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Fidelity & Guaranty Life
Form 10-Q
May 06, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from _____ to _____

Commission file number: 001-36227

FIDELITY & GUARANTY LIFE
(Exact name of registrant as specified in its charter)

Delaware	46-3489149
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Two Ruan Center	
601 Locust Street, 14th Floor	50309
Des Moines, Iowa	
(Address of principal executive offices)	(Zip Code)
(800) 445-6758	
(Registrant's telephone number, including area code)	
(Former name, former address and former fiscal year, if changed since last report)	

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

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

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

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-accelerated Filer <input checked="" type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes or No

There were 58,737,505 shares of the registrant's common stock outstanding as of May 4, 2015.

FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

FIDELITY & GUARANTY LIFE AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except share data)

	March 31, 2015 (Unaudited)	September 30, 2014
ASSETS		
Investments:		
Fixed maturity securities, available-for-sale, at fair value (amortized cost: March 31, 2015 - \$17,161; September 30, 2014 - \$16,692)	\$ 18,055	\$ 17,435
Equity securities, available-for-sale, at fair value (amortized cost: March 31, 2015 - \$574; September 30, 2014 - \$679)	606	698
Derivative investments	268	296
Commercial mortgage loans	304	136
Other invested assets	232	237
Total investments	19,465	18,802
Related party loans	75	113
Cash and cash equivalents	849	576
Accrued investment income	180	182
Reinsurance recoverable	3,691	3,665
Intangibles, net	610	515
Deferred tax assets	104	137
Other assets	221	163
Total assets	\$ 25,195	\$ 24,153
LIABILITIES AND SHAREHOLDERS' EQUITY		
Contractholder funds	\$ 17,521	\$ 16,464
Future policy benefits	3,481	3,504
Funds withheld for reinsurance liabilities	1,329	1,331
Liability for policy and contract claims	60	58
Debt	300	300
Other liabilities	794	837
Total liabilities	23,485	22,494
Commitments and contingencies		
Shareholders' equity:		
Preferred stock (\$.01 par value, 50,000,000 shares authorized, no shares issued at March 31, 2015)	\$ —	\$ —
Common stock (\$.01 par value, 500,000,000 shares authorized, 58,739,810 issued and outstanding at March 31, 2015; 58,442,721 shares issued and outstanding at September 30, 2014)	1	1
Additional paid-in capital	710	702
Retained earnings	601	607
Accumulated other comprehensive income	408	349
	(10) —

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Treasury Stock, at cost (463,394 shares at March 31, 2015; no shares at September 30, 2014)

Total shareholders' equity	1,710	1,659
Total liabilities and shareholders' equity	\$25,195	\$24,153

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except share data)

	Three months ended		Six months ended	
	March 31,	March 31,	March 31,	March 31,
	2015	2014	2015	2014
	(Unaudited)		(Unaudited)	
Revenues:				
Premiums	\$15	\$ 15	\$26	\$28
Net investment income	208	184	416	368
Net investment (losses) gains	(58	) (2	) 1	122
Insurance and investment product fees and other	22	18	42	33
Total revenues	187	215	485	551
Benefits and expenses:				
Benefits and other changes in policy reserves	172	179	396	396
Acquisition and operating expenses, net of deferrals	28	32	57	58
Amortization of intangibles	(7	) 11	9	34
Total benefits and expenses	193	222	462	488
Operating (loss) income	(6	) (7	) 23	63
Interest expense	(6	) (6	) (12	) (11
(Loss) income before income taxes	(12	) (13	) 11	52
Income tax expense (benefit)	—	(38	) 9	(16
Net (loss) income	\$(12	) \$ 25	\$ 2	\$68
Net (loss) income per common share:				
Basic	\$(0.21	) \$ 0.43	\$0.03	\$ 1.26
Diluted	\$(0.21	) \$ 0.42	\$0.03	\$ 1.26
Weighted average common shares used in computing net income per common share:				
Basic	58,033,064	58,270,822	58,159,572	53,656,357
Diluted	58,033,064	58,447,122	58,331,854	53,756,814
Cash dividend per common share	\$0.065	\$ 0.065	\$0.130	\$0.980
Supplemental disclosures:				
Total other-than-temporary impairments	\$(61	) \$ —	\$(61) \$—
Portion of other-than-temporary impairments included in other comprehensive income	—	—	—	—
Net other-than-temporary impairments	(61	) —	(61) —
Gains (losses) on derivative instruments	1	(8	) 63	103
Other realized investment gains (losses)	2	6	(1	) 19
Total net investment (losses) gains	\$(58	) \$ (2	) \$1	\$122

See accompanying notes to condensed consolidated financial statements.

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FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (In millions)

	Three months ended		Six months ended	
	March 31, 2015	March 31, 2014	March 31, 2015	March 31, 2014
	(Unaudited)		(Unaudited)	
Net (loss) income	\$(12)	\$25	\$2	\$68
Other comprehensive income (loss):				
Unrealized investment gains (losses):				
Change in unrealized investment gains before reclassification adjustment	111	384	100	375
Net reclassification adjustment for losses (gains) included in net income	58	(10)	62	(19)
Changes in unrealized investment gains after reclassification adjustment	169	374	162	356
Adjustments to intangible assets	(71)	(113)	(70)	(105)
Changes in deferred income tax asset/liability	(34)	(92)	(33)	(88)
Net changes to derive comprehensive income for the period	64	169	59	163
Comprehensive income, net of tax	\$52	\$194	\$61	\$231

See accompanying notes to condensed consolidated financial statements.

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FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
 (Unaudited) (In millions)

	Preferred Stock	Common Stock	Additional Paid-in Capital/Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
Balance, September 30, 2013	\$—	\$—	\$ 527	\$499	\$ 113	\$—	\$ 1,139
Dividends	—	—	—	(47)	—	—	(47)
Stock Split	—	1	(1)	—	—	—	—
Proceeds from issuance of common stock, net of transaction fees	—	—	173	—	—	—	173
Net income	—	—	—	68	—	—	68
Unrealized investment gains, net	—	—	—	—	163	—	163
Stock compensation	—	—	2	—	—	—	2
Balance, March 31, 2014	\$—	\$1	\$ 701	\$520	\$ 276	\$—	\$ 1,498
Balance, September 30, 2014	\$—	\$1	\$ 702	\$607	\$ 349	\$—	\$ 1,659
Treasury shares purchased	—	—	—	—	—	(10)	(10)
Dividends	—	—	—	(8)	—	—	(8)
Net income	—	—	—	2	—	—	2
Unrealized investment gains, net	—	—	—	—	59	—	59
Stock compensation	—	—	8	—	—	—	8
Balance, March 31, 2015	\$—	\$1	\$ 710	\$601	\$ 408	\$(10)	\$ 1,710

See accompanying notes to condensed consolidated financial statements.

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FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In millions)

	Six months ended	
	March 31, 2015	March 31, 2014
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$2	\$68
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	8	12
Amortization	(24	) (16
Deferred income taxes	—	(34
Interest credited/index credit to contractholder account balances	330	325
Net recognized (gains) on investments and derivatives	(1	) (122
Charges assessed to contractholders for mortality and administration	(32	) (21
Deferred policy acquisition costs, net of amortization	(165	) (82
Changes in operating assets and liabilities:		
Reinsurance recoverable	(4	) (14
Future policy benefits	(23	) (23
Funds withheld from reinsurers	(11	) (57
Collateral posted	7	37
Other assets and other liabilities	(56	) (12
Net cash provided by operating activities	31	61
Cash flows from investing activities:		
Proceeds from available-for-sale investments sold, matured or repaid	1,806	2,676
Proceeds from derivatives instruments and other invested assets	233	222
Proceeds from commercial mortgage loans	32	—
Cost of available-for-sale investments acquired	(2,218	) (3,816
Costs of derivatives instruments and other invested assets	(181	) (247
Costs of commercial mortgage loans	(200) —
Related party loans	38	(27
Capital expenditures	(3	) (4
Net cash (used in) investing activities	(493	) (1,196
Cash flows from financing activities:		
Treasury stock	(10) —
Proceeds from issuance of common stock, net of transaction fees	—	176
Dividends paid	(8	) (47
Contractholder account deposits	1,538	1,341
Contractholder account withdrawals	(785	) (837
Net cash provided by financing activities	735	633
Change in cash & cash equivalents	273	(502
Cash & cash equivalents, beginning of period	576	1,204
Cash & cash equivalents, end of period	\$849	\$702
Supplemental disclosures of cash flow information		
Interest paid	\$9	\$12
Taxes paid	\$28	\$24

See accompanying notes to condensed consolidated financial statements.

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FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

Fidelity & Guaranty Life (formerly, Harbinger F&G, LLC (“HFG”)) (“FGL” and, collectively with its subsidiaries, the “Company”) is a subsidiary of HRG Group, Inc. (formerly, Harbinger Group Inc. (“HRG”). The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission (“SEC”) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in Fidelity & Guaranty Life and Subsidiaries' Annual Report on Form 10-K, for the year ended September 30, 2014 (“2014 Form 10-K”), should be read in connection with the reading of these interim unaudited consolidated financial statements.

FGL markets products through its wholly-owned insurance subsidiaries, Fidelity & Guaranty Life Insurance Company (“FGL Insurance”) and Fidelity & Guaranty Life Insurance Company of New York (“FGL NY Insurance”), which together are licensed in all fifty states and the District of Columbia.

On April 6, 2015, HRG Group, Inc, the parent of the Company, announced that it is exploring strategic alternatives for Fidelity & Guaranty Life regarding their FGL holdings. Following this announcement, FGL has begun a strategic process involving a potential sale of the Company. There can be no assurance that the exploration of strategic alternatives will result in a transaction or that any transaction, if pursued, will be consummated. The exploration of strategic alternatives may be terminated at any time and without notice. Neither HRG Group nor any of its affiliates - including FGL - intend to disclose developments with respect to this process unless and until the FGL Board of Directors has approved a specific transaction or course of action.

Certain GAAP policies, which significantly affect the determination of financial position, results of operations and cash flows, are summarized in our 2014 Form 10-K.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company’s results. Operating results for the three and six months ended March 31, 2015, are not necessarily indicative of the results that may be expected for the full year ending September 30, 2015. All material inter-company accounts and transactions have been eliminated in consolidation. Amounts reclassified out of other comprehensive income are reflected in net investment gains in the Condensed Consolidated Statements of Operations.

Dollar amounts in the accompanying sections are presented in millions, unless otherwise noted.

(2) Significant Accounting Policies and Practices

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and all other entities in which FGL has a controlling financial interest (none of which are variable interest entities). All intercompany accounts and transactions have been eliminated in consolidation.

Recent Accounting Pronouncements

Investments in Qualified Affordable Housing Projects

In January 2014, the Financial Accounting Standards Board (“FASB”) issued amended guidance (ASU 2014-01, Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Project) which allows investors in Low Income Housing Tax Credit (“LIHTC”) programs that meet specified conditions to present the net tax benefits (net of the amortization of the cost of the investment)

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within income tax expense. The cost of the investments that meet the specified conditions will be amortized in proportion to (and over the same period as) the total expected tax benefits, including the tax credits and other tax benefits, as they are realized on the tax return. The guidance is required to be applied retrospectively, if investors elect the proportional amortization method. However, if investors have existing LIHTC investments accounted for under the effective-yield method at adoption, they may continue to apply that method for those existing investments. The Company early adopted this guidance effective October 1, 2014 for all new LIHTC investments made subsequent to that date. Prior LIHTC investments will continue to be accounted for under the effective-yield method. This adoption did not have a material effect on the Company's consolidated financial position and results of operations.

Share-Based Payments When a Performance Target is achieved after the Requisite Service Period

In June 2014, the FASB issued new guidance on Stock Compensation (ASU 2014-12, Accounting for Share-Based Payments When the Term of an Award Provide that a Performance Target Could Be Achieved after the Requisite Service Period), effective for fiscal years beginning after December 15, 2015 and interim periods within those years. The new guidance requires performance targets that affect vesting and that could be achieved after the requisite service period to be treated as performance conditions. Such performance targets would not be included in the grant-date fair value calculation of the award, rather compensation cost should be recorded when it is probable the performance target will be reached and should represent the compensation cost attributable to period(s) for which the requisite service has already been rendered. This standard may be early adopted and the amendments may be applied either prospectively or retrospectively. The Company will not early adopt this standard and is currently evaluating the impact of this new accounting guidance on its consolidated financial statements.

Amendments to the Consolidation Analysis

In February 2015, the FASB issued amended consolidation guidance (ASU 2015-02, Amendments to the Consolidation Analysis), effective for fiscal years beginning after December 15, 2015. The amended guidance changes the consolidation analysis of reporting entities with variable interest entity ("VIE") relationships by i) modifying the criteria used to evaluate whether limited partnerships and similar legal entities are VIEs or voting interest entities and revising the primary beneficiary determination of a VIE, ii) eliminating the specialized consolidation model and guidance for limited partnerships thereby removing the presumption that a general partner should consolidate a limited partnership, iii) reducing the criteria in the variable interest model contained in Accounting Standards Codification Topic 810, Consolidation, that is used to evaluate whether the fees paid to a decision maker or service provider represents a variable interest, and iv) exempting reporting entities from consolidating money market funds that operate in accordance with Rule 2a-7 of the Investment Company Act of 1940. This standard may be early adopted and the amendments in this Update may be applied with a modified retrospective approach or retrospective approach. The Company will not early adopt this standard and is currently evaluating the impact of this new accounting guidance on its consolidated financial statements.

Presentation of Debt Issuance Costs

In April 2015, the FASB issued amended guidance (ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30), Simplifying the Presentation of Debt Issuance Costs), effective for fiscal years beginning after December 15, 2015 and interim periods within those years. The amended guidance requires debt issuance costs related to a recognized debt liability to be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts or premiums. The cost of issuing debt will no longer be recorded as a separate asset, except when incurred before the receipt of the funding from the associated debt liability. Instead, debt issuance costs will be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability, and the costs will be amortized to interest expense using the effective interest method. This standard may be early adopted. The amendments in this Update are required to be applied retrospectively to all prior periods presented in the financial statements. The Company will not early adopt this standard and is currently evaluating the impact of this new accounting guidance on its consolidated financial statements.

(3) Significant Risks and Uncertainties

Use of Estimates and Assumptions

The preparation of the Company's Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of

contingent assets and liabilities at the date of the financial statements and the reported amounts of

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revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions used.

Concentrations of Financial Instruments

As of March 31, 2015 and September 30, 2014, the Company's most significant investment in one industry, excluding United States ("U.S.") Government securities, was its investment securities in the banking industry with a fair value of \$2,274 or 12% and \$2,240 or 12%, respectively, of the invested assets portfolio. The Company's holdings in this industry include investments in 83 different issuers with the top ten investments accounting for 39% of the total holdings in this industry. As of March 31, 2015, the Company had investments in 1 issuer, Wells Fargo & Company that exceeded 10% of shareholders' equity with a total fair value of \$188 or 1% of the invested assets portfolio. As of September 30, 2014, the Company had investments in 2 issuers, Wells Fargo & Company and J.P. Morgan Chase, that exceeded 10% of shareholders' equity with a total fair value of \$365 or 2% of the invested assets portfolio.

Additionally, the Company's largest concentration in any single issuer as of March 31, 2015 and September 30, 2014 was in Wells Fargo & Company which had a fair value of \$188 or 1% and \$185 or 1% of the invested assets portfolio, respectively.

Concentrations of Financial and Capital Markets Risk

The Company is exposed to financial and capital markets risk, including changes in interest rates and credit spreads which can have an adverse effect on the Company's results of operations, financial condition and liquidity. The Company expects to continue to face challenges and uncertainties that could adversely affect its results of operations and financial condition.

The Company's exposure to interest rate risk relates primarily to the market price and cash flow variability associated with changes in interest rates. A rise in interest rates, in the absence of other countervailing changes, will decrease the net unrealized gain position of the Company's investment portfolio and, if long-term interest rates rise dramatically within a six to twelve month time period, certain of the Company's products may be exposed to disintermediation risk. Disintermediation risk refers to the risk that policyholders may surrender their contracts in a rising interest rate environment, requiring the Company to liquidate assets in an unrealized loss position. This risk is mitigated to some extent by the high level of surrender charge protection provided by the Company's products.

Concentration of Reinsurance Risk

The Company has a significant concentration of reinsurance with Wilton Reassurance Company ("Wilton Re") and Front Street Re (Cayman) Ltd. ("FSRCI" - an affiliate) that could have a material impact on the Company's financial position in the event that Wilton Re or FSRCI fail to perform their obligations under the various reinsurance treaties. Wilton Re is a wholly owned subsidiary of Canada Pension Plan Investment Board ("CPPIB"). CPPIB has an AAA credit rating from Standard & Poor's Ratings Services ("S&P") as of March 31, 2015. As of March 31, 2015, the net amount recoverable from Wilton Re was \$1,514 and the net amount recoverable from FSRCI was \$1,289. The coinsurance agreement with FSRCI is on a funds withheld basis. The Company monitors both the financial condition of individual reinsurers and risk concentration arising from similar geographic regions, activities and economic characteristics of reinsurers to reduce the risk of default by such reinsurers.

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(4) Investments

The Company's debt and equity securities investments have been designated as available-for-sale and are carried at fair value with unrealized gains and losses included in accumulated other comprehensive income ("AOCI") net of associated adjustments for value of business acquired ("VOBA"), deferred acquisition costs ("DAC") and deferred income taxes. The Company's consolidated investments at March 31, 2015 and September 30, 2014 are summarized as follows:

March 31, 2015

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Carrying Value
Available-for sale securities					
Asset-backed securities	\$2,200	\$11	\$(19)	\$2,192	\$2,192
Commercial mortgage-backed securities	707	23	(1)	729	729
Corporates	9,253	648	(74)	9,827	9,827
Equities	574	35	(3)	606	606
Hybrids	1,303	74	(20)	1,357	1,357
Municipals	1,281	157	(2)	1,436	1,436
Residential mortgage-backed securities	2,108	108	(22)	2,194	2,194
U.S. Government	309	11	—	320	320
Total available-for-sale securities	17,735	1,067	(141)	18,661	18,661
Derivative investments	205	83	(20)	268	268
Commercial mortgage loans	304	—	—	304	304
Other invested assets	239	—	(7)	232	232
Total investments	\$18,483	\$1,150	\$(168)	\$19,465	\$19,465

September 30, 2014

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Carrying Value
Available-for-sale securities					
Asset-backed securities	\$2,040	\$12	\$(20)	\$2,032	\$2,032
Commercial mortgage-backed securities	618	21	(2)	637	637
Corporates	9,329	499	(49)	9,779	9,779
Equities	679	24	(5)	698	698
Hybrids	1,279	52	(15)	1,316	1,316
Municipals	1,150	117	(7)	1,260	1,260
Residential mortgage-backed securities	1,985	140	(11)	2,114	2,114
U.S. Government	291	7	(1)	297	297
Total available-for-sale securities	17,371	872	(110)	18,133	18,133
Derivatives investments	178	123	(5)	296	296
Commercial mortgage loans	136	—	—	136	136
Other invested assets	237	—	—	237	