CIGNA CORP
Form 10-Q
October 30, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2014

OR

o 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 1-08323

Cigna Corporation

(Exact name of registrant as specified in its charter)

Delaware	**06-1059331**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
900 Cottage Grove Road Bloomfield, Connecticut	**06002**

(Address of principal executive offices)	*(Zip Code)*

(860) 226-6000

Registrant s telephone number, including area code

(860) 226-6741

Registrant s facsimile number, including area code

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark		**YES**		**NO**
• 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.		R		o
• 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).		R		o
• whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.				
Large accelerated filer R	Accelerated filer o	Non-accelerated filer o	Smaller Reporting Company o	
• whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).		o		R

As of October 15, 2014, 261,578,645 shares of the issuer s common stock were outstanding.

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Cigna Corporation

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As used herein, Cigna or the Company refers to one or more of Cigna Corporation and its consolidated subsidiaries.

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Part I. *FINANCIAL INFORMATION*

Item 1. *FINANCIAL STATEMENTS*

Cigna Corporation

Consolidated Statements of Income

(In millions, except per share amounts)	Unaudited Three Months Ended September 30, 2014	2013	Unaudited Nine Months Ended September 30, 2014	2013
Revenues				
Premiums and fees	$ 7,793	$ 7,206	$ 23,167	$ 21,692
Net investment income	292	297	863	873
Mail order pharmacy revenues	583	471	1,625	1,333
Other revenues	66	65	201	139
Realized investment gains (losses):				
Other-than-temporary impairments on fixed maturities	(9)	(3)	(10)	(11)
Other realized investment gains, net	32	30	140	203
Total realized investment gains, net	23	27	130	192
Total revenues	**8,757**	8,066	**25,986**	24,229
Benefits and Expenses				
Global Health Care medical claims expense	4,153	3,913	12,403	11,864
Other benefit expenses	1,207	1,031	3,473	3,890
Mail order pharmacy costs	499	390	1,382	1,096
Other operating expenses	2,080	1,933	6,156	5,739
Total benefits and expenses	**7,939**	7,267	**23,414**	22,589
Income before Income Taxes	818	799	2,572	1,640

Income taxes (benefits):								
Current		289		205		928		285
Deferred		(2)		41		12		237
Total income taxes		**287**		246		**940**		522
Net Income		531		553		1,632		1,118
Less: Net Income (Loss) Attributable to Noncontrolling Interests		(3)		-		(3)		3
Shareholders Net Income	**$**	**534**	**$**	553	$	**1,635**	$	1,115
Shareholders Net Income Per Share:								
Basic	$	2.04	$	1.99	$	6.16	$	3.96
Diluted	$	2.01	$	1.95	$	6.05	$	3.89
Dividends Declared Per Share	$	-	$	-	$	0.04	$	0.04

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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Cigna Corporation

Consolidated Statements of Comprehensive Income

	Unaudited Three Months Ended September 30,		Unaudited Nine Months Ended September 30,	
(In millions)	**2014**	**2013**	**2014**	**2013**
Shareholders net income	$ 534	$ 553	$ 1,635	$ 1,115
Shareholders other comprehensive income (loss):				
Net unrealized appreciation (depreciation) on securities:				
Fixed maturities	(49)	(7)	141	(348)
Equity securities	-	(7)	(1)	(5)
Net unrealized appreciation (depreciation), on securities	(49)	(14)	140	(353)
Net unrealized appreciation (depreciation), derivatives	6	(2)	6	7
Net translation of foreign currencies	(113)	59	(78)	(15)
Postretirement benefits liability adjustment	10	12	33	73
Shareholders other comprehensive income (loss)	(146)	55	101	(288)
Shareholders comprehensive income	388	608	1,736	827
Comprehensive income attributable to noncontrolling interests:				
Net income (loss) attributable to redeemable noncontrolling interests	(2)	-	3	3
Net (loss) attributable to other noncontrolling interest	(1)	-	(6)	-
Other comprehensive (loss) attributable to redeemable noncontrolling interests	(6)	(6)	(6)	(15)
Other comprehensive income attributable to other noncontrolling interest	-	-	1	-
Total comprehensive income	**$ 379**	$ 602	**$ 1,728**	$ 815

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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Cigna Corporation

Consolidated Balance Sheets

(In millions, except per share amounts)	**Unaudited As of September 30, 2014**		**As of December 31, 2013**	
Assets				
Investments:				
Fixed maturities, at fair value (amortized cost, $17,171; $15,273)		$ 18,797		$ 16,486
Equity securities, at fair value (cost, $196; $146)		190		141
Commercial mortgage loans		2,058		2,252
Policy loans		1,436		1,485
Real estate		62		97
Other long-term investments		1,365		1,273
Short-term investments		153		631
Total investments		24,061		22,365
Cash and cash equivalents		1,621		2,795
Accrued investment income		272		247
Premiums, accounts and notes receivable, net		2,574		1,991
Reinsurance recoverables		7,086		7,299
Deferred policy acquisition costs		1,501		1,395
Property and equipment		1,494		1,464
Deferred tax assets, net		19		92
Goodwill		6,003		6,029
Other assets, including other intangibles		2,440		2,407
Separate account assets		8,582		8,252
Total assets		**$ 55,653**		**$ 54,336**
Liabilities				
Contractholder deposit funds		$ 8,438		$ 8,470
Future policy benefits		9,573		9,306
Unpaid claims and claim expenses		4,400		4,298
Global Health Care medical claims payable		2,230		2,050
Unearned premiums and fees		602		580
Total insurance and contractholder liabilities		25,243		24,704
Accounts payable, accrued expenses and other liabilities		5,415		5,456
Short-term debt		121		233
Long-term debt		5,024		5,014
Separate account liabilities		8,582		8,252
Total liabilities		**44,385**		**43,659**
Contingencies Note 16				
Redeemable noncontrolling interests		93		96
Shareholders Equity				
Common stock (par value per share, $0.25; shares issued, 366; authorized, 600)		92		92
Additional paid-in capital		3,409		3,356
Net unrealized appreciation, fixed maturities	$ 614		$ 473	
Net unrealized appreciation, equity securities	3		4	
Net unrealized depreciation, derivatives	(13)		(19)	
Net translation of foreign currencies	4		82	
Postretirement benefits liability adjustment	(1,027)		(1,060)	
Accumulated other comprehensive loss		(419)		(520)
Retained earnings		15,196		13,676

Less treasury stock, at cost	(7,121)	(6,037)
Total shareholders equity	11,157	10,567
Noncontrolling interest	18	14
Total equity	11,175	10,581
Total liabilities and equity	$ 55,653	$ 54,336
Shareholders Equity Per Share	**$ 42.45**	**$ 38.35**

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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Cigna Corporation

Consolidated Statements of Changes in Total Equity

Unaudited **For the three months ended September 30, 2014** *(In millions)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders Equity**	**Non-controlling Interest**	**Total Equity**	**Redeemable Non-controlling Interests**
Balance at July 1, 2014	$ 92	$ 3,405	$ (273)	$ 14,677	$ (6,964)	$ 10,937	$ 15	$ 10,952	$ 99
Effect of issuing stock for employee benefit plans		8		(15)	42	35		35	
Other comprehensive (loss)			(146)			(146)		(146)	(6)
Net income (loss)				534		534	(1)	533	(2)
Repurchase of common stock					(199)	(199)		(199)	
Capital contribution by noncontrolling interest		(4)				(4)	4	-	2
Balance at September 30, 2014	**$ 92**	**$ 3,409**	**$ (419)**	**$ 15,196**	**$ (7,121)**	**$ 11,157**	**$ 18**	**$ 11,175**	**$ 93**

For the three months ended September 30, 2013 *(In millions)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders Equity**	**Non-controlling Interest**	**Total Equity**	**Redeemable Non-controlling Interest**
Balance at July 1, 2013	$ 92	$ 3,326	$ (1,014)	$ 12,806	$ (5,435)	$ 9,775	$ -	$ 9,775	$ 101
Effect of issuing stock for employee benefit plans		18		(32)	64	50		50	
Other comprehensive income (loss)			55			55		55	(6)
Net income				553		553		553	-
Repurchase of common stock					(559)	(559)		(559)	
Balance at September 30, 2013	$ 92	$ 3,344	$ (959)	$ 13,327	$ (5,930)	$ 9,874	$ -	$ 9,874	$ 95

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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Cigna Corporation

Consolidated Statements of Changes in Total Equity

Unaudited **For the nine months ended September 30, 2014** *(In millions)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders Equity**	**Non-controlling Interest**	**Total Equity**	**Redeemable Non-controlling Interests**
Balance at January 1, 2014	$ 92	$ 3,356	$ (520)	$ 13,676	$ (6,037)	$ 10,567	$ 14	$ 10,581	$ 96
Effect of issuing stock for employee benefit plans		57		(104)	172	125		125	
Other comprehensive income (loss)			101			101	1	102	(6)
Net income (loss)				1,635		1,635	(6)	1,629	3
Common dividends declared (per share: $0.04)				(11)		(11)		(11)	
Repurchase of common stock					(1,256)	(1,256)		(1,256)	
Capital contribution by noncontrolling interest		(4)				(4)	9	5	4
Distribution to redeemable noncontrolling interest									(4)
Balance at September 30, 2014	**$ 92**	**$ 3,409**	**$ (419)**	**$ 15,196**	**$ (7,121)**	**$ 11,157**	**$ 18**	**$ 11,175**	**$ 93**

For the nine months ended September 30, 2013 *(In millions)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders Equity**	**Non-controlling Interest**	**Total Equity**	**Redeemable Non-controlling Interest**
Balance at January 1, 2013	$ 92	$ 3,295	$ (671)	$ 12,330	$ (5,277)	$ 9,769	$ -	$ 9,769	$ 114
Effect of issuing stock for employee benefit plans		49		(107)	210	152		152	
Other comprehensive loss			(288)			(288)		(288)	(15)
Net income				1,115		1,115		1,115	3
Common dividends declared (per share: $0.04)				(11)		(11)		(11)	
Repurchase of common stock					(863)	(863)		(863)	
Distribution to redeemable noncontrolling interest									(7)
Balance at September 30, 2013	$ 92	$ 3,344	$ (959)	$ 13,327	$ (5,930)	$ 9,874	$ -	$ 9,874	$ 95

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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Consolidated Statements of Cash Flows

	Unaudited Nine Months Ended September 30,	
(In millions)	**2014**	**2013**
Cash Flows from Operating Activities		
Net income	$ 1,632	$ 1,118
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	435	445
Realized investment gains	(130)	(192)
Deferred income taxes	12	237
Gains on sale of businesses	(11)	(11)
Net changes in assets and liabilities, net of non-operating effects:		
Premiums, accounts and notes receivable	(574)	(64)
Reinsurance recoverables	49	348
Deferred policy acquisition costs	(138)	(183)
Other assets	(186)	368
Insurance liabilities	433	870
Accounts payable, accrued expenses and other liabilities	(39)	(524)
Current income taxes	53	(33)
Cash used to effectively exit run-off reinsurance business	-	(2,196)
Other, net	(64)	(76)
Net cash provided by operating activities	**1,472**	107
Cash Flows from Investing Activities		
Proceeds from investments sold:		
Fixed maturities	818	1,671
Equity securities	36	3
Investment maturities and repayments:		
Fixed maturities	1,285	1,192
Equity securities	-	27
Commercial mortgage loans	375	468
Other sales, maturities and repayments (primarily short-term and other long-term investments)	1,889	766
Investments purchased or originated:		
Fixed maturities	(3,953)	(1,580)
Equity securities	(74)	(56)
Commercial mortgage loans	(186)	(26)
Other (primarily short-term and other long-term investments)	(1,221)	(1,227)
Property and equipment purchases	(350)	(414)
Other, net	(24)	(84)
Net cash (used in) / provided by investing activities	**(1,405)**	740
Cash Flows from Financing Activities		
Deposits and interest credited to contractholder deposit funds	1,154	1,078
Withdrawals and benefit payments from contractholder deposit funds	(1,129)	(1,029)
Change in cash overdraft position	20	9
Net change in short-term debt	(104)	(100)
Repayment of long-term debt	-	(7)
Repurchase of common stock	(1,256)	(836)
Issuance of common stock	93	132
Common dividends paid	(11)	(11)
Other, net	9	(7)
Net cash used in financing activities	**(1,224)**	(771)
Effect of foreign currency rate changes on cash and cash equivalents	(17)	1

Net (decrease) / increase in cash and cash equivalents		(1,174)		77
Cash and cash equivalents, January 1,		2,795		2,978
Cash and cash equivalents, September 30,	**$**	**1,621**	$	3,055
Supplemental Disclosure of Cash Information:				
Income taxes paid, net of refunds	$	846	$	289
Interest paid	$	203	$	203

The accompanying Notes to the Consolidated Financial Statements (unaudited) are an integral part of these statements.

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CIGNA CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

Cigna Corporation and its subsidiaries (either individually or collectively referred to as Cigna , the Company , we , or our) is a global health services organization with a mission to help its customers improve their health, well-being and sense of security. Its insurance subsidiaries are major providers of medical, dental, disability, life and accident insurance and related products and services, the majority of which are offered through employers and other groups (e.g. governmental and non-governmental organizations, unions and associations). Cigna also offers Medicare and Medicaid products and health, life and accident insurance coverages primarily to individuals in the U.S. and selected international markets. In addition to its ongoing operations described above, Cigna also has certain run-off operations.

The Consolidated Financial Statements include the accounts of Cigna Corporation and its subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation. These Consolidated Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). Amounts recorded in the Consolidated Financial Statements necessarily reflect management s estimates and assumptions about medical costs, investment valuation, interest rates and other factors. Significant estimates are discussed throughout these Notes; however, actual results could differ from those estimates. The impact of a change in estimate is generally included in earnings in the period of adjustment. Certain reclassifications have been made to prior year amounts to conform to the current presentation.

These interim Consolidated Financial Statements are unaudited but include all adjustments (including normal recurring adjustments) necessary, in the opinion of management, for a fair statement of financial position and results of operations for the periods reported. The interim Consolidated Financial Statements and notes should be read in conjunction with the Consolidated Financial Statements and Notes included in the Company s 2013 Form 10-K. The preparation of interim Consolidated Financial Statements necessarily relies heavily on estimates. This and certain other factors, including the seasonal nature of portions of the health care and related benefits business as well as competitive and other market conditions, call for caution in estimating full year results based on interim results of operations.

Beginning in the first quarter of 2014, the Company combined the results of its run-off reinsurance business with Other Operations for segment reporting purposes. Prior year information has been conformed to the current year presentation. See Note 15 for additional information.

Note 2 Recent Accounting Changes

Accounting for Health Care Reform s Risk Mitigation Programs. Beginning in 2014, as prescribed by the Patient Protection and Affordable Care Act (referred to as Health Care Reform), three programs went into effect to reduce the risk for participating health insurance companies selling coverage on the public exchanges.

- *A three-year (2014-2016) reinsurance program* is designed to provide reimbursement to insurers for high cost individual business sold on or off the public exchanges. The reinsurance entity established by the U.S. Department of Health and Human Services (HHS) is funded by a per-customer reinsurance fee assessed on all commercial medical plans, including self-insured group health plans. Only non-grandfathered individual plans are eligible for recoveries if claims exceed a specified threshold, up to a reinsurance cap. Reinsurance contributions associated with non-grandfathered individual plans are reported as a reduction in premium revenue, and estimated reinsurance recoveries are established with an offsetting reduction in Global Health Care medical claims expense. Reinsurance fee contributions for other insured business are reported in other operating expenses.

- *A permanent risk adjustment program* reallocates funds from insurers with lower risk populations to insurers with higher risk populations based on the relative risk scores of participants in non-grandfathered plans in the individual and small group markets, both on and off the exchanges. Based on the risk of our members compared to the risk of other members in the same state and market, considering data obtained from industry studies, we estimate our year-to-date risk adjustment. The Company records a risk adjustment receivable or payable, with an offsetting adjustment to premium revenue when the amounts are reasonably estimable and collection is reasonably assured.

- *A three year (2014-2016) risk corridor program* is designed to limit insurer gains and losses by comparing allowable medical costs to a target amount as defined by HHS. This program applies to individual and small group qualified health plans, operating on and off the exchanges. Variances from the target amount exceeding certain thresholds may result in amounts due to or due from HHS. The Company records a risk corridor receivable or payable as an adjustment to premium revenue based on our year-to-date experience when the amounts are reasonably estimable and collection is reasonably assured.

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Revenue from Contracts with Customers (Accounting Standards Update (ASU) 2014-09). In May 2014, the Financial Accounting Standards Board (FASB) issued new revenue recognition guidance that will apply to various contracts with customers to provide goods or services, including the Company s non-insurance, administrative services contracts. It will not apply to certain contracts within the scope of other GAAP, such as insurance contracts. This new guidance introduces a model that requires companies to estimate and allocate the expected contract revenue among distinct goods or services in the contract based on relative standalone selling prices. Revenue is recognized as goods or services are delivered. This new method replaces the current GAAP approach of recognizing revenue that is fixed and determinable primarily based on contract terms. In addition, extensive new disclosures will be required including the presentation of additional categories of revenues and information about related contract assets and liabilities. This new guidance must be implemented on January 1, 2017; early adoption is not permitted. The Company may choose to adopt these changes through retrospective restatement with or without using certain practical expedients or with a cumulative effect adjustment on adoption. The Company continues to monitor developing implementation guidance and evaluate these new requirements for its noninsurance customer contracts to determine the method of implementation and any resulting estimated effects on the financial statements.

Fees Paid to the Federal Government by Health Insurers (ASU 2011-06). Effective January 1, 2014, the Company adopted the FASB s accounting guidance for the health insurance industry assessment (the tax) mandated by Health Care Reform. This non-deductible tax is being levied based on a ratio of an insurer s net health insurance premiums written for the previous calendar year compared to the U.S. health insurance industry total. As required by the guidance, the Company reported a liability as of June 30, 2014 of $245 million in accounts payable, accrued expenses and other liabilities based on a preliminary assessment of the full year 2014 tax. A corresponding deferred cost was reported in other assets, including other intangibles. In September 2014, the Company paid $243 million for its 2014 tax and adjusted the corresponding deferred cost. Through September 30, 2014, $182 million of the deferred cost was recognized in other operating expenses; the remainder will be recorded in the fourth quarter of 2014.

Investment Company Accounting (ASU 2013-08). Effective January 1, 2014, the Company adopted the FASB s amended accounting guidance to change the criteria for reporting as an investment company, clarify the fair value measurement used by an investment company and require additional disclosures. This guidance also confirms that parent company accounting for an investment company should reflect fair value accounting. While this guidance applies to certain of the Company s security and real estate partnership investments, its adoption did not have a material impact on the Company s financial statements.

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI) (ASU 2013-02). Effective January 1, 2013, the Company adopted new requirements to disclose the effect of items reclassified out of AOCI into net income for each individual line item impacted in the statement of income. See Note 13 for the Company s disclosures.

Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). The FASB s new requirements to disclose information related to certain investments on both a gross and net basis became effective January 1, 2013. The Company had no transactions or arrangements subject to these new disclosure requirements.

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Note 3 Earnings Per Share (EPS)

Basic and diluted earnings per share were computed as follows:

(Dollars in millions, except per share amounts)	**Basic**	**Effect of Dilution**	**Diluted**
Three Months Ended September 30,			
2014			
Shareholders net income	$ 534		$ 534
Shares *(in thousands)*:			
Weighted average	261,402		261,402
Common stock equivalents		4,489	4,489
Total shares	261,402	4,489	265,891
EPS	**$ 2.04**	**$ (0.03)**	**$ 2.01**
2013			
Shareholders net income	$ 553		$ 553
Shares *(in thousands)*:			
Weighted average	278,054		278,054
Common stock equivalents		5,509	5,509
Total shares	278,054	5,509	283,563
EPS	$ 1.99	$ (0.04)	$ 1.95

(Dollars in millions, except per share amounts)	**Basic**	**Effect of Dilution**	**Diluted**
Nine Months Ended September 30,			
2014			
Shareholders net income	$ 1,635		$ 1,635
Shares *(in thousands)*:			
Weighted average	265,554		265,554
Common stock equivalents		4,507	4,507
Total shares	265,554	4,507	270,061
EPS	**$ 6.16**	**$ (0.11)**	**$ 6.05**
2013			
Shareholders net income	$ 1,115		$ 1,115
Shares *(in thousands)*:			
Weighted average	281,279		281,279
Common stock equivalents		5,336	5,336
Total shares	281,279	5,336	286,615
EPS	$ 3.96	$ (0.07)	$ 3.89

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The following outstanding employee stock options were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2014 and 2013 because their effect was anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	**2014**	**2013**	**2014**	**2013**
Anti-dilutive options	**-**	-	**1.3**	1.2

The Company held 103,340,125 shares of common stock in Treasury as of September 30, 2014, and 89,059,772 shares as of September 30, 2013.

Note 4 Global Health Care Medical Claims Payable

Medical claims payable for the Global Health Care segment reflects estimates of the ultimate cost of claims that have been incurred but not yet reported, those that have been reported but not yet paid (reported claims in process), and other medical expenses payable that is primarily comprised of accruals for incentives and other amounts payable to health care professionals and facilities, as follows:

(In millions)	**September 30, 2014**	**December 31, 2013**
Incurred but not yet reported	$ 1,872	$ 1,615
Reported claims in process	252	355
Physician incentives and other medical expense payable	106	80
Medical claims payable	**$ 2,230**	$ 2,050

Activity in medical claims payable was as follows:

	For the period ended	
(In millions)	**September 30, 2014**	**December 31, 2013**
Balance at January 1,	$ 2,050	$ 1,856
Less: Reinsurance and other amounts recoverable	194	242
Balance at January 1, net	1,856	1,614
Incurred claims related to:		
Current year	12,558	16,049
Prior years	(155)	(182)
Total incurred	12,403	15,867
Paid claims related to:		
Current year	10,670	14,267
Prior years	1,605	1,358
Total paid	12,275	15,625
Ending Balance, net	1,984	1,856

Add: Reinsurance and other amounts recoverable		246		194
Ending Balance	**$**	**2,230**	$	2,050

Reinsurance and other amounts recoverable includes amounts due from reinsurers and policyholders to cover incurred but not reported and pending claims for minimum premium products and certain administrative services only business where the right of offset does not exist. See Note 5 for additional information on reinsurance. For the nine months ended September 30, 2014, actual experience differed from the Company s key assumptions resulting in favorable incurred claims related to prior years medical claims payable of $155 million, or 1.0% of the current year incurred claims as reported for the year ended December 31, 2013. Actual completion factors accounted for $60 million, or 0.4% of the favorability, while actual medical cost trend resulted in the remaining $95 million, or 0.6%.

For the year ended December 31, 2013, actual experience differed from the Company s key assumptions, resulting in favorable incurred claims related to prior years medical claims payable of $182 million, or 1.3% of the current year incurred claims as reported

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for the year ended December 31, 2012. Actual completion factors accounted for $74 million, or 0.5% of favorability, while actual medical cost trend resulted in the remaining $108 million, or 0.7%.

The impact of prior year development on shareholders net income was $53 million for the nine months ended September 30, 2014 compared with $77 million for the nine months ended September 30, 2013. The favorable effect of prior year development for both years primarily reflects low utilization of medical services. The change in the amount of the incurred claims related to prior years in the medical claims payable liability does not directly correspond to an increase or decrease in the Company s shareholders net income recognized for the following reasons:

First, the Company consistently recognizes the actuarial best estimate of the ultimate liability within a level of confidence, as required by actuarial standards of practice that require the liabilities be adequate under moderately adverse conditions. As the Company establishes the liability for each incurral year, the Company ensures that its assumptions appropriately consider moderately adverse conditions. When a portion of the development relates to a release of the prior year s provision for moderately adverse conditions, the Company does not consider that amount as impacting shareholders net income to the extent that it is offset by an increase determined appropriate to address moderately adverse conditions for the current year incurred claims.

Second, as a result of the medical loss ratio (MLR) provisions of Health Care Reform, changes in medical claim estimates due to prior year development may be offset by a change in the MLR rebate accrual.

Third, changes in reserves for the Company s retrospectively experience-rated business for accounts in surplus do not usually impact shareholders net income because such amounts are generally offset by a change in the liability to the policyholder. An account is in surplus when the accumulated premium received exceeds the accumulated medical costs and administrative charges, including profit charges. For additional information regarding the Company s retrospectively experience-rated business, see page 3 of the Company s 2013 Form 10-K.

The determination of liabilities for the Global Health Care medical claims payable requires the Company to make critical accounting estimates. See Note 2(N) to the Consolidated Financial Statements in the Company s 2013 Form 10-K.

Note 5 Reinsurance

The Company s insurance subsidiaries enter into agreements with other insurance companies to assume and cede reinsurance. Reinsurance is ceded primarily to limit losses from large exposures and to permit recovery of a portion of direct or assumed losses. Reinsurance is also used in acquisition and disposition transactions when the underwriting company is not being acquired. Reinsurance does not relieve the originating insurer of liability. The Company regularly evaluates the financial condition of its reinsurers and monitors its concentrations of credit risk.

Effective Exit of GMDB and GMIB Business

On February 4, 2013, the Company entered into an agreement with Berkshire Hathaway Life Insurance Company of Nebraska (Berkshire) to effectively exit the guaranteed minimum death benefit (GMDB) and guaranteed minimum income benefit (GMIB) business via a reinsurance transaction. Berkshire reinsured 100% of the Company s future claim payments in these businesses, net of retrocessional arrangements existing at that time. The reinsurance agreement is subject to an overall limit of approximately $3.8 billion.

This transaction resulted in an after-tax charge to shareholders net income in the first quarter of 2013 of $507 million ($781 million pre-tax reported as follows: $727 million in other benefits expense; $45 million in GMIB fair value loss; and $9 million in other operating expenses). The payment to Berkshire under the agreement was $2.2 billion and was funded from the sale of investment assets, tax benefits related to the transaction and available parent cash.

Because this effective exit was accomplished via a reinsurance contract, the amounts related to the reinsured GMDB and GMIB contracts cannot be netted, so the gross assets and liabilities must continue to be measured and reported. The following disclosures provide further context to the methods and assumptions used to determine these assets and liabilities.

GMDB

The Company estimates this liability with an internal model based on the Company s experience and future expectations over an extended period, consistent with the long-term nature of this product. Because the product is premium deficient, the Company records increases to the reserve if it is inadequate based on the model. Prior to the reinsurance transaction with Berkshire, any such reserve

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increases were recorded as a charge to shareholders net income. Reserve increases after the reinsurance transaction are expected to have a corresponding increase in the recorded reinsurance recoverable, provided the increased recoverable remains within the overall Berkshire limit (including the GMIB assets).

The Company s dynamic hedge programs were discontinued at the time of the Berkshire reinsurance transaction in 2013. These hedge programs generated losses (included in other revenues) of $32 million for the nine months ended September 30, 2013.

Activity in the future policy benefit reserve for the GMDB business was as follows:

	For the period ended	
(In millions)	**September 30, 2014**	**December 31, 2013**
Balance at January 1	$ 1,396	$ 1,090
Add: Unpaid claims	18	24
Less: Reinsurance and other amounts recoverable	1,317	42
Balance at January 1, net	97	1,072
Add: Incurred benefits	2	699
Less: Paid benefits (including the $1,647 payment in 2013 for the Berkshire reinsurance transaction)	-	1,674
Ending balance, net	99	97
Less: Unpaid claims	17	18
Add: Reinsurance and other amounts recoverable	1,225	1,317
Ending balance	**$ 1,307**	$ 1,396

Benefits paid and incurred are net of ceded amounts. The ending net retained reserve is to cover ongoing administrative expenses, as well as claims retained by the Company.

The death benefit coverage in force for GMDB contracts assumed by the Company was $2.9 billion as of September 30, 2014 and $3.0 billion as of December 31, 2013 assuming no reinsurance. The death benefit coverage in force is the amount the Company would have to pay if all contract holders (approximately 363,000 as of September 30, 2014 and 390,000 as of December 31, 2013) died as of the specified date. Unless the Berkshire reinsurance limit is exceeded, the Company would be reimbursed in full for these payments. The aggregate value of the underlying mutual fund investments for these GMDB contracts was $13.1 billion as of September 30, 2014 and $14.1 billion as of December 31, 2013.

GMIB

As discussed further in Note 7, because GMIB contracts are without significant life insurance risk, they are not accounted for as insurance products. Instead, the Company reports GMIB liabilities and assets as derivatives at fair value. The GMIB assets are classified in other assets, including other intangibles, and the GMIB liabilities are classified in accounts payable, accrued expenses and other liabilities in the Consolidated Balance Sheet. Disclosures related to fair value are included in Note 7 and derivatives are further described in Note 9.

GMIB assets included $409 million as of September 30, 2014 and $352 million as of December 31, 2013 from Berkshire, and were 100% secured by assets in a trust. GMIB assets also included $471 million as of September 30, 2014 and $399 million as of December 31, 2013 from two other retrocessionaires, and 38% were secured by assets in a trust.

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Effects of Reinsurance

In the Company s Consolidated Statements of Income, Premiums and fees were net of ceded premiums, and Total benefits and expenses were net of reinsurance recoveries, in the following amounts:

(In millions)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Ceded premiums and fees				
Individual life insurance and annuity business sold	$ 38	$ 39	$ 127	$ 130
Other	80	90	260	273
Total	$ 118	$ 129	$ 387	$ 403
Reinsurance recoveries				
Individual life insurance and annuity business sold	$ 46	$ 74	$ 214	$ 256
Other	122	125	292	(69)
Total	**$ 168**	$ 199	**$ 506**	$ 187

As noted in the GMDB section above, recoveries for the nine months ended September 30, 2013 are net of a decrease in reinsurance recoverables from a change in the growth rate assumption, due to discontinuing the hedge programs at the time of the reinsurance transaction with Berkshire.

Reinsurance Recoverables

Components of the Company s reinsurance recoverables are presented below:

(In millions)

Line of Business	Reinsurer(s)	September 30, 2014	December 31, 2013	Collateral and Other Terms at September 30, 2014
GMDB	Berkshire	$ 1,185	$ 1,276	100% secured by assets in a trust.
	Other	40	41	98% secured by assets in a trust or letter of credit.
Individual Life and Annuity (sold)	Lincoln National Life and Lincoln Life &Annuity of New York	3,825	3,905	Both companies ratings are sufficient to avoid triggering a contractual obligation to fully secure the outstanding balance.
Retirement Benefits Business (sold)	Prudential Retirement Insurance and Annuity	1,115	1,200	100% secured by assets in a trust.

Supplemental Benefits business	Great American Life	342	363	100% secured by assets in a trust.
Global Health Care, Global Supplemental Benefits, Group Disability and Life	Various	485	407	Recoverables from more than 80 reinsurers used in the ordinary course of business. Balances range from less than $1 million up to $110 million, with 10% secured by assets in trusts or letters of credit.
Other run-off reinsurance	Various	94	107	90% of this balance is secured by assets in a trust.
Total reinsurance recoverables		$ **7,086**	$ **7,299**	

Reserves for underlying reinsurance exposures assumed by the Company, as well as those for amounts recoverable from reinsurers and retrocessionaires for both ongoing operations and the run-off reinsurance operation, are considered appropriate as of September 30, 2014 based on current information. The Company bears the risk of loss if its reinsurers and retrocessionaires do not meet or are unable to meet their reinsurance obligations to the Company.

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Note 6 Organizational Efficiency Plans

The Company is regularly evaluating ways to deliver its products and services more efficiently and at a lower cost. During 2013 and 2012, the Company adopted specific plans to increase its organizational efficiency as follows.

2013 Plan. During the fourth quarter of 2013, the Company committed to a plan to increase its organizational efficiency and reduce costs through a series of actions that includes employee headcount reductions. As a result, the Company recognized charges in other operating expenses of $60 million pre-tax ($40 million after-tax) in the fourth quarter of 2013, primarily for severance costs. The Company expects most of the severance to be paid by the end of 2015.

2012 Plan. During the third quarter of 2012, in connection with the execution of its strategy, the Company committed to a series of actions to further improve its organizational alignment, operational effectiveness, and efficiency. As a result, the Company recognized charges in other operating expenses of $77 million pre-tax ($50 million after-tax) in the third quarter of 2012 consisting primarily of severance costs. The costs associated with this plan were substantially paid as of March 31, 2014.

Summarized below is activity for these plans for 2013 and the nine months ended September 30, 2014.

(In millions)	**Severance**	**Real estate**	**Total**
Balance, January 1, 2013	$ 67	$ 4	$ 71
Fourth quarter 2013 charge	47	13	60
Less: 2013 Payments	46	4	50
Balance, December 31, 2013	68	13	81
Less: First quarter 2014 payments	11	1	12
Less: Second quarter 2014 payments	7	1	8
Less: Third quarter 2014 payments	14	1	15
Balance, September 30, 2014	$ 36	$ 10	$ 46

Note 7 Fair Value Measurements

The Company carries certain financial instruments at fair value in the financial statements including fixed maturities, equity securities, short-term investments and derivatives. Other financial instruments are measured at fair value under certain conditions, such as when impaired.

Fair value is defined as the price at which an asset could be exchanged in an orderly transaction between market participants at the balance sheet date. A liability s fair value is defined as the amount that would be paid to transfer the liability to a market participant, not the amount that would be paid to settle the liability with the creditor.

The Company s financial assets and liabilities carried at fair value have been classified based upon a hierarchy defined by GAAP. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset s or a liability s classification is based on the lowest level of input that is significant to its measurement. For example, a financial asset or liability carried at fair value would be classified in Level 3 if unobservable inputs were significant to the instrument s fair value, even though the measurement may be derived using inputs that are both observable (Levels 1 and 2) and unobservable (Level 3).

The Company estimates fair values using prices from third parties or internal pricing methods. Fair value estimates received from third-party pricing services are based on reported trade activity and quoted market prices when available, and other market information that a market participant may use to estimate fair value. The internal pricing methods are performed by the Company s investment professionals and generally involve using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality, as well as other qualitative factors. In instances where there is little or no market activity for the same or similar instruments, fair value is estimated using methods, models and assumptions that the Company believes a hypothetical market participant would use to determine a current transaction price. These valuation techniques involve some level of estimation and judgment that becomes significant with increasingly complex instruments or pricing models.

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The Company is responsible for determining fair value, as well as the appropriate level within the fair value hierarchy, based on the significance of unobservable inputs. The Company reviews methodologies, processes and controls of third-party pricing services and compares prices on a test basis to those obtained from other external pricing sources or internal estimates. The Company performs ongoing analyses of both prices received from third-party pricing services and those developed internally to determine that they represent appropriate estimates of fair value. The controls completed by the Company and third-party pricing services include reviewing to ensure that prices do not become stale and whether changes from prior valuations are reasonable or require additional review. The Company also performs sample testing of sales values to confirm the accuracy of prior fair value estimates. Exceptions identified during these processes indicate that adjustments to prices are infrequent and do not significantly impact valuations.

Financial Assets and Financial Liabilities Carried at Fair Value

The following tables provide information as of September 30, 2014 and December 31, 2013 about the Company s financial assets and liabilities carried at fair value. Separate account assets that are also recorded at fair value on the Company s Consolidated Balance Sheets are reported separately under the heading Separate account assets as gains and losses related to these assets generally accrue directly to policyholders.

September 30, 2014 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Financial assets at fair value:				
Fixed maturities:				
Federal government and agency	$ 585	$ 657	$ -	$ 1,242
State and local government	-	1,948	-	1,948
Foreign government	-	1,853	4	1,857
Corporate	-	12,520	429	12,949
Federal agency mortgage-backed	-	12	-	12
Other mortgage-backed	-	73	1	74
Other asset-backed	-	208	507	715
Total fixed maturities (1)	585	17,271	941	18,797
Equity securities	61	86	43	190
Subtotal	646	17,357	984	18,987
Short-term investments	-	153	-	153
GMIB assets (2)	-	-	880	880
Other derivative assets (3)	-	2	-	2
Total financial assets at fair value, excluding separate accounts	**$ 646**	**$ 17,512**	**$ 1,864**	**$ 20,022**
Financial liabilities at fair value:				
GMIB liabilities	$ -	$ -	$ 857	$ 857
Other derivative liabilities (3)	-	8	-	8
Total financial liabilities at fair value	**$ -**	**$ 8**	**$ 857**	**$ 865**

(1) Fixed maturities included $684 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including $70 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represent retrocessional contracts in place from three external reinsurers that cover the exposures on these contracts. See Note 5 for additional information.

(3) Other derivative assets and other derivative liabilities reflected foreign currency and interest rate swaps qualifying as cash flow hedges. See Note 9 for additional information.

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December 31, 2013 *(In millions)*		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Total**
Financial assets at fair value:								
Fixed maturities:								
Federal government and agency	$	297	$	583	$	-	$	880
State and local government		-		2,144		-		2,144
Foreign government		-		1,421		23		1,444
Corporate		-		10,476		505		10,981
Federal agency mortgage-backed		-		76		-		76
Other mortgage-backed		-		76		1		77
Other asset-backed		-		282		602		884
Total fixed maturities (1)		297		15,058		1,131		16,486
Equity securities		8		74		59		141
Subtotal		305		15,132		1,190		16,627
Short-term investments		-		631		-		631
GMIB assets (2)		-		-		751		751
Other derivative assets (3)		-		3		-		3
Total financial assets at fair value, excluding separate accounts	$	305	$	15,766	$	1,941	$	18,012
Financial liabilities at fair value:								
GMIB liabilities	$	-	$	-	$	741	$	741
Other derivative liabilities (3)		-		16		-		16
Total financial liabilities at fair value	$	-	$	16	$	741	$	757

(1) Fixed maturities included $458 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including $60 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represented retrocessional contracts in place from three external reinsurers that cover the exposures on these contracts. See Note 5 for additional information.

(3) Other derivative assets reflected interest rate and foreign currency swaps qualifying as cash flow hedges. Other derivative liabilities included $15 million of interest rate and foreign currency swaps qualifying as cash flow hedges and $1 million of interest rate and foreign currency swaps not designated as accounting hedges. See Note 9 for additional information.

Level 1 Financial Assets

Inputs for instruments classified in Level 1 include unadjusted quoted prices for identical assets in active markets accessible at the measurement date. Active markets provide pricing data for trades occurring at least weekly and include exchanges and dealer markets.

Assets in Level 1 include actively-traded U.S. government bonds and exchange-listed equity securities. Given the narrow definition of Level 1 and the Company s investment asset strategy to maximize investment returns, a relatively small portion of the Company s investment assets are classified in this category.

Level 2 Financial Assets and Financial Liabilities

Inputs for instruments classified in Level 2 include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are market observable or can be corroborated by market data for the term of the instrument. Such other inputs include market interest rates and volatilities, spreads and yield curves. An instrument is classified in Level 2 if the Company determines that unobservable inputs are insignificant.

Fixed maturities and equity securities. Approximately 92% of the Company s investments in fixed maturities and equity securities are classified in Level 2 including most public and private corporate debt and equity securities, federal agency and municipal bonds, non-government mortgage-backed securities and preferred stocks. Because many fixed maturities do not trade daily, third-party pricing services and internal methods often use recent trades of securities with similar features and characteristics. When recent trades are not available, pricing models are used to determine these prices. These models calculate fair values by discounting future cash flows at estimated market interest rates. Such market rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities, based on the credit quality, industry and structure of the asset. Typical inputs and assumptions to pricing models include, but are not limited to, a combination of benchmark yields, reported trades, issuer spreads, liquidity, benchmark securities, bids, offers, reference data, and industry and economic events. For mortgage-backed securities, inputs and assumptions may also

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include characteristics of the issuer, collateral attributes, prepayment speeds and credit rating.

Nearly all of these instruments are valued using recent trades or pricing models. Less than 1% of the fair value of investments classified in Level 2 represent foreign bonds that are valued using a single unadjusted market-observable input derived by averaging multiple broker-dealer quotes, consistent with local market practice.

Short-term investments are carried at fair value which approximates cost. On a regular basis, the Company compares market prices for these securities to recorded amounts to validate that current carrying amounts approximate exit prices. The short-term nature of the investments and corroboration of the reported amounts over the holding period support their classification in Level 2.

Other derivatives classified in Level 2 represent over-the-counter instruments such as interest rate and foreign currency swap contracts. Fair values for these instruments are determined using market observable inputs including forward currency and interest rate curves and widely published market observable indices. Credit risk related to the counterparty and the Company is considered when estimating the fair values of these derivatives. However, the Company is largely protected by collateral arrangements with counterparties, and determined that no adjustment for credit risk was required as of September 30, 2014 or December 31, 2013. Level 2 also includes exchange-traded interest rate swap contracts. Credit risk related to the clearinghouse counterparty and the Company is considered minimal when estimating the fair values of these derivatives because of upfront margin deposits and daily settlement requirements. The nature and use of these other derivatives are described in Note 9.

Level 3 Financial Assets and Financial Liabilities

Certain inputs for instruments classified in Level 3 are unobservable (supported by little or no market activity) and significant to their resulting fair value measurement. Unobservable inputs reflect the Company s best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

The Company classifies certain newly issued, privately-placed, complex or illiquid securities, as well as assets and liabilities relating to GMIB, in Level 3.

Fixed maturities and equity securities. Approximately 5% of fixed maturities and equity securities are priced using significant unobservable inputs and classified in this category, including:

(In millions)	September 30, 2014	December 31, 2013
Other asset and mortgage-backed securities - valued using pricing models	$ 508	$ 603
Corporate and government fixed maturities - valued using pricing models	369	417
Corporate fixed maturities - valued at transaction price	64	111
Equity securities - valued at transaction price	43	59

Total	**$**	**984**	$	1,190

Fair values of other asset and mortgage-backed securities, corporate and government fixed maturities are primarily determined using pricing models that incorporate the specific characteristics of each asset and related assumptions including the investment type and structure, credit quality, industry and maturity date in comparison to current market indices, spreads and liquidity of assets with similar characteristics. For other asset and mortgage-backed securities, inputs and assumptions for pricing may also include collateral attributes and prepayment speeds. Recent trades in the subject security or similar securities are assessed when available, and the Company may also review published research, as well as the issuer s financial statements, in its evaluation. Approximately 6% of fixed maturities classified in Level 3 represent single, unadjusted, non-binding broker quotes that are not considered market observable. Certain private equity investments and subordinated corporate fixed maturities, representing approximately 11% of securities included in Level 3, are valued at transaction price in the absence of market data indicating a change in the estimated fair values.

Quantitative Information about Unobservable Inputs

The following tables summarize the fair value and significant unobservable inputs used in pricing Level 3 securities that were developed directly by the Company as of September 30, 2014 and December 31, 2013. The range and weighted average basis point amounts reflect the Company s best estimates of the unobservable adjustments a market participant would make to the market observable spreads (adjustment to discount rates) used to calculate the fair values in a discounted cash flow analysis.

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Other asset and mortgage-backed securities. The significant unobservable inputs used to value the following other asset and mortgage-backed securities are liquidity and weighting of credit spreads. When there is limited trading activity for the security, an adjustment for liquidity is made as of the measurement date that considers current market conditions, issuer circumstances and complexity of the security structure. An adjustment to weight credit spreads is needed to value a more complex bond structure with multiple underlying collateral and no standard market valuation technique. The weighting of credit spreads is primarily based on the underlying collateral s characteristics and their proportional cash flows supporting the bond obligations. The resulting wide range of unobservable adjustments in the table below is due to the varying liquidity and quality of the underlying collateral, ranging from high credit quality to below investment grade.

Corporate and government fixed maturities. The significant unobservable input used to value the following corporate and government fixed maturities is an adjustment for liquidity. When there is limited trading activity for the security, an adjustment is needed to reflect current market conditions and issuer circumstances.

As of September 30, 2014 *(In millions except basis points)*		**Fair Value**	**Unobservable Input**	**Unobservable Adjustment to Discount Rates Range (Weighted Average) *in Basis Points***
Other asset and mortgage-backed securities	$	501	Liquidity	40-350 (140)
			Weighting of credit spreads	140-2,540 (250)
Corporate and government fixed maturities	$	316	Liquidity	80-340 (170)

As of December 31, 2013 *(In millions except basis points)*		**Fair Value**	**Unobservable Input**	**Unobservable Adjustment to Discount Rates Range (Weighted Average) *in Basis Points***
Other asset and mortgage-backed securities	$	593	Liquidity	60 - 620 (170)
			Weighting of credit spreads	120 - 2,090 (290)
Corporate and government fixed maturities	$	305	Liquidity	80 - 370 (200)

Significant increases in any of these inputs would result in a lower fair value measurement while decreases in these inputs would result in a higher fair value measurement. Generally, the unobservable inputs are not interrelated and a change in the assumption used for one unobservable input is not accompanied by a change in the other unobservable input. The tables do not include Level 3 securities when fair value and significant unobservable inputs were not developed directly by the Company, including securities using single, unadjusted non-binding broker quotes and securities valued at transaction price. See the preceding discussion regarding the Company s valuation processes and controls.

Guaranteed minimum income benefit contracts. As discussed in Note 5, the Company effectively exited from this business in 2013. Although these GMIB assets and liabilities must continue to be reported as derivatives at fair value, the only assumption that is expected to impact future shareholders net income is the risk of non-performance. This assumption reflects a market participant s view of (a) the risk of the Company not fulfilling its GMIB obligations (GMIB liabilities) and (b) the credit risk that the reinsurers do not pay their obligations (GMIB assets).

The Company reports GMIB liabilities and assets as derivatives at fair value because cash flows of these liabilities and assets are affected by equity markets and interest rates, but are without significant life insurance risk and are settled in lump sum payments. Under the terms of these written and purchased contracts, the Company periodically receives and pays fees based on either contractholders account values or deposits increased at a contractual rate. The Company will also pay and receive cash depending on changes in account values and interest rates when contractholders first elect to receive minimum income payments. The Company estimates the fair value of the assets and liabilities for GMIB contracts by calculating the results for many scenarios run through a model utilizing various assumptions that include non-performance risk, among other things.

The non-performance risk adjustment is incorporated by adding an additional spread to the discount rate in the calculation of both (a) the GMIB liabilities to reflect a market participant s view of the risk of the Company not fulfilling its GMIB obligations, and (b) the GMIB assets to reflect a market participant s view of the credit risk of the reinsurers, after considering collateral. Non-performance risk adjustments had an immaterial effect on shareholders net income for the three months and nine months ended September 30, 2014 and 2013.

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Other assumptions that affect GMIB assets and liabilities include capital market assumptions (including market returns, interest rates and market volatilities of the underlying equity and bond mutual fund investments) and future annuitant behavior (including mortality, lapse, and annuity election rates). As certain assumptions used to estimate fair values for these contracts are largely unobservable (primarily related to future annuitant behavior), the Company classifies GMIB assets and liabilities in Level 3.

The Company regularly evaluates each of the assumptions used in establishing these assets and liabilities. Significant decreases in assumed lapse rates or spreads used to calculate non-performance risk, or increases in assumed annuity election rates, would result in higher fair value measurements. A change in one of these assumptions is not necessarily accompanied by a change in another assumption.

GMIB liabilities are reported in the Company s Consolidated Balance Sheets in accounts payable, accrued expenses and other liabilities. GMIB assets associated with these contracts represent net receivables in connection with reinsurance that the Company has purchased from three external reinsurers and are reported in the Company s Consolidated Balance Sheets in other assets, including other intangibles.

Changes in Level 3 Financial Assets and Financial Liabilities Carried at Fair Value

The following tables summarize the changes in financial assets and financial liabilities classified in Level 3 for the three months and nine months ended September 30, 2014 and 2013. Separate account asset changes are reported separately under the heading Separate account assets as the changes in fair values of these assets accrue directly to the policyholders. Gains and losses reported in these tables may include net changes in fair value that are attributable to both observable and unobservable inputs.

For the Three Months Ended September 30, 2014 *(In millions)*	**Fixed Maturities & Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at July 1, 2014	$ 1,122	$ 863	$ (839)	$ 24
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	33	(33)	-
Other	-	-	2	2
Total gains (losses) included in shareholders net income	-	33	(31)	2
Losses included in other comprehensive income	(3)	-	-	-
Losses required to adjust future policy benefits for settlement annuities (1)	(3)	-	-	-
Purchases, sales and settlements:				
Purchases	6	-	-	-
Sales	(2)	-	-	-
Settlements	(43)	(16)	13	(3)
Total purchases, sales and settlements	(39)	(16)	13	(3)
Transfers into/(out of) Level 3:				
Transfers into Level 3	10	-	-	-
Transfers out of Level 3	(103)	-	-	-
Total transfers into/(out of) Level 3	(93)	-	-	-
Balance at September 30, 2014	**$ 984**	**$ 880**	**$ (857)**	**$ 23**
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	**$ 1**	**$ 33**	**$ (31)**	**$ 2**

(1) Amounts do not accrue to shareholders.

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For the Three Months Ended September 30, 2013

(In millions)	Fixed Maturities & Equity Securities	GMIB Assets	GMIB Liabilities	GMIB Net
Balance at July 1, 2013	$ 1,209	$ 945	$ (922)	$ 23
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	(81)	81	-
Other	3	10	(16)	(6)
Total gains (losses) included in shareholders net income	3	(71)	65	(6)
Losses included in other comprehensive income	(1)	-	-	-
Losses required to adjust future policy benefits for settlement annuities (1)	(8)	-	-	-
Purchases, sales and settlements:				
Purchases	64	-	-	-
Sales	(18)	-	-	-
Settlements	(35)	(21)	16	(5)
Total purchases, sales and settlements	11	(21)	16	(5)
Transfers into/(out of) Level 3:				
Transfers into Level 3	32	-	-	-
Transfers out of Level 3	(20)	-	-	-
Total transfers into/(out of) Level 3	12	-	-	-
Balance at September 30, 2013	$ 1,226	$ 853	$ (841)	$ 12
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	$ 2	$ (71)	$ 65	$ (6)

(1) Amounts do not accrue to shareholders.

For the Nine Months Ended September 30, 2014

(In millions)	Fixed Maturities & Equity Securities	GMIB Assets	GMIB Liabilities	GMIB Net
Balance at January 1, 2014	$ 1,190	$ 751	$ (741)	$ 10
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	163	(163)	-
Other	14	2	12	14
Total gains (losses) included in shareholders net income	14	165	(151)	14
Gains included in other comprehensive income	14	-	-	-
Gains required to adjust future policy benefits for settlement annuities **(1)**	39	-	-	-
Purchases, sales and settlements:				
Purchases	83	-	-	-
Sales	(117)	-	-	-
Settlements	(150)	(36)	35	(1)
Total purchases, sales and settlements	(184)	(36)	35	(1)
Transfers into/(out of) Level 3:				
Transfers into Level 3	164	-	-	-
Transfers out of Level 3	(253)	-	-	-
Total transfers into/(out of) Level 3	(89)	-	-	-
Balance at September 30, 2014	**$ 984**	**$ 880**	**$ (857)**	**$ 23**
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	**$ 3**	**$ 165**	**$ (151)**	**$ 14**

(1) Amounts do not accrue to shareholders.

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For the Nine Months Ended September 30, 2013	**Fixed Maturities &**			
(In millions)	**Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at January 1, 2013	$ 1,351	$ 622	$ (1,170)	$ (548)
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	(286)	286	-
Other	13	12	(16)	(4)
Total gains (losses) included in shareholders net income	13	(274)	270	(4)
Losses included in other comprehensive income	(18)	-	-	-
Losses required to adjust future policy benefits for settlement annuities (1)	(46)	-	-	-
Purchases, sales and settlements:				
Purchases	104	-	-	-
Sales	(48)	-	-	-
Settlements	(96)	505	59	564
Total purchases, sales and settlements	(40)	505	59	564
Transfers into/(out of) Level 3:				
Transfers into Level 3	101	-	-	-
Transfers out of Level 3	(135)	-	-	-
Total transfers into/(out of) Level 3	(34)	-	-	-
Balance at September 30, 2013	$ 1,226	$ 853	$ (841)	$ 12
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	$ 6	$ (274)	$ 270	$ (4)

(1) Amounts do not accrue to shareholders.

As noted in the tables above, total gains and losses included in shareholders net income are reflected in the following captions in the Consolidated Statements of Income:

- Realized investment gains (losses) and net investment income for amounts related to fixed maturities and equity securities and realized investment gains (losses) for the impact of changes in non-performance risk related to GMIB assets and liabilities beginning February 4, 2013, similar to hedge ineffectiveness; and
- GMIB fair value (gain) loss for amounts related to GMIB assets and liabilities, except for the impact of changes in non-performance risk subsequent to February 4, 2013.

In the tables above, gains and losses included in other comprehensive income are reflected in net unrealized appreciation (depreciation) on securities in the Consolidated Statements of Comprehensive Income.

Reclassifications impacting Level 3 financial instruments are reported as transfers into or out of the Level 3 category as of the beginning of the quarter in which the transfer occurs. Therefore gains and losses in income only reflect activity for the period the instrument was classified in Level 3.

Transfers into or out of the Level 3 category occur when unobservable inputs, such as the Company s best estimate of what a market participant would use to determine a current transaction price, become more or less significant to the fair value measurement. For the three months and nine months ended September 30, 2014 and September 30, 2013, transfers between Level 2 and Level 3 primarily reflect the change in significance of the unobservable inputs used to value certain public and private corporate bonds, principally related to liquidity of the securities and credit risk of the issuers.

Because GMIB reinsurance arrangements remain in effect at the reporting date, the Company has reflected the total gain or loss for the period as the total gain or loss included in income attributable to instruments still held at the reporting date. However, the Company reduces the GMIB assets and liabilities resulting from these reinsurance arrangements when annuitants lapse, die, elect their benefit, or reach the age after which the right to elect their benefit expires.

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Separate account assets

Fair values and changes in the fair values of separate account assets generally accrue directly to the policyholders and are excluded from the Company s revenues and expenses. As of September 30, 2014 and December 31, 2013 separate account assets were as follows:

September 30, 2014 *(In millions)*		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Total**
Guaranteed separate accounts (See Note 16)	$	248	$	279	$	-	$	527
Non-guaranteed separate accounts (1)		1,849		5,132		1,074		8,055
Total separate account assets	**$**	**2,097**	**$**	**5,411**	**$**	**1,074**	**$**	**8,582**

(1) As of September 30, 2014, non-guaranteed separate accounts included $4.0 billion in assets supporting the Company s pension plans, including $1,024 million classified in Level 3.

December 31, 2013 *(In millions)*		**Quoted Prices in Active Markets for Identical Assets (Level 1)**		**Significant Other Observable Inputs (Level 2)**		**Significant Unobservable Inputs (Level 3)**		**Total**
Guaranteed separate accounts (See Note 16)	$	264	$	284	$	-	$	548
Non-guaranteed separate accounts (1)		1,844		4,825		1,035		7,704
Total separate account assets	$	2,108	$	5,109	$	1,035	$	8,252

(1) As of December 31, 2013, non-guaranteed separate accounts included $3.8 billion in assets supporting the Company s pension plans, including $983 million classified in Level 3.

Separate account assets in Level 1 primarily include exchange-listed equity securities. Level 2 assets primarily include:

- corporate and structured bonds valued using recent trades of similar securities or pricing models that discount future cash flows at estimated market interest rates as described above; and

- actively-traded institutional and retail mutual fund investments and separate accounts priced using the daily net asset value which is the exit price.

Separate account assets classified in Level 3 include investments primarily in securities partnerships, real estate and hedge funds generally valued based on the separate account s ownership share of the equity of the investee including changes in the fair values of its underlying investments.

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The following tables summarize the changes in separate account assets reported in Level 3 for the three and nine months ended September 30, 2014 and 2013.

(In millions)	Three Months Ended September 30, 2014	2013
Balance at July 1,	$ 1,074	$ 1,049
Policyholder gains (1)	9	17
Purchases, sales and settlements:		
Purchases	24	18
Sales	-	(2)
Settlements	(29)	(69)
Total purchases, sales and settlements	(5)	(53)
Transfers into/(out of) Level 3:		
Transfers into Level 3	1	5
Transfers out of Level 3	(5)	(3)
Total transfers into/(out of) Level 3	(4)	2
Balance at September 30,	**$ 1,074**	**$ 1,015**

(1) Included in this amount are gains of $9 million attributable to instruments still held at September 30, 2014 and gains of $17 million attributable to instruments still held at September 30, 2013.

(In millions)	Nine Months Ended September 30, 2014	2013
Balance at January 1	$ 1,035	$ 1,005
Policyholder gains (1)	64	46
Purchases, sales and settlements:		
Purchases	148	106
Sales	(2)	(2)
Settlements	(173)	(138)
Total purchases, sales and settlements	(27)	(34)
Transfers into/(out of) Level 3:		
Transfers into Level 3	14	5
Transfers out of Level 3	(12)	(7)
Total transfers into/(out of) Level 3	2	(2)
Balance at September 30,	**$ 1,074**	**$ 1,015**

(1) Included in this amount are gains of $64 million attributable to instruments still held at September 30, 2014 and gains of $46 million attributable to instruments still held at September 30, 2013.

Assets and Liabilities Measured at Fair Value under Certain Conditions

Some financial assets and liabilities are not carried at fair value each reporting period, but may be measured using fair value only under certain conditions, such as investments in real estate entities and commercial mortgage loans when they become impaired. Impaired real estate entities and commercial mortgage loans representing less than 1% of total investments were written down to their fair values, resulting in realized investment losses of $10 million, after-tax for the nine months ended September 30, 2014 and $5 million, after-tax for the nine months ended September 30, 2013.

Fair Value Disclosures for Financial Instruments Not Carried at Fair Value

The following table includes the Company s financial instruments not recorded at fair value that are subject to fair value disclosure requirements at September 30, 2014 and December 31, 2013. Financial instruments that are carried in the Company s Consolidated Financial Statements at amounts that approximate fair value are excluded from the following table.

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(In millions)	Classification in the Fair Value Hierarchy	September 30, 2014 Fair Value	Carrying Value	December 31, 2013 Fair Value	Carrying Value
Commercial mortgage loans	Level 3	$ 2,148	$ 2,058	$ 2,338	$ 2,252
Contractholder deposit funds, excluding universal life products	Level 3	$ 1,132	$ 1,119	$ 1,081	$ 1,072
Long-term debt, including current maturities, excluding capital leases	Level 2	$ 5,648	$ 4,981	$ 5,550	$ 4,997

The fair values presented in the table above have been estimated using market information when available. The following valuation methodologies and inputs are used by the Company to determine fair value.

Commercial mortgage loans. The Company estimates the fair value of commercial mortgage loans generally by discounting the contractual cash flows at estimated market interest rates that reflect the Company s assessment of the credit quality of the loans. Market interest rates are derived by calculating the appropriate spread over comparable U.S. Treasury rates, based on the property type, quality rating and average life of the loan. The quality ratings reflect the relative risk of the loan, considering debt service coverage, the loan-to-value ratio and other factors. Fair values of impaired mortgage loans are based on the estimated fair value of the underlying collateral generally determined using an internal discounted cash flow model. The fair value measurements were classified in Level 3 because the cash flow models incorporate significant unobservable inputs.

Contractholder deposit funds, excluding universal life products. Generally, these funds do not have stated maturities. Approximately 60% of these balances can be withdrawn by the customer at any time without prior notice or penalty. The fair value for these contracts is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. Most of the remaining contractholder deposit funds are reinsured by the buyers of the individual life and annuity and retirement benefits businesses. The fair value for these contracts is determined using the fair value of these buyers assets supporting these reinsured contracts. The Company had reinsurance recoverables equal to the carrying values of these reinsured contracts. These instruments were classified in Level 3 because certain inputs are unobservable (supported by little or no market activity) and significant to their resulting fair value measurement.

Long-term debt, including current maturities, excluding capital leases. The fair value of long-term debt is based on quoted market prices for recent trades. When quoted market prices are not available, fair value is estimated using a discounted cash flow analysis and the Company s estimated current borrowing rate for debt of similar terms and remaining maturities. These measurements were classified in Level 2 because the fair values are based on quoted market prices or other inputs that are market observable or can be corroborated by market data.

Fair values of off-balance-sheet financial instruments were not material as of September 30, 2014 and December 31, 2013.

Note 8 Investments

Total Realized Investment Gains and Losses

The following total realized gains and losses on investments exclude amounts required to adjust future policy benefits for the run-off settlement annuity business:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(In millions)	2014	2013	2014	2013
Fixed maturities	$ 2	$ 16	$ 14	$ 105
Equity securities	(3)	-	14	4
Commercial mortgage loans	(2)	-	(6)	(4)
Real estate	-	-	13	-
Other investments, including derivatives	26	11	95	87
Realized investment gains before income taxes	23	27	130	192
Less income taxes	8	10	45	65
Net realized investment gains	**$ 15**	**$ 17**	**$ 85**	**$ 127**

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Included in the above realized investment gains (losses) before income taxes were asset write-downs as follows:

(In millions)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Credit-related (1)	$ (1)	$ -	$ (16)	$ (8)
Other	(9)	(3)	(10)	(11)
Total	**$ (10)**	**$ (3)**	**$ (26)**	**$ (19)**

(1) Credit-related losses include other-than-temporary declines in fair value of equity securities and increases in valuation reserves on commercial mortgage loans and asset write-downs related to investments in real estate entities.

Fixed Maturities and Equity Securities

The amortized cost and fair value by contractual maturity periods for fixed maturities were as follows at September 30, 2014:

(In millions)	Amortized Cost	Fair Value
Due in one year or less	$ 1,181	$ 1,201
Due after one year through five years	5,483	5,887
Due after five years through ten years	6,669	7,020
Due after ten years	3,134	3,888
Mortgage and other asset-backed securities	704	801
Total	**$ 17,171**	**$ 18,797**

Actual maturities of these securities could differ from their contractual maturities used in the table above. This could occur because issuers may have the right to call or prepay obligations, with or without penalties, or because in certain cases the Company may have the option to unilaterally extend the contractual maturity date.

Gross unrealized appreciation (depreciation) on fixed maturities by type of issuer is shown below.

(In millions)	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
	September 30, 2014			
Federal government and agency	$ 911	$ 331	$ -	$ 1,242
State and local government	1,768	182	(2)	1,948
Foreign government	1,759	106	(8)	1,857
Corporate	12,029	945	(25)	12,949
Federal agency mortgage-backed	12	-	-	12
Other mortgage-backed	72	3	(1)	74

Other asset-backed		620		95		-		715
Total	**$**	**17,171**	**$**	**1,662**	**$**	**(36)**	**$**	**18,797**

(In millions)				**December 31, 2013**				
Federal government and agency	$	640	$	242	$	(2)	$	880
State and local government		1,983		167		(6)		2,144
Foreign government		1,392		64		(12)		1,444
Corporate		10,306		749		(74)		10,981
Federal agency mortgage-backed		77		-		(1)		76
Other mortgage-backed		76		3		(2)		77
Other asset-backed		799		87		(2)		884
Total	**$**	**15,273**	**$**	**1,312**	**$**	**(99)**	**$**	**16,486**

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The above table includes investments with a fair value of $3.1 billion supporting the Company s run-off settlement annuity business, with gross unrealized appreciation of $687 million and gross unrealized depreciation of $3 million at September 30, 2014. Such unrealized amounts are required to support the future policy benefit liabilities of this business and, as such, are not included in accumulated other comprehensive income. At December 31, 2013, investments supporting this business had a fair value of $2.6 billion, gross unrealized appreciation of $478 million and gross unrealized depreciation of $20 million.

Included in equity securities are hybrid investments consisting of preferred stock with call features. These securities are carried at fair value with changes in fair value reported in other realized investment gains (losses) and dividends reported in net investment income. As of September 30, 2014, fair values of these securities were $58 million and amortized cost was $68 million. As of December 31, 2013, fair values of these securities were $56 million and amortized cost was $68 million.

Sales information for available-for-sale fixed maturities and equity securities was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	**2014**	**2013**	**2014**	**2013**
Proceeds from sales	$ 344	$ 402	$ 854	$ 1,674
Gross gains on sales	$ 13	$ 10	$ 38	$ 93
Gross losses on sales	$ 4	$ 1	$ 5	$ 4

Review of declines in fair value. Management reviews fixed maturities with a decline in fair value from cost for impairment based on criteria that include:

- length of time and severity of decline;
- financial health and specific near term prospects of the issuer;
- changes in the regulatory, economic or general market environment of the issuer s industry or geographic region; and
- the Company s intent to sell or the likelihood of a required sale prior to recovery.

As of September 30, 2014, fixed maturities with a decline in fair value from amortized cost (primarily corporate securities) were, by length of time of decline, as follows:

	September 30, 2014			
(Dollars in millions)	Fair Value	Amortized Cost	Unrealized Depreciation	Number of Issues
Fixed maturities:				
One year or less:				
Investment grade	$ 1,307	$ 1,321	$ (14)	276
Below investment grade	$ 319	$ 325	$ (6)	301
More than one year:				
Investment grade	$ 285	$ 296	$ (11)	123
Below investment grade	$ 63	$ 68	$ (5)	21

The unrealized depreciation of investment grade fixed maturities is due primarily to increases in market yields since purchase. Excluding hybrid investments, there were no equity securities with a fair value significantly lower than cost as of September 30, 2014.

Commercial Mortgage Loans

Mortgage loans held by the Company are made exclusively to commercial borrowers and are diversified by property type, location and borrower. Loans are generally issued at a fixed rate of interest and are secured by high quality, primarily completed and substantially leased operating properties.

Credit quality. The Company regularly evaluates and monitors credit risk, beginning with the initial underwriting of a mortgage loan and continuing throughout the investment holding period. Mortgage origination professionals employ an internal credit quality rating system designed to evaluate the relative risk of the transaction at each loan s origination that is then updated each year as part of the annual portfolio loan review. The Company evaluates and monitors credit quality on an ongoing basis, classifying each loan as a loan

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in good standing, potential problem loan or problem loan.

Quality ratings are based on our evaluation of a number of key inputs related to the loan, including real estate market-related factors such as rental rates and vacancies, and property-specific inputs such as growth rate assumptions and lease rollover statistics. However, the two most significant contributors to the credit quality rating are the debt service coverage and loan-to-value ratios. The debt service coverage ratio measures the amount of property cash flow available to meet annual interest and principal payments on debt, with a ratio below 1.0 indicating that there is not enough cash flow to cover the required loan payments. The loan-to-value ratio, commonly expressed as a percentage, compares the amount of the loan to the fair value of the underlying property collateralizing the loan.

The following tables summarize the credit risk profile of the Company s commercial mortgage loan portfolio based on loan-to-value and debt service coverage ratios, as of September 30, 2014 and December 31, 2013:

	September 30, 2014					
	Debt Service Coverage Ratio					
(In millions)						
Loan-to-Value Ratios	**1.30x or Greater**	**1.20x to 1.29x**	**1.10x to 1.19x**	**1.00x to 1.09x**	**Less than 1.00x**	**Total**
Below 50%	$ 364	$ -	$ -	$ 6	$ -	$ 370
50% to 59%	686	55	-	-	-	741
60% to 69%	340	-	15	-	61	416
70% to 79%	68	36	33	-	80	217
80% to 89%	7	41	-	-	58	106
90% to 100%	-	-	54	-	154	208
Total	**$ 1,465**	**$ 132**	**$ 102**	**$ 6**	**$ 353**	**$ 2,058**

	December 31, 2013					
	Debt Service Coverage Ratio					
(In millions)						
Loan-to-Value Ratios	**1.30x or Greater**	**1.20x to 1.29x**	**1.10x to 1.19x**	**1.00x to 1.09x**	**Less than 1.00x**	**Total**
Below 50%	$ 314	$ -	$ -	$ 6	$ -	$ 320
50% to 59%	581	131	-	18	-	730
60% to 69%	438	16	29	-	24	507
70% to 79%	79	113	-	-	-	192
80% to 89%	65	42	34	28	143	312
90% to 100%	-	-	58	50	83	191
Total	**$ 1,477**	**$ 302**	**$ 121**	**$ 102**	**$ 250**	**$ 2,252**

The Company s annual in-depth review of its commercial mortgage loan investments is the primary mechanism for identifying emerging risks in the portfolio. The most recent review was completed by the Company s investment professionals in the second quarter of 2014 and included an analysis of each underlying property s most recent annual financial statements, rent rolls, operating plans, budgets, a physical inspection of the property and other pertinent factors. Based on historical results, current leases, lease expirations and rental conditions in each market, the Company estimates the current year and future stabilized property income and fair value, and categorizes the investments as loans in good standing, potential problem loans or problem loans. Based on property valuations and cash flows estimated as part of this review, and considering updates for loans where material changes were subsequently identified, the portfolio s average loan-to-value ratio improved slightly to 62% at September 30, 2014 from 64% at December 31, 2013. The portfolio s average debt service coverage ratio was estimated to be 1.66 at September 30, 2014, a modest improvement from 1.62 at December 31, 2013.

The Company will reevaluate a loan s credit quality between annual reviews if new property information is received or an event such as delinquency or a borrower s request for restructure causes management to believe that the Company s estimate of financial performance, fair value or the risk profile of the underlying property has been impacted.

During 2013, the Company restructured its subordinate interest in two cross-collateralized pools of industrial loans totaling $31 million by extending the maturity dates and reducing the interest rates. This modification was considered a troubled debt restructuring and the loans were classified as problem mortgage loans because the borrower was experiencing financial difficulties and an interest rate concession was granted. No valuation reserves were required because the fair values of the underlying properties exceeded the

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carrying values of the outstanding loans.

Certain other loans were modified during the nine months ended September 30, 2014 and the twelve months ended December 31, 2013. However, these were not considered troubled debt restructures and the impact of such modifications was not material to the Company s results of operations, financial condition or liquidity.

Potential problem mortgage loans are considered current (no payment more than 59 days past due), but exhibit certain characteristics that increase the likelihood of future default. The characteristics management considers include, but are not limited to, the deterioration of debt service coverage below 1.0, estimated loan-to-value ratios increasing to 100% or more, downgrade in quality rating and requests from the borrower for restructuring. In addition, loans are considered potential problems if principal or interest payments are past due by more than 30 but less than 60 days. Problem mortgage loans are either in default by 60 days or more or have been restructured as to terms, which could include concessions on interest rate, principal payment or maturity date. The Company monitors each problem and potential problem mortgage loan on an ongoing basis, and updates the loan categorization and quality rating when warranted.

Problem and potential problem mortgage loans, net of valuation reserves, totaled $208 million at September 30, 2014 and $158 million at December 31, 2013. At September 30, 2014 and December 31, 2013, industrial loans located in the South Atlantic region represented the most significant component of problem and potential problem mortgage loans.

Impaired commercial mortgage loans. A commercial mortgage loan is considered impaired when it is probable that the Company will not collect all amounts due (principal and interest) according to the terms of the original loan agreement. These loans are included in either problem or potential problem loans. The Company assesses each loan individually for impairment, using the information obtained from the quality review process discussed above. Impaired loans are carried at the lower of unpaid principal balance or the fair value of the underlying real estate. In some cases when it is probable that the Company will not collect the interest due under the original agreements, the loan will be considered impaired but a related valuation reserve will not be recorded because the fair value of the underlying real estate is higher than the remaining carrying value of the loan.

The carrying value of the Company s impaired commercial mortgage loans and related valuation reserves were as follows:

	September 30, 2014			December 31, 2013		
(In millions)	**Gross**	**Reserves**	**Net**	**Gross**	**Reserves**	**Net**
Impaired commercial mortgage loans with valuation reserves	$ 147	$ (12)	$ 135	$ 89	$ (8)	$ 81
Impaired commercial mortgage loans with no valuation reserves	31	-	31	31	-	31
Total	**$ 178**	**$ (12)**	**$ 166**	$ 120	$ (8)	$ 112

The average recorded investment in impaired loans was $149 million during the nine months ended September 30, 2014 and $128 million during the nine months ended September 30, 2013. Because of the risk profile of the underlying investment, the Company recognizes interest income on problem mortgage loans only when payment is actually received. Interest income that would have been reflected in net income if interest on non-accrual commercial mortgage loans had been received in accordance with the original terms was not significant for the nine months ended September 30, 2014 or 2013. Interest income on impaired commercial mortgage loans was not significant for the nine months ended

September 30, 2014 or 2013.

The following table summarizes the changes in valuation reserves for commercial mortgage loans:

(In millions)	**2014**	2013
Reserve balance, January 1,	$ 8	$ 7
Increase in valuation reserves	4	4
Reserve balance, September 30,	**$ 12**	$ 11

Short-term investments and cash equivalents

Short-term investments and cash equivalents include corporate securities of $661 million, federal government securities of $154 million and money market funds of $45 million as of September 30, 2014. The Company s short-term investments and cash equivalents as of December 31, 2013 included corporate securities of $2.2 billion, federal government securities of $323 million and money market funds of $35 million.

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Note 9 Derivative Financial Instruments

The Company uses derivative financial instruments to manage the characteristics of investment assets to meet the varying demands of the related insurance and contractholder liabilities and to hedge long-term debt. The Company has written and purchased reinsurance contracts in its run-off reinsurance business that are accounted for as freestanding derivatives. The Company also used derivative financial instruments to manage the equity, foreign currency, and certain interest rate risk exposures of its run-off reinsurance business until the time of the Berkshire reinsurance transaction in 2013 (for further information, see Note 5). For information on the Company s accounting policy for derivative financial instruments, see Note 2 to the Financial Statements contained in the Company s 2013 Form 10-K. Derivatives in the Company s separate accounts are excluded from the following discussion because associated gains and losses generally accrue directly to separate account policyholders.

Collateral and termination features. The Company routinely monitors exposure to credit risk associated with derivatives and diversifies the portfolio among approved dealers of high credit quality to minimize this risk. As of September 30, 2014, the Company had $22 million in cash on deposit representing the upfront margin required for the Company s centrally-cleared derivative instruments. Certain of the Company s over-the-counter derivative instruments contain provisions requiring either the Company or the counterparty to post collateral or demand immediate payment depending on the amount of the net liability position and predefined financial strength or credit rating thresholds. Collateral posting requirements vary by counterparty. The net liability positions of these derivatives were not material as of September 30, 2014 or December 31, 2013.

Derivative instruments used in the Company s investment and interest rate risk management.

The Company uses derivative financial instruments as a part of its investment strategy to manage the characteristics of investment assets (such as duration, yield, currency and liquidity) to meet the varying demands of the related insurance and contractholder liabilities (such as paying claims, investment returns and withdrawals). Derivatives are typically used in this strategy to reduce interest rate and foreign currency risks. The Company also uses derivative financial instruments to hedge interest rate risk on its long-term debt.

Investment Cash Flow Hedges

Purpose. The Company uses interest rate, foreign currency, and combination (interest rate and foreign currency) swap contracts to hedge the interest and foreign currency cash flows of its fixed maturity bonds to match associated insurance liabilities.

Accounting policy. Using cash flow hedge accounting, fair values are reported in other long-term investments or other liabilities. Changes in fair value are reported in accumulated other comprehensive income and amortized into net investment income or reported in other realized investment gains and losses as interest or principal payments are received.

Cash flows. Under the terms of these various contracts, the Company periodically exchanges cash flows between variable and fixed interest rates and/or between two currencies for both principal and interest. Foreign currency and combination swaps are primarily Euros, Australian dollars, Canadian dollars, Japanese yen and British pounds and have terms for periods of up to seven years. Net interest cash flows are reported in operating activities.

Volume of activity. The following table provides the notional values of these derivative instruments for the indicated periods:

	Notional Amount *(In millions)*	
Instrument	**As of September 30, 2014**	**As of December 31, 2013**
Interest rate swaps	$ 44	$ 45
Foreign currency swaps	111	118
Combination interest rate and foreign currency swaps	40	40
Total	**$ 195**	**$ 203**

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The following table provides the effect of these derivative instruments on the financial statements for the indicated periods:

Fair Value Effect on the Financial Statements *(In millions)*

	Other Long-Term Investments (2)		Accounts Payable, Accrued Expenses and Other Liabilities (2)		Gain (Loss) Recognized in Other Comprehensive Income (1)			
	As of September 30,	As of December 31,	As of September 30,	As of December 31,	For the three months ended September 30,		For the nine months ended September 30,	
Instrument	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**	**2014**	**2013**
Interest rate swaps	$ 1	$ 2	$ -	$ -	$ -	$ (1)	$ (1)	$ (2)
Foreign currency swaps	1	1	6	13	6	(4)	8	-
Combination interest rate and foreign currency swaps	-	-	2					