)	Balance as of December 31, 2010	Total gains (losses) included in: Net income (1)	OCI	Transfers into Level 3	Transfers out of Level 3
Assets					
Fixed income securities:					
Municipal	$ 2,016	$ (34)	$ 67	$ --	$ (81)
Corporate	1,908	31	(5)	185	(271)
RMBS	1,794	(87)	108	--	(1,213)
CMBS	923	(43)	113	86	(946)
ABS	2,417	19	(47)	--	(642)
Redeemable preferred stock	1	--	--	--	--
Total fixed income securities	9,059	(114)	236	271	(3,153)
Equity securities	63	(10)	--	--	(10)
Other investments:					
Free-standing derivatives, net	(21)	(91)	--	--	--
Other assets	1	--	--	--	--
Total recurring Level 3 assets	$ 9,102	$ (215)	$ 236	$ 271	$ (3,163)
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ (653)	$ (24)	$ --	$ --	$ --
Total recurring Level 3 liabilities	$ (653)	$ (24)	$ --	$ --	$ --

	Purchases	Sales	Issues	Settlements	Balance as of September 30, 2011
Assets					
Fixed income securities:					
Municipal	$ 13	$ (525)	$ --	$ (3)	$ 1,453
Corporate	376	(437)	--	(57)	1,730
RMBS	--	(378)	--	(132)	92
CMBS	12	(66)	--	(3)	76
ABS	468	(164)	--	(250)	1,801
Redeemable preferred stock	--	--	--	--	1
Total fixed income securities	869	(1,570)	--	(445)	5,153
Equity securities	--	(1)	--	--	42
Other investments:					
Free-standing derivatives, net	72	--	--	(70)	(110)(2)
Other assets	--	--	--	--	1
Total recurring Level 3 assets	$ 941	$ (1,571)	$ --	$ (515)	$ 5,086
Liabilities					
Contractholder funds:					
Derivatives embedded in life and annuity contracts	$ --	$ --	$ (42)	$ 122	$ (597)
Total recurring Level 3 liabilities	$ --	$ --	$ (42)	$ 122	$ (597)

(1) The effect to net income totals $(239) million and is reported in the Condensed Consolidated Statements of Operations as follows: $(242) million in realized capital gains and losses, $30 million in net investment income, $(9) million in interest credited to contractholder funds and $(18) million in life and annuity contract benefits.

(2) Comprises $1 million of assets and 111 million of liabilities.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs, which generally are caused by changes in market conditions such as liquidity, trading volume or bid-ask spreads. Transfers between level categorizations may also occur due to changes in the valuation source. For example, in situations where a fair value quote is not provided by the Company s independent third-party valuation service provider and as a result the price is stale or has been replaced with a broker quote whose inputs have not been corroborated to be market observable, the security is transferred into Level 3. Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. Therefore, for all transfers into Level 3, all realized and changes in unrealized gains and losses in the quarter of transfer are reflected in the Level 3 rollforward table.

During the nine months ended September 30, 2012, certain U.S. government securities were transferred into Level 1 from Level 2 as a result of increased liquidity in the market and a sustained increase in the market activity for these assets.

During the nine months ended September 30, 2011, certain RMBS, CMBS and ABS were transferred into Level 2 from Level 3 as a result of increased liquidity in the market and a sustained increase in the market activity for these assets. When transferring these securities into Level 2, the Company did not change the source of fair value estimates or modify the estimates received from independent third-party valuation service providers or the internal valuation approach. Accordingly, for securities included within this group, there was no change in fair value in conjunction with the transfer resulting in a realized or unrealized gain or loss.

Transfers into Level 3 during the three and nine months ended September 30, 2012 and 2011 included situations where a fair value quote was not provided by the Company s independent third-party valuation service provider and as a result the price was stale or had been replaced with a broker quote where the inputs have not been corroborated to be market observable resulting in the security being classified as Level 3. Transfers out of Level 3 during the three and nine months ended September 30, 2012 and 2011 included situations where a broker quote was used in the prior period and a fair value quote became available from the Company s independent third-party valuation service provider in the current period. A quote utilizing the new pricing source was not available as of the prior period, and any gains or losses related to the change in valuation source for individual securities were not significant.

The following table provides the change in unrealized gains and losses included in net income for Level 3 assets and liabilities held as of September 30.

($ in millions)	**Three months ended September 30,**		**Nine months ended September 30,**	
	2012	**2011**	**2012**	**2011**
Assets				
Fixed income securities:				
Municipal	$ (5)	$ (7)	$ (10)	$ (17)
Corporate	5	(12)	13	3
RMBS	--	--	(1)	--
CMBS	(1)	(1)	(2)	(10)
ABS	--	(38)	--	(26)
Total fixed income securities	(1)	(58)	--	(50)
Equity securities	(3)	--	(9)	--
Other investments:				
Free-standing derivatives, net	(7)	(57)	4	(54)
Total recurring Level 3 assets	$ (11)	$ (115)	$ (5)	$ (104)
Liabilities				
Contractholder funds:				
Derivatives embedded in life and annuity contracts	$ 160	$ 2	$ 151	$ (24)
Total recurring Level 3 liabilities	$ 160	$ 2	$ 151	$ (24)

The amounts in the table above represent the change in unrealized gains and losses included in net income for the period of time that the asset or liability was determined to be in Level 3. These gains and losses total $149 million for the three months ended September 30, 2012 and are reported as follows: $(17) million in realized capital gains and losses, $6 million in net investment income, $142 million in interest credited to contractholder funds and $18 million in life and annuity contract benefits. These gains and losses total $(113) million for the three months ended September 30, 2011 and are reported as follows: $(128) million in realized capital gains and losses, $13 million in net investment income, $57 million in interest credited to contractholder funds and $(55) million in life and annuity contract benefits. These gains and losses total

$146 million for the nine months ended September 30, 2012 and are reported as follows: $(20) million in realized capital gains and losses, $16 million in net investment income, $118 million in interest credited to contractholder funds and $32 million in life and annuity contract benefits. These gains and losses total $(128) million for the nine months ended September 30, 2011 and are reported as follows: $(145) million in realized capital gains and losses, $41 million in net investment income, $(6) million in interest credited to contractholder funds and $(18) million in life and annuity contract benefits.

Presented below are the carrying values and fair value estimates of financial instruments not carried at fair value.

Financial assets

($ in millions)	September 30, 2012		December 31, 2011	
	Carrying value	Fair value	Carrying value	Fair value
Mortgage loans	$ 6,904	$ 7,240	$ 7,139	$ 7,350
Cost method limited partnerships	1,456	1,756	1,569	1,838
Bank loans	410	411	339	328

The fair value of mortgage loans is based on discounted contractual cash flows or, if the loans are impaired due to credit reasons, the fair value of collateral less costs to sell. Risk adjusted discount rates are selected using current rates at which similar loans would be made to borrowers with similar characteristics, using similar types of properties as collateral. The fair value of cost method limited partnerships is determined using reported net asset values of the underlying funds. The fair value of bank loans, which are reported in other investments, is based on broker quotes from brokers familiar with the loans and current market conditions. The fair value measurements for mortgage loans, cost method limited partnerships and bank loans are categorized as Level 3.

Financial liabilities

($ in millions)	September 30, 2012		December 31, 2011	
	Carrying value	Fair value	Carrying value	Fair value
Contractholder funds on investment contracts	$ 27,934	$ 29,029	$ 30,192	$ 30,499
Long-term debt	6,057	7,147	5,908	6,312
Liability for collateral	765	765	462	462

The fair value of contractholder funds on investment contracts is based on the terms of the underlying contracts utilizing prevailing market rates for similar contracts adjusted for the Company s own credit risk. Deferred annuities included in contractholder funds are valued using discounted cash flow models which incorporate market value margins, which are based on the cost of holding economic capital, and the Company s own credit risk. Immediate annuities without life contingencies and fixed rate funding agreements are valued at the present value of future benefits using market implied interest rates which include the Company s own credit risk. The fair value measurements for contractholder funds on investment contracts are categorized as Level 3.

The fair value of long-term debt is based on market observable data (such as the fair value of the debt when traded as an asset) or, in certain cases, is determined using discounted cash flow calculations based on current interest rates for instruments with comparable terms and considers the Company s own credit risk. The liability for collateral is valued at carrying value due to its short-term nature. The fair value measurements for long-term debt and liability for collateral are categorized as Level 2.

6. Derivative Financial Instruments

The Company uses derivatives to manage risks with certain assets and liabilities arising from the potential adverse impacts from changes in risk-free interest rates, changes in equity market valuations, increases in credit spreads and foreign currency fluctuations, and for asset replication. The Company does not use derivatives for speculative purposes.

Property-Liability uses interest rate swaps, swaptions, futures and options to manage the interest rate risks of existing investments and to reduce exposure to rising or falling interest rates. Portfolio duration management is a risk management strategy that is principally employed by Property-Liability wherein financial futures and interest rate swaps are utilized to change the duration of the portfolio in order to offset the economic effect that interest rates would otherwise have on the fair value of its fixed income securities. Equity index futures and options are used by Property-Liability to offset valuation losses in the equity portfolio during periods of declining equity market values. Credit default swaps are typically used to mitigate the credit risk within the Property-Liability fixed income portfolio. Property-Liability uses equity futures to hedge the market risk related to deferred compensation liability contracts and forward contracts to hedge foreign currency risk associated with holding foreign currency denominated investments and foreign operations.

Asset-liability management is a risk management strategy that is principally employed by Allstate Financial to balance the respective interest-rate sensitivities of its assets and liabilities. Depending upon the attributes of the assets acquired and liabilities issued, derivative instruments such as interest rate swaps, caps, floors, swaptions and futures are utilized to change the interest rate characteristics of existing assets and liabilities to ensure the relationship is maintained within specified ranges and to reduce exposure to rising or falling interest rates. Allstate Financial uses financial futures and interest rate swaps to hedge anticipated asset purchases and liability issuances and futures and options for hedging the equity exposure contained in its equity indexed life and annuity product contracts that offer equity returns to contractholders. In addition, Allstate Financial uses interest rate swaps to hedge interest rate risk inherent in funding agreements. Allstate Financial uses foreign currency swaps primarily to reduce the foreign currency risk associated with issuing foreign currency denominated funding agreements and holding foreign currency denominated investments. Credit default swaps are typically used to mitigate the credit risk within the Allstate Financial fixed income portfolio.

Asset replication refers to the synthetic creation of assets through the use of derivatives and primarily investment grade host bonds to replicate securities that are either unavailable in the cash markets or more economical to acquire in synthetic form. The Company replicates fixed income securities using a combination of a credit default swap and one or more highly rated fixed income securities to synthetically replicate the economic characteristics of one or more cash market securities.

The Company also has derivatives embedded in non-derivative host contracts that are required to be separated from the host contracts and accounted for at fair value with changes in fair value of embedded derivatives reported in net income. The Company s primary embedded derivatives are equity options in life and annuity product contracts, which provide equity returns to contractholders; equity-indexed notes containing equity call options, which provide a coupon payout that is determined using one or more equity-based indices; credit default swaps in synthetic collateralized debt obligations, which provide enhanced coupon rates as a result of selling credit protection; and conversion options in fixed income securities, which provide the Company with the right to convert the instrument into a predetermined number of shares of common stock.

When derivatives meet specific criteria, they may be designated as accounting hedges and accounted for as fair value, cash flow, foreign currency fair value or foreign currency cash flow hedges. Allstate Financial designates certain of its interest rate and foreign currency swap contracts and certain investment risk transfer reinsurance agreements as fair value hedges when the hedging instrument is highly effective in offsetting the risk of changes in the fair value of the hedged item. Allstate Financial designates certain of its foreign currency swap contracts as cash flow hedges when the hedging instrument is highly effective in offsetting the exposure of variations in cash flows for the hedged risk that could affect net income. Amounts are reclassified to net investment income or realized capital gains and losses as the hedged item affects net income.

The notional amounts specified in the contracts are used to calculate the exchange of contractual payments under the agreements and are generally not representative of the potential for gain or loss on these agreements. However, the notional amounts specified in credit default swaps where the Company has sold credit protection represent the maximum amount of potential loss, assuming no recoveries.

Fair value, which is equal to the carrying value, is the estimated amount that the Company would receive or pay to terminate the derivative contracts at the reporting date. The carrying value amounts for OTC derivatives are further adjusted for the effects, if any, of legally enforceable master netting agreements and are presented on a net basis, by counterparty agreement, in the Condensed Consolidated Statements of Financial Position. For certain exchange traded derivatives, the exchange requires margin deposits as well as daily cash settlements of margin accounts. As of September 30, 2012, the Company pledged $9 million of cash and securities in the form of margin deposits.

For those derivatives which qualify for fair value hedge accounting, net income includes the changes in the fair value of both the derivative instrument and the hedged risk, and therefore reflects any hedging ineffectiveness. For cash flow hedges, gains and losses are amortized from accumulated other comprehensive income and are reported in net income in the same period the forecasted transactions being hedged impact net income. For embedded derivatives in fixed income securities, net income includes the change in fair value of the embedded derivative and accretion income related to the host instrument.

Non-hedge accounting is generally used for portfolio level hedging strategies where the terms of the individual hedged items do not meet the strict homogeneity requirements to permit the application of hedge accounting. For non-hedge derivatives, net income includes changes in fair value and accrued periodic settlements, when applicable. With the exception of non-hedge derivatives used for asset replication and non-hedge embedded derivatives, all of the Company s derivatives are evaluated for their ongoing effectiveness as either accounting hedge or non-hedge derivative financial instruments on at least a quarterly basis.

The following table provides a summary of the volume and fair value positions of derivative instruments as well as their reporting location in the Condensed Consolidated Statement of Financial Position as of September 30, 2012.

($ in millions, except number of contracts)		**Asset derivatives**				
		Volume (1)				
	Balance sheet location	**Notional amount**	**Number of contracts**	**Fair value, net**	**Gross asset**	**Gross liability**
Derivatives designated as accounting hedging instruments						
Foreign currency swap agreements	Other investments	$ 101	n/a	$ (6)	$ 2	$ (8)
Total		101	n/a	(6)	2	(8)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other investments	7,941	n/a	56	74	(18)
Interest rate swaption agreements	Other investments	250	n/a	--	--	--
Interest rate cap and floor agreements	Other investments	673	n/a	2	2	--
Financial futures contracts and options	Other assets	--	2	--	--	--
Equity and index contracts						
Options, futures and warrants (2)	Other investments	147	14,600	226	226	--
Options, futures and warrants	Other assets	--	1,667	1	1	--
Foreign currency contracts						
Foreign currency forwards and options	Other investments	206	n/a	4	5	(1)
Embedded derivative financial instruments						
Conversion options	Fixed income securities	5	n/a	1	1	--
Equity-indexed call options	Fixed income securities	90	n/a	10	10	--
Credit default swaps	Fixed income securities	12	n/a	(12)	--	(12)
Other embedded derivative financial instruments	Other investments	1,000	n/a	--	--	--
Credit default contracts						
Credit default swaps - buying protection	Other investments	470	n/a	2	6	(4)
Credit default swaps - selling protection	Other investments	275	n/a	2	2	--
Other contracts						
Other contracts	Other assets	4	n/a	1	1	--
Total		11,073	16,269	293	328	(35)
Total asset derivatives		$ 11,174	16,269	$ 287	$ 330	$ (43)

(1) Volume for OTC derivative contracts is represented by their notional amounts. Volume for exchange traded derivatives is represented by the number of contracts, which is the basis on which they are traded. (n/a = not applicable)

(2) In addition to the number of contracts presented in the table, the Company held 7,307 stock rights and 3,915,485 stock warrants. Stock rights and warrants can be converted to cash upon sale of those instruments or exercised for shares of common stock.

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		Liability derivatives				
		Volume (1)				
	Balance sheet location	**Notional amount**	**Number of contracts**	**Fair value, net**	**Gross asset**	**Gross liability**
Derivatives designated as accounting hedging instruments						
Foreign currency swap agreements	Other liabilities & accrued expenses	$ 50	n/a	$ (9)	$ --	$ (9)
Total		50	n/a	(9)	--	(9)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other liabilities & accrued expenses	85	n/a	9	9	--
Interest rate cap and floor agreements	Other liabilities & accrued expenses	359	n/a	--	--	--
Financial futures contracts and options	Other liabilities & accrued expenses	--	496	--	--	--
Equity and index contracts						
Options and futures	Other liabilities & accrued expenses	--	13,919	(106)	--	(106)
Foreign currency contracts						
Foreign currency forwards and options	Other liabilities & accrued expenses	222	n/a	6	6	--
Embedded derivative financial instruments						
Guaranteed accumulation benefits	Contractholder funds	853	n/a	(85)	--	(85)
Guaranteed withdrawal benefits	Contractholder funds	573	n/a	(44)	--	(44)
Equity-indexed and forward starting options in life and annuity product contracts	Contractholder funds	3,835	n/a	(413)	--	(413)
Other embedded derivative financial instruments	Contractholder funds	85	n/a	(9)	--	(9)
Credit default contracts						
Credit default swaps buying protection	Other liabilities & accrued expenses	314	n/a	(1)	2	(3)
Credit default swaps selling protection	Other liabilities & accrued expenses	338	n/a	(33)	1	(34)
Total		6,664	14,415	(676)	18	(694)
Total liability derivatives		6,714	14,415	(685)	$ 18	$ (703)
Total derivatives		$ 17,888	30,684	$ (398)		

(1) Volume for OTC derivative contracts is represented by their notional amounts. Volume for exchange traded derivatives is represented by the number of contracts, which is the basis on which they are traded. (n/a = not applicable)

The following table provides a summary of the volume and fair value positions of derivative instruments as well as their reporting location in the Condensed Consolidated Statement of Financial Position as of December 31, 2011.

($ in millions, except number of contracts)		**Asset derivatives**				
		Volume (1)				
	Balance sheet location	**Notional amount**	**Number of contracts**	**Fair value, net**	**Gross asset**	**Gross liability**
Derivatives designated as accounting hedging instruments						
Interest rate swap agreements	Other investments	$ 144	n/a	$ (8)	$ --	$ (8)
Foreign currency swap agreements	Other investments	127	n/a	(5)	3	(8)
Total		271	n/a	(13)	3	(16)
Derivatives not designated as accounting hedging instruments						
Interest rate contracts						
Interest rate swap agreements	Other investments	8,028	n/a	122	137	(15)
Interest rate swaption agreements	Other investments	1,750	n/a	--	--	--
Interest rate cap and floor agreements	Other investments	1,591	n/a	(12)	--	(12)
Financial futures contracts and options	Other assets	n/a	40	--	--	--
Equity and index contracts						
Options, futures and warrants (2)	Other investments	163	15,180			