PROTECTIVE LIFE CORP
Form 10-Q
November 09, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2018

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 001-11339

PROTECTIVE LIFE CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	95-2492236
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

2801 HIGHWAY 280 SOUTH
BIRMINGHAM, ALABAMA 35223
(Address of principal executive offices and zip code)

Registrant’s telephone number, including area code (205) 268-1000

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 ý No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ý No o

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

Large accelerated filer o Accelerated Filer o

Non-accelerated filer x Smaller Reporting Company o

Emerging Growth Company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Number of shares of Common Stock, $0.01 Par Value, outstanding as of October 23, 2018: 1,000

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PROTECTIVE LIFE CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018

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PART I

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Revenues				
Premiums and policy fees	$878,182	$855,088	$2,709,216	$2,583,813
Reinsurance ceded	(269,335)	(325,120)	(1,005,699)	(984,094)
Net of reinsurance ceded	608,847	529,968	1,703,517	1,599,719
Net investment income	672,139	507,914	1,809,464	1,522,098
Realized investment gains (losses):				
Derivative financial instruments	(27,465)	(82,341)	62,859	(260,407)
All other investments	(19,869)	18,150	(157,070)	94,708
Other-than-temporary impairment losses	(14)	(366)	(715)	(3,124)
Portion recognized in other comprehensive income (before taxes)	—	93	(2,949)	(7,765)
Net impairment losses recognized in earnings	(14)	(273)	(3,664)	(10,889)
Other income	113,530	110,970	341,802	331,523
Total revenues	1,347,168	1,084,388	3,756,908	3,276,752
Benefits and expenses				
Benefits and settlement expenses, net of reinsurance ceded: (three and nine months 2018 - $215,848 and $861,501; three and nine months 2017 - $256,703 and $806,314)	952,353	743,934	2,600,703	2,205,937
Amortization of deferred policy acquisition costs and value of business acquired	33,511	3,991	144,009	47,612
Other operating expenses, net of reinsurance ceded: (three and nine months 2018 - $54,439 and $149,115; three and nine months 2017 - $57,293 and $161,615)	224,585	225,613	684,907	674,236
Total benefits and expenses	1,210,449	973,538	3,429,619	2,927,785
Income before income tax	136,719	110,850	327,289	348,967
Income tax expense	26,619	28,308	61,582	106,743
Net income	$110,100	$82,542	$265,707	$242,224

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Net income	$110,100	$82,542	$265,707	$242,224
Other comprehensive income (loss):				
Change in net unrealized gains (losses) on investments, net of income tax: (three months: 2018 - $(53,488); 2017 - $54,464; nine months: 2018 - $(320,520); 2017 - $295,743)	(201,216)	101,148	(1,206,478)	549,234
Reclassification adjustment for investment amounts included in net income, net of income tax: (three months: 2018 - $427; 2017 - $(146); nine months: 2018 - $(554); 2017 - $631)	1,605	(271)	(2,086)	1,174
Change in net unrealized gains (losses) relating to other-than-temporary impaired investments for which a portion has been recognized in earnings, net of income tax: (three months: 2018 - $0; 2017 - $452; nine months: 2018 - $6; 2017 - $3,837)	—	839	22	7,125
Change in accumulated (loss) gain - derivatives, net of income tax: (three months: 2018 - $61; 2017 - $445; nine months: 2018 - $813; 2017 - $19)	229	828	3,060	36
Reclassification adjustment for derivative amounts included in net income, net of income tax: (three months: 2018 - $101; 2017 - $14; nine months: 2018 - $168; 2017 - $139)	380	24	631	257
Total other comprehensive income (loss)	(199,002)	102,568	(1,204,851)	557,826
Total comprehensive income (loss)	$(88,902)	$185,110	$(939,144)	$800,050

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(Unaudited)

	As of September 30, 2018	December 31, 2017
	(Dollars In Thousands)	
Assets		
Fixed maturities, at fair value (amortized cost: 2018 - $54,555,431; 2017 - $41,153,551)	$52,381,464	$41,176,052
Fixed maturities, at amortized cost (fair value: 2018 - $2,577,841; 2017 - $2,776,327)	2,653,605	2,718,904
Equity securities, at fair value (cost: 2018 - $663,338; 2017 - $740,813)	662,880	754,360
Mortgage loans (related to securitizations: 2018 - $505; 2017 - $226,409)	7,572,349	6,817,723
Investment real estate, net of accumulated depreciation (2018 - $219; 2017 - $132)	7,147	8,355
Policy loans	1,703,462	1,615,615
Other long-term investments	1,051,719	915,595
Short-term investments	532,053	615,210
Total investments	66,564,679	54,621,814
Cash	194,460	252,310
Accrued investment income	652,462	491,802
Accounts and premiums receivable	167,635	124,934
Reinsurance receivables	4,816,606	5,075,698
Deferred policy acquisition costs and value of business acquired	2,974,293	2,199,577
Goodwill	793,470	793,470
Other intangibles, net of accumulated amortization (2018 - $183,268; 2017 - $140,368)	626,424	663,572
Property and equipment, net of accumulated depreciation (2018 - $30,569; 2017 - $22,926)	106,638	111,417
Other assets	238,068	227,357
Income tax receivable	—	76,543
Assets related to separate accounts		
Variable annuity	13,555,469	13,956,071
Variable universal life	1,077,842	1,035,202
Total assets	$91,768,046	$79,629,767

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(Unaudited)
(continued)

	As of September 30, 2018	December 31, 2017
	(Dollars In Thousands)	
Liabilities		
Future policy benefits and claims	$42,013,542	$30,957,592
Unearned premiums	875,095	875,405
Total policy liabilities and accruals	42,888,637	31,832,997
Stable value product account balances	5,211,668	4,698,371
Annuity account balances	13,590,482	10,921,190
Other policyholders’ funds	1,142,522	1,267,198
Other liabilities	2,575,056	2,353,565
Income tax payable	1,259	—
Deferred income taxes	890,421	1,232,407
Non-recourse funding obligations	2,651,967	2,747,477
Secured financing liabilities	514,413	1,017,749
Debt	1,107,388	945,052
Subordinated debt	605,392	495,289
Liabilities related to separate accounts		
Variable annuity	13,555,469	13,956,071
Variable universal life	1,077,842	1,035,202
Total liabilities	85,812,516	72,502,568
Commitments and contingencies - Note 12		
Shareowner’s equity		
Common Stock: 2018 and 2017 - $0.01 par value; shares authorized: 5,000; shares issued: 1,000	—	—
Additional paid-in-capital	5,554,059	5,554,059
Retained earnings	1,604,178	1,560,444
Accumulated other comprehensive income (loss):		
Net unrealized (losses) gains on investments, net of income tax: (2018 - $317,185; 2017 - $6,883)	(1,193,220)	25,896
Net unrealized losses relating to other-than-temporary impaired investments for which a portion has been recognized in earnings, net of income tax: (2018 - $0; 2017 - $(6))	—	(22)
Accumulated gain (loss) - derivatives, net of income tax: (2018 - $1,180; 2017 - $198)	4,438	747
Postretirement benefits liability adjustment, net of income tax: (2018 - $(3,469); 2017 - $(3,469))	(13,925)	(13,925)
Total shareowner’s equity	5,955,530	7,127,199
Total liabilities and shareowner’s equity	$91,768,046	$79,629,767

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF SHAREOWNER'S EQUITY
(Unaudited)

	Common Stock	Additional Paid-In-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareowner's Equity
	(Dollars In Thousands)				
Balance, December 31, 2017	$ —	$ 5,554,059	$ 1,560,444	$ 12,696	$ 7,127,199
Net income for the nine months ended September 30, 2018			265,707		265,707
Other comprehensive loss				(1,204,851)	(1,204,851)
Comprehensive loss for the nine months ended September 30, 2018					(939,144)
Cumulative effect adjustments			(81,973)	(10,552)	(92,525)
Dividends to parent			(140,000)		(140,000)
Balance, September 30, 2018	$ —	$ 5,554,059	$ 1,604,178	$ (1,202,707)	$ 5,955,530

See Notes to the Consolidated Condensed Financial Statements
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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	For The Nine Months Ended September 30, 2018	2017
	(Dollars In Thousands)	
Cash flows from operating activities		
Net income	$265,707	$242,224
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses	97,875	176,588
Amortization of DAC and VOBA	144,009	47,612
Capitalization of DAC	(331,277)	(249,640)
Depreciation and amortization expense	50,826	49,227
Deferred income tax	10,340	86,463
Accrued income tax	77,802	17,453
Interest credited to universal life and investment products	630,770	507,229
Policy fees assessed on universal life and investment products	(1,146,980)	(1,004,829)
Change in reinsurance receivables	259,429	132,617
Change in accrued investment income and other receivables	(11,823)	(17,550)
Change in policy liabilities and other policyholders' funds of traditional life and health products	(512,879)	(273,640)
Trading securities:		
Maturities and principal reductions of investments	140,851	131,563
Sale of investments	307,632	195,733
Cost of investments acquired	(403,355)	(277,423)
Other net change in trading securities	10,641	17,741
Amortization of premiums and accretion of discounts on investments and mortgage loans	232,401	232,939
Change in other liabilities	21,569	36,239
Other, net	(44,952)	(58,308)
Net cash used in operating activities	$(201,414)	$(7,762)

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(continued)

	For The Nine Months Ended September 30, 2018	2017
	(Dollars In Thousands)	
Cash flows from investing activities		
Maturities and principal reductions of investments, available-for-sale	$1,249,048	$541,155
Sale of investments, available-for-sale	1,935,178	1,302,576
Cost of investments acquired, available-for-sale	(4,304,036)	(3,248,911)
Change in investments, held-to-maturity	62,000	36,000
Mortgage loans:		
New lendings	(1,185,316)	(1,081,226)
Repayments	797,450	644,189
Change in investment real estate, net	647	3,679
Change in policy loans, net	43,642	24,280
Change in other long-term investments, net	(292,893)	(282,506)
Change in short-term investments, net	82,748	(203,169)
Net unsettled security transactions	84,036	349,544
Purchase of property, equipment, and intangibles	(9,888)	(34,229)
Cash received from reinsurance transaction	20,669	—
Net cash used in investing activities	$(1,516,715)	$(1,948,618)
Cash flows from financing activities		
Borrowings under line of credit arrangement, debt, and subordinated debt	$1,075,000	$975,000
Principal payments on line of credit arrangement, debt, and subordinated debt	(757,884)	(934,123)
Issuance (repayment) of non-recourse funding obligations	(100,000)	(36,000)
Secured financing liabilities	(503,336)	(198,165)
Dividends to shareowner	(140,000)	(143,848)
Investment product deposits and change in universal life deposits	4,397,886	3,901,051
Investment product withdrawals	(2,311,096)	(1,698,062)
Other financing activities, net	(291)	(93)
Net cash provided by financing activities	$1,660,279	$1,865,760
Change in cash	(57,850)	(90,620)
Cash at beginning of period	252,310	348,182
Cash at end of period	$194,460	$257,562

See Notes to the Consolidated Condensed Financial Statements

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PROTECTIVE LIFE CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

Basis of Presentation

On February 1, 2015, Protective Life Corporation (the “Company”) became a wholly owned subsidiary of The Dai-ichi Life Insurance Company, Limited, a kabushiki kaisha organized under the laws of Japan (now known as Dai-ichi Life Holdings, Inc., “Dai-ichi Life”), when DL Investment (Delaware), Inc., a wholly owned subsidiary of Dai-ichi Life, merged with and into the Company (the “Merger”). Prior to February 1, 2015, the Company’s stock was publicly traded on the New York Stock Exchange. Subsequent to the Merger, the Company remains as an SEC registrant within the United States. The Company is a holding company with subsidiaries that provide financial services through the production, distribution, and administration of insurance and investment products. The Company markets individual life insurance, credit life and disability insurance, guaranteed investment contracts, guaranteed funding agreements, fixed and variable annuities, and extended service contracts throughout the United States. The Company also maintains a separate segment devoted to the acquisition of insurance policies from other companies. Founded in 1907, Protective Life Insurance Company (“PLICO”) is the Company’s largest operating subsidiary.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for the interim periods presented herein. In the opinion of management, the accompanying financial statements reflect all adjustments (consisting only of normal recurring items) necessary for a fair statement of the results for the interim periods presented. Operating results for the three and nine months ended September 30, 2018, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2018. The year-end consolidated condensed financial data included herein was derived from audited financial statements but does not include all disclosures required by GAAP within this report. For further information, refer to the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

The operating results of companies in the insurance industry have historically been subject to significant fluctuations due to changing competition, economic conditions, interest rates, investment performance, insurance ratings, claims, persistency, and other factors.

Entities Included

The consolidated condensed financial statements in this report include the accounts of Protective Life Corporation and subsidiaries and its affiliate companies in which the Company holds a majority voting or economic interest. Intercompany balances and transactions have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant Accounting Policies

For a full description of significant accounting policies, see Note 2 to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. There were no significant changes to the Company’s accounting policies during the nine months ended September 30, 2018 other than those discussed below.

Property and Casualty Insurance Products

Property and casualty insurance products include service contract business, surety bonds, and guaranteed asset protection (“GAP”). Premiums and fees associated with service contracts and GAP products are recognized based on expected claim patterns. For all other products, premiums are generally recognized over the terms of the contract on a pro-rata basis. Commissions and fee income associated with other products are recognized as earned when the related services are provided to the customer. Unearned premium reserves are maintained for the portion of the premiums that is related to the unexpired period of the policy. Benefit reserves are recorded when insured events occur. Benefit reserves include case basis reserves for known but unpaid claims as of the balance sheet date as well as incurred but not reported (“IBNR”) reserves for claims where the insured event has occurred but has not been reported to the Company as of the balance sheet date. The case basis reserves and IBNR are calculated based on historical experience and on assumptions relating to claim severity and frequency, the level of used vehicle prices, and other factors. These assumptions are modified as necessary to reflect anticipated trends.

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Effective January 1, 2018, the Company adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. In consideration of the amendments in this Update, the Company revised its recognition pattern for administrative fees associated with certain vehicle service and GAP products. Previously, these fees were recognized based on the work effort involved in satisfying the Company's contract obligations. The Company will recognize these fees on a claims occurrence basis in future periods. To reflect this change in accounting principle, the Company recorded a cumulative effect adjustment as of January 1, 2018 that resulted in a decrease in retained earnings of $92.5 million. The pre-tax impact to each affected line item on the Company's financial statements is reflected in the table below:

	As of September 30, 2018	
	As Reported	Previous Accounting Method
	(Dollars In Millions)	
Financial Statement Line Item:		
Balance Sheet		
Deferred policy acquisition costs and value of business acquired	$2,974.3	$ 2,832.4
Other liabilities	$2,575.1	$ 2,308.7

	For The Three Months Ended September 30, 2018		For The Nine Months Ended September 30, 2018	
	As Reported	Previous Accounting Method	As Reported	Previous Accounting Method
	(Dollars In Millions)		(Dollars In Millions)	
Financial Statement Line Item:				
Statements of Income				
Other income	$113.5	$ 115.1	$341.8	$ 345.3
Amortization of deferred policy acquisition costs and value of business acquired	$33.5	$ 21.7	$144.0	$ 107.3
Other operating expenses, net of reinsurance ceded	$224.6	$ 237.7	$684.9	$ 725.1

Accounting Pronouncements Recently Adopted

ASU No. 2014-09 - Revenue from Contracts with Customers (Topic 606). This Update provides for significant revisions to the recognition of revenue from contracts with customers across various industries. Under the new guidance, entities are required to apply a prescribed 5-step process to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The accounting for revenues associated with insurance products is not within the scope of this Update. The Update was originally effective for annual and interim periods beginning after December 15, 2016. However, in August 2015, the FASB issued ASU No. 2015-14 - Revenues from Contracts with Customers: Deferral of the Effective Date, to defer the effective date of ASU No. 2014-09 by one year to annual and interim periods beginning after December 15, 2017. The Company adopted this Update using the modified retrospective approach via a cumulative effect adjustment to retained earnings as of January 1, 2018. The amendments in the Update, along with clarifying updates issued subsequent to ASU 2014-09, impacted some of the Company's smaller lines of business, specifically revenues at the Company's affiliated broker dealers and insurance agency, and certain revenues associated with the Company's Asset Protection products. The lines of business to which the revised guidance applies are not material to the Company's financial statements. In consideration of the amendments in this Update, the Company revised its recognition pattern for administrative fees associated with certain vehicle service and GAP products. Previously, these fees were recognized based on the work effort involved in satisfying the Company's contract obligations. The Company will recognize these fees on a claims occurrence basis in future periods. To reflect this change in accounting principle, the Company recorded a cumulative effect adjustment as of January 1, 2018 that resulted in a decrease in retained earnings of $92.5 million. The Company also implemented minor changes to its accounting and disclosures with respect to the lines of business referenced above to ensure compliance with the revised guidance. See above for additional discussion.

ASU No. 2016-01 - Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this Update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, the Update requires that equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) be measured at fair value with changes in fair value recognized in net income. The Update also introduces a single-step impairment model for equity investments without a readily determinable fair value. Additionally, the Update requires changes in instrument-specific credit risk for fair value option liabilities to be recorded in other comprehensive income. The amendments in this Update are effective for annual and interim periods beginning after December 15, 2017 and were applied on a modified retrospective basis. The Company recorded a cumulative-

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effect adjustment at the date of adoption, January 1, 2018, transferring unrealized gains and losses on available-for-sale equity securities to retained earnings from accumulated other comprehensive income. The impact of this adjustment, net of income tax, resulted in a $10.6 million increase to retained earnings and a corresponding decrease to accumulated other comprehensive income, resulting in no net impact to consolidated shareowner’s equity. The Company has updated its disclosures in Note 5, Investment Operations and Note 6, Fair Value of Financial Instruments in accordance with the ASU.

ASU No. 2016-15 - Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. The amendments in this Update are intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. Specific transactions addressed in the new guidance include: Debt prepayment/extinguishment costs, contingent consideration payments, proceeds from the settlement of corporate-owned life insurance policies, and distributions received from equity method investments. The Update does not introduce any new accounting or financial reporting requirements, and is effective for annual and interim periods beginning after December 15, 2017 using the retrospective method. There was no financial impact.

ASU No. 2016-18 - Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Task Force). The amendments in this update provide guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows, thereby reducing diversity in practice related to the presentation of these amounts. The amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The Update is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. There was no impact to the Company on adoption.

ASU No. 2017-01 - Business Combinations (Topic 805): Clarifying the Definition of a Business. The purpose of this update is to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments in the Update provide a specific test by which an entity may determine whether an acquisition involves a set of assets or a business. The amendments in the Update are to be applied prospectively for periods beginning after December 15, 2017. The Company has reviewed the revised requirements, and does not anticipate that the changes will impact its policies or recent conclusions related to its acquisition activities.

ASU No. 2017-07 - Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The amendments in this update require entities to disaggregate the current-service-cost component from other components of net benefit cost and present it with other current compensation costs in the income statement. The other components of net benefit cost must be presented outside of income from operations if that subtotal is presented. In addition, the Update requires entities to disclose the income statement lines that contain the other components if they are not presented on appropriately described separate lines. The amendments in this update are effective for interim and annual periods beginning after December 15, 2017. As provided for in the ASU, the Company expects to apply the provisions of the statement retrospectively for components of net periodic pension costs and prospectively for capitalization of the service costs component of net periodic costs and net periodic postretirement benefits. The Update did not impact the Company’s financial position, results of operations, or current disclosures.

Accounting Pronouncements Not Yet Adopted

ASU No. 2016-02 - Leases. The amendments in this Update address certain aspects of recognition, measurement, presentation, and disclosure of leases. The most significant change will relate to the accounting model used by lessees. The Update will require all leases with terms greater than 12 months to be recorded on the balance sheet in the form of a lease asset and liability. The lease asset and liability will be measured at the present value of the minimum lease payments less any upfront payments or fees. The amendments in the Update are effective for annual and interim periods beginning after December 15, 2018 on a modified retrospective basis. The Company has completed an inventory of all leases in the organization. Based on our lease portfolio as of September 30, 2018, the Company expects to record a right of use asset and lease liability of approximately $21 million on its consolidated condensed balance sheet in the period of adoption. However, the ultimate impact of adopting the ASU will depend on the Company's lease portfolio as of the adoption date.

ASU No. 2016-13 - Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments. The amendments in this Update introduce a new current expected credit loss ("CECL") model for certain financial assets, including mortgage loans and reinsurance receivables. The new model will not apply to debt securities classified as available-for-sale. For assets within the scope of the new model, an entity will recognize as an allowance against earnings its estimate of the contractual cash flows not expected to be collected on day one of the asset's acquisition. The allowance may be reversed through earnings if a security recovers in value. This differs from the current impairment model, which requires recognition of credit losses when they have been incurred and recognizes a security's subsequent recovery in value in other comprehensive income. The Update also makes targeted changes to the current impairment model for available-for-sale debt securities, which comprise the majority of the Company's invested assets. Similar to the CECL model, credit loss impairments will be recorded in an allowance against earnings that may be reversed for subsequent recoveries in value. The amendments in this Update are effective for annual and interim periods beginning after December 15, 2019 on a modified retrospective basis. The Company is reviewing its policies and processes to ensure compliance with the requirements in this Update, upon adoption, and assessing the impact this standard will have on its operations and financial results.

ASU No. 2017-08 - Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The amendments in this Update require that premiums on callable debt securities be amortized to the first call date. This is a change from current guidance, under which premiums are amortized to the maturity date of the security. The amendments are effective for annual and interim periods beginning after December 15, 2018, and early adoption is permitted. Transition will be through a modified retrospective approach in which the cumulative effect of application is recorded to retained earnings at the beginning of the annual period in which an entity adopts the revised guidance. Based on our population of callable debt securities held as of September 30, 2018, the Company estimates it would record a reduction to retained earnings of approximately $56.1 million as a result of adopting the ASU. However, the adoption impact will ultimately depend on the population of callable debt securities held as of the adoption date.

ASU No. 2017-12 - Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The amendments in this Update are designed to permit hedge accounting to be applied to a broader range of hedging strategies as well as to more closely align hedge accounting and risk management objectives. Specific provisions include requiring changes in the fair value of a hedging instrument be recorded in the same income statement line as the hedged item when it affects earnings. In addition, after a hedge has initially qualified as an effective hedge the Update permits the use of a qualitative hedge effectiveness test in subsequent periods. The amendments in this Update are effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted. The Company does not expect the adoption of this standard to have a material impact on its operations or financial results.

ASU No. 2018-12 - Financial Services - Insurance (Topic 944): Targeted Improvements to Accounting for Long-Duration Contracts. The amendments in this Update are designed to make improvements to the existing recognition, measurement, presentation, and disclosure requirements for certain long-duration contracts issued by an insurance company. The new amendments require insurance entities to provide a more current measure of the liability for future policy benefits for traditional and limited-payment contracts by regularly refining the liability for actual past experience and updated future assumptions. This differs from current requirements where assumptions are locked-in at contract issuance for these contract types. In addition, the updated liability will be discounted using an upper-medium grade (low-credit-risk) fixed income instrument yield that reflects the characteristics of the liability which differs from currently used rates based on the invested assets supporting the liability. In addition, the amendments introduce new requirements to assess market-based insurance contract options and guarantees for Market Risk Benefits and measure them at fair value. This Update also requires insurance entities to amortize deferred acquisition costs on a constant-level basis over the expected life of the contract. Finally this Update requires new disclosures including liability rollforwards and information about significant inputs, judgements, assumptions, and methods used in the measurement. The amendments in this Update are effective for annual and interim periods beginning after December 15, 2020 with early adoption permitted. The Company is currently reviewing its policies, processes, and applicable systems to determine the impact this standard will have on its operations and financial results.

3. SIGNIFICANT TRANSACTIONS

On May 1, 2018, The Lincoln National Life Insurance Company (“Lincoln Life”) completed its previously announced acquisition (the “Closing”) of Liberty Mutual Group Inc.’s (“Liberty Mutual”) Group Benefits Business and Individual Life and Annuity Business (the “Life Business”) through the acquisition of all of the issued and outstanding capital stock of Liberty Life Assurance Company of Boston (“Liberty”). In connection with the Closing and pursuant to the Master Transaction Agreement, dated January 18, 2018 (the “Master Transaction Agreement”), previously reported in our Current Report on Form 8-K filed on January 23, 2018, PLICO and Protective Life and Annuity Insurance Company (“PLAIC”), a wholly owned subsidiary of PLICO, entered into reinsurance agreements (the “Reinsurance Agreements”) and related ancillary documents (including administrative services agreements and transition services agreements) providing for the reinsurance and administration of the Life Business.

Pursuant to the Reinsurance Agreements, Liberty ceded to PLICO and PLAIC the insurance policies related to the Life Business on a 100% coinsurance basis. The aggregate ceding commission for the reinsurance of the Life Business was $422.4 million, which is the purchase price. Other than cash received as part of the acquired Liberty investment portfolio as reflected in “amounts received from reinsurance transaction” in the Consolidated Condensed Statement of

Cash Flows and as reflected in the table below, this was a non-cash transaction.

All policies issued in states other than New York were ceded to PLICO under a reinsurance agreement between Liberty and PLICO, and all policies issued in New York were ceded to PLAIC under a reinsurance agreement between Liberty and PLAIC. The aggregate statutory reserves of Liberty ceded to PLICO and PLAIC as of the closing of the Transaction were approximately $13.3 billion, which amount was based on initial estimates and is subject to adjustment following the Closing. Pursuant to the terms of the Reinsurance Agreements, each of PLICO and PLAIC are required to maintain assets in trust for the benefit of Liberty to secure their respective obligations to Liberty under the Reinsurance Agreements. The trust accounts were initially funded by each of PLICO and PLAIC principally with the investment assets that were received from Liberty. Additionally, PLICO and PLAIC have each agreed to provide, on behalf of Liberty, administration and policyholder servicing of the Life Business reinsured by it pursuant to administrative services agreements between Liberty and each of PLICO and PLAIC.

The terms of the Reinsurance Agreements resulted in an acquisition of the Life Business by the Company in accordance with Accounting Standards Codification ("ASC") Topic 805, Business Combinations.

The following table details the purchase consideration and preliminary allocation of assets acquired and liabilities assumed from the Life Business reinsurance transaction as of the transaction date. These estimates remain preliminary and are subject to adjustment. While they are not expected to be materially different than those shown, any material adjustments to the estimates will be reflected, retroactively, as of the date of the acquisition.

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	Fair Value as of May 1, 2018 (Dollars In Thousands)
ASSETS	
Fixed maturities	$12,588,512
Mortgage loans	435,405
Policy loans	131,489
Total investments	13,155,406
Cash	20,669
Accrued investment income	151,610
Reinsurance receivables	337
Value of business acquired	336,437
Other assets	2,542
Total assets	13,667,001
LIABILITIES	
Future policy benefits and claims	$11,744,496
Unearned premiums	—
Total policy liabilities and accruals	11,744,496
Annuity account balances	1,823,444
Other policyholders' funds	41,954
Other liabilities	57,107
Total liabilities	13,667,001
NET ASSETS ACQUIRED	$—

The following unaudited pro forma condensed consolidated results of operations assumes that the aforementioned transactions of the Life Business were completed as of January 1, 2017. The unaudited pro forma condensed results of operations are presented solely for information purposes and are not necessarily indicative of the consolidated condensed results of operations that might have been achieved had the transaction been completed as of the date indicated.

	Unaudited For The Three Months Ended September 30,		Unaudited For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Revenue	$1,344,806	$1,397,739	$4,078,285	$4,231,177
Net income	$110,100	$118,547	$311,851	$347,113

The amount of revenue and income before income tax of the Life Business since the transaction date, May 1, 2018, included in the consolidated condensed statements of income for the three and nine months ended September 30, 2018 amounted to $218.1 million and $360.9 million and $26.1 million and $33.7 million, respectively. Also, included in the income before income tax for the nine months ended September 30, 2018, is approximately $5.5 million of non-recurring transaction costs.

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Based on the balance recorded as of May 1, 2018, the expected amortization of VOBA for the next five years is as follows:

Years	Expected Amortization
	(Dollars In Thousands)
Remainder of 2018	$ 5,265
2019	21,063
2020	19,950
2021	18,329
2022	16,611

4. MONY CLOSED BLOCK OF BUSINESS

In 1998, MONY Life Insurance Company ("MONY") converted from a mutual insurance company to a stock corporation ("demutualization"). In connection with its demutualization, an accounting mechanism known as a closed block (the "Closed Block") was established for certain individuals' participating policies in force as of the date of demutualization. Assets, liabilities, and earnings of the Closed Block are specifically identified to support its participating policyholders. The Company acquired the Closed Block in conjunction with the acquisition of MONY in 2013.

Assets allocated to the Closed Block inure solely to the benefit of each Closed Block's policyholders and will not revert to the benefit of MONY or the Company. No reallocation, transfer, borrowing or lending of assets can be made between the Closed Block and other portions of MONY's general account, any of MONY's separate accounts or any affiliate of MONY without the approval of the Superintendent of The New York State Department of Financial Services (the "Superintendent"). Closed Block assets and liabilities are carried on the same basis as similar assets and liabilities held in the general account.

The excess of Closed Block liabilities over Closed Block assets (adjusted to exclude the impact of related amounts in AOCI) at the acquisition date of October 1, 2013, represented the estimated maximum future post-tax earnings from the Closed Block that would be recognized in income from continuing operations over the period the policies and contracts in the Closed Block remain in force. In connection with the acquisition of MONY, the Company developed an actuarial calculation of the expected timing of MONY's Closed Block's earnings as of October 1, 2013. Pursuant to the acquisition of the Company by Dai-ichi Life, this actuarial calculation of the expected timing of MONY's Closed Block earnings was recalculated and reset as February 1, 2015, along with the establishment of a policyholder dividend obligation as of such date.

If the actual cumulative earnings from the Closed Block are greater than the expected cumulative earnings, only the expected earnings will be recognized in the Company's net income. Actual cumulative earnings in excess of expected cumulative earnings at any point in time are recorded as a policyholder dividend obligation because they will ultimately be paid to Closed Block policyholders as an additional policyholder dividend unless offset by future performance that is less favorable than originally expected. If a policyholder dividend obligation has been previously established and the actual Closed Block earnings in a subsequent period are less than the expected earnings for that period, the policyholder dividend obligation would be reduced (but not below zero). If, over the period the policies and contracts in the Closed Block remain in force, the actual cumulative earnings of the Closed Block are less than the expected cumulative earnings, only actual earnings would be recognized in income from continuing operations. If the Closed Block has insufficient funds to make guaranteed policy benefit payments, such payments will be made from assets outside the Closed Block.

Many expenses related to Closed Block operations, including amortization of VOBA, are charged to operations outside of the Closed Block; accordingly, net revenues of the Closed Block do not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside of the Closed Block are, therefore, disproportionate to the business outside of the Closed Block.

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Summarized financial information for the Closed Block as of September 30, 2018, and December 31, 2017, is as follows:

	As of September 30, 2018	December 31, 2017
	(Dollars In Thousands)	
Closed block liabilities		
Future policy benefits, policyholders' account balances and other policyholder liabilities	$5,699,118	$ 5,791,867
Policyholder dividend obligation	—	160,712
Other liabilities	42,640	30,764
Total closed block liabilities	5,741,758	5,983,343
Closed block assets		
Fixed maturities, available-for-sale, at fair value	$4,339,342	$ 4,669,856
Mortgage loans on real estate	76,608	108,934
Policy loans	679,760	700,769
Cash	72,868	31,182
Other assets	144,077	122,637
Total closed block assets	5,312,655	5,633,378
Excess of reported closed block liabilities over closed block assets	429,103	349,965
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains (losses) net of policyholder dividend obligation: $(149,219) and $(13,429); and net of income tax: $57,054 and $2,820	(96,749)	—
Future earnings to be recognized from closed block assets and closed block liabilities	$332,354	$ 349,965

Reconciliation of the policyholder dividend obligation is as follows:

	For The Nine Months Ended September 30, 2018	2017
	(Dollars In Thousands)	
Policyholder dividend obligation, beginning of period	$160,712	$31,932
Applicable to net revenue (losses)	(24,922)	(38,147)
Change in net unrealized investment gains (losses) allocated to the policyholder dividend obligation	(135,790)	142,219
Policyholder dividend obligation, end of period	$—	$136,004

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Closed Block revenues and expenses were as follows:

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Revenues				
Premiums and other income	$39,691	$40,962	$121,768	$128,697
Net investment income	50,833	50,780	152,248	153,481
Net investment gains	40	341	66	448
Total revenues	90,564	92,083	274,082	282,626
Benefits and other deductions				
Benefits and settlement expenses	83,588	81,721	251,480	249,319
Other operating expenses	291	621	310	1,216
Total benefits and other deductions	83,879	82,342	251,790	250,535
Net revenues before income taxes	6,685	9,741	22,292	32,091
Income tax expense	1,404	3,409	4,681	11,232
Net revenues	$5,281	$6,332	$17,611	$20,859

5. INVESTMENT OPERATIONS

Net realized gains (losses) for all other investments are summarized as follows:

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Fixed maturities	$(2,018)	$1,042	$6,304	$10,482
Equity gains and losses[(1)]	(6,638)	(352)	(16,466)	(1,398)
Impairments	(14)	(273)	(3,664)	(10,889)
Modco trading portfolio	(10,901)	19,399	(148,427)	93,181
Other investments	(312)	(1,939)	1,519	(7,557)
Total realized gains (losses) - investments	$(19,883)	$17,877	$(160,734)	$83,819

(1) Beginning January 1, 2018, all changes in the fair market value of equity securities are recorded as a realized gains (loss) as a result of the adoption of ASU No. 2016-01.

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Gross realized gains and gross realized losses on investments available-for-sale (fixed maturities and short-term investments) are as follows:

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Gross realized gains	$3,410	$1,933	$21,596	$14,968
Gross realized losses:				
Impairment losses	$(14)	$(273)	$(3,664)	$(10,889)
Other realized losses	$(5,428)	$(1,243)	$(15,292)	$(5,884)

The chart below summarizes the fair value (proceeds) and the gains (losses) realized on available-for-sale securities the Company sold that were in an unrealized gain position and an unrealized loss position.

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Securities in an unrealized gain position:				
Fair value (proceeds)	$306,600	$121,459	$914,885	$566,064
Gains realized	$3,410	$1,933	$21,596	$14,968
Securities in an unrealized loss position[(1)]:				
Fair value (proceeds)	$122,317	$37,186	$380,493	$121,450
Losses realized	$(5,428)	$(1,243)	$(15,292)	$(5,884)

(1) The Company made the decision to exit these holdings in conjunction with its overall asset/liability management process.

The chart below summarizes the realized gains (losses) on equity securities sold during the period and equity securities still held at the reporting date.

	For The Three Months Ended September 30, 2018	For The Nine Months Ended September 30, 2018
	(Dollars In Thousands)	
Net gains (losses) recognized during the period on equity securities	$(6,638)	$(16,466)
Less: net gains (losses) recognized on equity securities sold during the period	$(1,476)	$(3,856)
Gains (losses) recognized during the period on equity securities still held	$(5,162)	$(12,610)

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The amortized cost and fair value of the Company's investments classified as available-for-sale are as follows:

As of September 30, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Total OTTI Recognized in OCI(1)
	(Dollars In Thousands)				
Fixed maturities:					
Residential mortgage-backed securities	$3,515,247	$5,808	$(105,950)	$3,415,105	$ —
Commercial mortgage-backed securities	2,344,653	181	(82,063)	2,262,771	—
Other asset-backed securities	1,456,768	13,749	(16,382)	1,454,135	—
U.S. government-related securities	1,653,626	160	(72,807)	1,580,979	—
Other government-related securities	548,343	2,926	(21,688)	529,581	—
States, municipals, and political subdivisions	3,691,930	6,070	(139,927)	3,558,073	—
Corporate securities	38,778,746	167,850	(1,924,671)	37,021,925	—
Redeemable preferred stock	94,362	—	(7,223)	87,139	—
	52,083,675	196,744	(2,370,711)	49,909,708	—
Short-term investments	476,188	—	—	476,188	—
	$52,559,863	$196,744	$(2,370,711)	$50,385,896	$ —

As of December 31, 2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Total OTTI Recognized in OCI(1)
	(Dollars In Thousands)				
Fixed maturities:					
Residential mortgage-backed securities	$2,330,832	$19,413	$(23,033)	$2,327,212	$ 10
Commercial mortgage-backed securities	1,914,998	5,010	(30,186)	1,889,822	—
Other asset-backed securities	1,234,376	20,936	(5,763)	1,249,549	—
U.S. government-related securities	1,255,244	185	(32,177)	1,223,252	—
Other government-related securities	282,767	9,463	(4,948)	287,282	—
States, municipals, and political subdivisions	1,770,299	16,959	(45,613)	1,741,645	(37)
Corporate securities	29,606,484	623,713	(528,187)	29,702,010	(1)
Redeemable preferred stock	94,362	232	(3,503)	91,091	—
	38,489,362	695,911	(673,410)	38,511,863	(28)
Equity securities	735,569	22,318	(8,771)	749,116	—
Short-term investments	558,949	—	—	558,949	—
	$39,783,880	$718,229	$(682,181)	$39,819,928	$ (28)

(1) These amounts are included in the gross unrealized gains and gross unrealized losses columns above.

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The fair values of the Company's investments classified as trading are as follows:

	As of September 30, 2018	As of December 31, 2017
	(Dollars In Thousands)	
Fixed maturities:		
Residential mortgage-backed securities	$254,037	$259,694
Commercial mortgage-backed securities	135,403	146,804
Other asset-backed securities	111,770	138,097
U.S. government-related securities	58,081	27,234
Other government-related securities	43,030	63,925
States, municipals, and political subdivisions	296,618	326,925
Corporate securities	1,569,652	1,698,183
Redeemable preferred stock	3,165	3,327
	2,471,756	2,664,189
Equity securities	3,801	5,244
Short-term investments	55,865	56,261
	$2,531,422	$2,725,694

The amortized cost and fair value of available-for-sale and held-to-maturity fixed maturities as of September 30, 2018, by expected maturity, are shown below. Expected maturities of securities without a single maturity date are allocated based on estimated rates of prepayment that may differ from actual rates of prepayment.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars In Thousands)			
Due in one year or less	$957,984	$955,779	$—	$—
Due after one year through five years	9,269,777	9,096,671	—	—
Due after five years through ten years	9,259,344	9,001,644	—	—
Due after ten years	32,596,570	30,855,614	2,653,605	2,577,841
	$52,083,675	$49,909,708	$2,653,605	$2,577,841

The charts below summarize the Company's other-than-temporary impairments of investments. All of the impairments were related to fixed maturities.

	For The Three Months Ended September 30, 2018	For The Nine Months Ended September 30, 2018
	Fixed Maturities	Fixed Maturities
	(Dollars In Thousands)	
Other-than-temporary impairments	$ (14)	$ (715)
Non-credit impairment losses recorded in other comprehensive income	—	(2,949)
Net impairment losses recognized in earnings	$ (14)	$ (3,664)

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	For The Three Months Ended September 30, 2017			For The Nine Months Ended September 30, 2017		
	Fixed Maturities	Equity Securities	Total Securities	Fixed Maturities	Equity Securities	Total Securities
	(Dollars In Thousands)					
Other-than-temporary impairments	$(366)	$ —	$(366)	$(494)	$(2,630)	$(3,124)
Non-credit impairment losses recorded in other comprehensive income	93	—	93	(7,765)	—	(7,765)
Net impairment losses recognized in earnings	$(273)	$ —	$(273)	$(8,259)	$(2,630)	$(10,889)

There were no other-than-temporary impairments related to fixed maturities or equity securities that the Company intended to sell or expected to be required to sell for the three and nine months ended September 30, 2018 and 2017.

The following chart is a rollforward of available-for-sale credit losses on fixed maturities held by the Company for which a portion of an other-than-temporary impairment was recognized in other comprehensive income (loss):

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2018	2017	2018	2017
	(Dollars In Thousands)			
Beginning balance	$2	$2,783	$3,268	$12,685
Additions for newly impaired securities	—	266	—	266
Additions for previously impaired securities	—	6	2	2,791
Reductions for previously impaired securities due to a change in expected cash flows	—	(37)	—	(12,724)
Reductions for previously impaired securities that were sold in the current period	(2)	(600)	(3,270)	(600)
Ending balance	$—	$2,418	$—	$2,418

The following table includes the gross unrealized losses and fair value of the Company’s investments that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2018:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(Dollars In Thousands)					
Residential mortgage-backed securities	$2,831,969	$(80,873)	$407,345	$(25,077)	$3,239,314	$(105,950)
Commercial mortgage-backed securities	1,442,862	(40,080)	757,095	(41,983)	2,199,957	(82,063)
Other asset-backed securities	645,956	(9,131)	125,847	(7,251)	771,803	(16,382)
U.S. government-related securities	551,939	(14,066)	1,012,450	(58,741)	1,564,389	(72,807)
Other government-related securities	256,902	(7,459)	111,089	(14,229)	367,991	(21,688)
States, municipalities, and political subdivisions	2,268,935	(51,019)	998,399	(88,908)	3,267,334	(139,927)
Corporate securities	21,828,788	(787,017)	9,771,234	(1,137,654)	31,600,022	(1,924,671)
Redeemable preferred stock	43,712	(1,902)	43,427	(5,321)	87,139	(7,223)
	$29,871,063	$(991,547)	$13,226,886	$(1,379,164)	$43,097,949	$(2,370,711)

RMBS and CMBS had gross unrealized losses greater than twelve months of $25.1 million and $42.0 million, respectively, as of September 30, 2018. Factors such as the credit enhancement within the deal structure, the average life of the securities, and the performance of the underlying collateral support the recoverability of these investments.

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The other asset-backed securities had a gross unrealized loss greater than twelve months of $7.3 million as of September 30, 2018. This category predominately includes student loan backed auction rate securities whose underlying collateral is at least 97% guaranteed by the Federal Family Education Loan Program ("FFELP"). At this time, the Company has no reason to believe that the U.S. Department of Education would not honor the FFELP guarantee, if it were necessary.

The U.S. government-related securities and the other government-related securities had gross unrealized losses greater than twelve months of $58.7 million and $14.2 million as of September 30, 2018, respectively. These declines were related to changes in interest rates.

The states, municipalities, and political subdivisions category had gross unrealized losses greater than twelve months of $88.9 million as of September 30, 2018. The aggregate decline in market value of these securities was deemed temporary due to positive factors supporting the recoverability of the respective investments. Positive factors considered include credit ratings, the financial health of the issuer, the continued access of the issuer to capital markets, and other pertinent information.

The corporate securities category had gross unrealized losses greater than twelve months of $1.1 billion as of September 30, 2018. The aggregate decline in market value of these securities was deemed temporary due to positive factors supporting the recoverability of the respective investments. Positive factors considered include credit ratings, the financial health of the issuer, the continued access of the issuer to capital markets, and other pertinent information.

As of September 30, 2018, the Company had a total of 4,367 positions that were in an unrealized loss position, but the Company does not consider these unrealized loss positions to be other-than-temporary. This is based on the aggregate factors discussed previously and because the Company has the ability and intent to hold these investments until the fair values recover, and the Company does not intend to sell or expect to be required to sell the securities before recovering the Company's amortized cost of the securities.

The following table includes the gross unrealized losses and fair value of the Company's investments that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2017:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(Dollars In Thousands)					
Residential mortgage-backed securities	$766,599	$(9,671)	$416,221	$(13,362)	$1,182,820	$(23,033)
Commercial mortgage-backed securities	757,471	(8,592)	796,456	(21,594)	1,553,927	(30,186)
Other asset-backed securities	86,506	(322)	134,316	(5,441)	220,822	(5,763)
U.S. government-related securities	94,110	(688)	1,072,232	(31,489)	1,166,342	(32,177)
Other government-related securities	24,830	(169)	115,294	(4,778)	140,124	(4,947)
States, municipalities, and political subdivisions	170,268	(1,738)	1,027,747	(43,874)	1,198,015	(45,612)
Corporate securities	5,054,316	(55,795)	10,962,689	(472,394)	16,017,005	(528,189)
Redeemable preferred stock	22,048	(1,120)	23,197	(2,383)	45,245	(3,503)
Equities	86,586	(1,401)	91,195	(7,370)	177,781	(8,771)
	$7,062,734	$(79,496)	$14,639,347	$(602,685)	$21,702,081	$(682,181)

RMBS and CMBS had gross unrealized losses greater than twelve months of $13.4 million and $21.6 million, respectively, as of December 31, 2017. Factors such as the credit enhancement within the deal structure, the average life of the securities, and the performance of the underlying collateral support the recoverability of these investments.

The other asset-backed securities had a gross unrealized loss greater than twelve months of $5.4 million as of December 31, 2017. This category predominately includes student loan backed auction rate securities whose underlying collateral is at least 97% guaranteed by the FFELP. At this time, the Company has no reason to believe that the U.S. Department of Education would not honor the FFELP guarantee, if it were necessary.

The U.S. government-related securities and other government-related securities had gross unrealized losses greater than twelve months of $31.5 million and $4.8 million as of December 31, 2017, respectively. These declines were

related to changes in interest rates.
The states, municipalities, and political subdivisions category had gross unrealized losses greater than twelve months of $43.9 million as of December 31, 2017. These declines were related to changes in interest rates.
The corporate securities category had gross unrealized losses greater than twelve months of $472.4 million as of December 31, 2017. The aggregate decline in market value of these securities was deemed temporary due to positive factors supporting the recoverability of the respective investments. Positive factors considered include credit ratings, the financial health of the issuer, the continued access of the issuer to capital markets, and other pertinent information.

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As of September 30, 2018, the Company had securities in its available-for-sale portfolio which were rated below investment grade of $1.7 billion and had an amortized cost of $1.7 billion. In addition, included in the Company's trading portfolio, the Company held $175.6 million of securities which were rated below investment grade. Approximately $263.1 million of the available-for-sale and trading securities that were below investment grade were not publicly traded.

The change in unrealized gains (losses), net of income tax, on fixed maturities, classified as available-for-sale is summarized as follows:

	For The Three Months Ended September 30, 2018	2017	For The Nine Months Ended September 30, 2018	2017
	(Dollars In Thousands)			
Fixed maturities	$(229,912)	$168,062	$(1,735,210)	$868,767

The amortized cost and fair value of the Company's investments classified as held-to-maturity as of September 30, 2018 and December 31, 2017, are as follows:

As of September 30, 2018	Amortized Cost	Gross Unrecognized Holding Gains	Gross Unrecognized Holding Losses	Fair Value	Total OTTI Recognized in OCI
	(Dollars In Thousands)				
Fixed maturities:					
Securities issued by affiliates:					
Red Mountain, LLC	$736,605	$ —	$ (77,492)	$659,113	$ —
Steel City, LLC	1,917,000	1,728	—	1,918,728	—
	$2,653,605	$ 1,728	$ (77,492)	$2,577,841	$ —

As of December 31, 2017	Amortized Cost	Gross Unrecognized Holding Gains	Gross Unrecognized Holding Losses	Fair Value	Total OTTI Recognized in OCI
	(Dollars In Thousands)				
Fixed maturities:					
Securities issued by affiliates:					
Red Mountain, LLC	$704,904	$ —	$ (19,163)	$685,741	$ —
Steel City, LLC	2,014,000	76,586	—	2,090,586	—
	$2,718,904	$ 76,586	$ (19,163)	$2,776,327	$ —

During the three and nine months ended September 30, 2018 and 2017, the Company recorded no other-than-temporary impairments on held-to-maturity securities.

The Company's held-to-maturity securities had $1.7 million of gross unrecognized holding gains and $77.5 million of gross unrecognized holding losses by maturity as of September 30, 2018. The Company does not consider these unrecognized holding losses to be other-than-temporary based on certain positive factors associated with the securities which include credit ratings of the guarantor, financial health of the issuer and guarantor, continued access of the issuer to capital markets and other pertinent information. These held-to-maturity securities are issued by affiliates of the Company which are considered variable interest entities ("VIEs"). The Company is not the primary beneficiary of these entities and thus the securities are not eliminated in consolidation. These securities are collateralized by non-recourse funding obligations issued by captive insurance companies that are affiliates of the Company.

The Company's held-to-maturity securities had $76.6 million of gross unrecognized holding gains and $19.2 million of gross unrecognized holding losses by maturity as of December 31, 2017. The Company does not consider these unrecognized holding losses to be other-than-temporary based on certain positive factors associated with the securities which include credit ratings of the guarantor, financial health of the issuer and guarantor, continued access of the issuer to capital markets and other pertinent information.

Variable Interest Entities

The Company holds certain investments in entities in which its ownership interests could possibly be considered variable interests under Topic 810 of the Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC" or "Codification") (excluding debt and equity securities held as trading, available for sale, or held to maturity). The Company reviews the characteristics of each of these applicable entities and compares those characteristics to applicable criteria to determine whether the entity is a VIE. If the entity is determined to be a VIE, the Company then performs a detailed review to determine whether the interest would be considered a variable interest under the guidance. The Company then performs a qualitative review of all variable interests with the entity and determines whether the Company is the primary beneficiary. ASC 810 provides that an entity is the primary beneficiary of a VIE if the entity has 1) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, and 2) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

Based on this analysis, the Company had an interest in two subsidiaries as of September 30, 2018 and December 31, 2017, Red Mountain, LLC ("Red Mountain") and Steel City, LLC ("Steel City"), that were determined to be VIEs. The activity most significant to Red Mountain is the issuance of a note in connection with a financing transaction involving Golden Gate V Vermont Captive Insurance Company ("Golden Gate V") in which Golden Gate V issued non-recourse funding obligations to Red Mountain and Red Mountain issued a note (the "Red Mountain Note") to Golden Gate V. For details of this transaction, see Note 11, Debt and Other Obligations. The Company had the power, via its 100% ownership through an affiliate, to direct the activities of the VIE, but did not have the obligation to absorb losses related to the primary risks or sources of variability to the VIE. The variability of loss would be borne primarily by the third party in its function as provider of credit enhancement on the Red Mountain Note. Accordingly, it was determined that the Company is not the primary beneficiary of the VIE. The Company's risk of loss related to the VIE is limited to its investment, through an affiliate, of $10,000. Additionally, the Company has guaranteed Red Mountain's payment obligation for the credit enhancement fee to the unrelated third party provider. As of September 30, 2018, no payments have been made or required related to this guarantee.

Steel City, a wholly owned subsidiary of the Company, entered into a financing agreement on January 15, 2016 involving Golden Gate Captive Insurance Company ("Golden Gate"), in which Golden Gate issued non-recourse funding obligations to Steel City and Steel City issued three notes (the "Steel City Notes") to Golden Gate. Credit enhancement on the Steel City Notes is provided by unrelated third parties. For details of the financing transaction, see Note 11, Debt and Other Obligations. The activity most significant to Steel City is the issuance of the Steel City Notes. The Company had the power, via its 100% ownership, to direct the activities of the VIE, but did not have the obligation to absorb losses related to the primary risks or sources of variability to the VIE. The variability of loss would be borne primarily by the third parties in their function as providers of credit enhancement on the Steel City Notes. Accordingly, it was determined that the Company is not the primary beneficiary of the VIE. The Company's risk of loss related to the VIE is limited to its investment of $10,000. Additionally, the Company has guaranteed Steel City's payment obligation for the credit enhancement fee to the unrelated third party providers. As of September 30, 2018, no payments have been made or required related to this guarantee.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company determined the fair value of its financial instruments based on the fair value hierarchy established in FASB guidance referenced in the Fair Value Measurements and Disclosures Topic which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company has adopted the provisions from the FASB guidance that is referenced in the Fair Value Measurements and Disclosures Topic for non-financial assets and liabilities (such as property and equipment, goodwill, and other intangible assets) that are required to be measured at fair value on a periodic basis. The effect on the Company's periodic fair value measurements for non-financial assets and liabilities was not material.

The Company has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three level hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded at fair value on the consolidated balance sheets are categorized as follows:

- Level 1: Unadjusted quoted prices for identical assets or liabilities in an active market.

- Level 2: Quoted prices in markets that are not active or significant inputs that are observable either directly or indirectly. Level 2 inputs include the following:

a. Quoted prices for similar assets or liabilities in active markets;
b. Quoted prices for identical or similar assets or liabilities in non-active markets;
c. Inputs other than quoted market prices that are observable; and
d. Inputs that are derived principally from or corroborated by observable market data through correlation or other means.

- Level 3: Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. They reflect management’s own estimates about the assumptions a market participant would use in pricing the asset or liability.

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The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of September 30, 2018:

	Measurement Category	Level 1	Level 2	Level 3	Total
		(Dollars In Thousands)			
Assets:					
Fixed maturity securities - available-for-sale					
Residential mortgage-backed securities	4	$—	$3,415,105	$—	$3,415,105
Commercial mortgage-backed securities	4	—	2,243,304	19,467	2,262,771
Other asset-backed securities	4	—	951,874	502,261	1,454,135
U.S. government-related securities	4	946,679	634,300	—	1,580,979
State, municipalities, and political subdivisions	4	—	3,558,073	—	3,558,073
Other government-related securities	4	—	529,581	—	529,581
Corporate securities	4	—	36,393,641	628,284	37,021,925
Redeemable preferred stock	4	69,550	17,589	—	87,139
Total fixed maturity securities - available-for-sale		1,016,229	47,743,467	1,150,012	49,909,708
Fixed maturity securities - trading					
Residential mortgage-backed securities	3	—	254,037	—	254,037
Commercial mortgage-backed securities	3	—	135,403	—	135,403
Other asset-backed securities	3	—	83,758	28,012	111,770
U.S. government-related securities	3	26,859	31,222	—	58,081
State, municipalities, and political subdivisions	3	—	296,618	—	296,618
Other government-related securities	3	—	43,030	—	43,030
Corporate securities	3	—	1,564,429	5,223	1,569,652
Redeemable preferred stock	3	3,165	—	—	3,165
Total fixed maturity securities - trading		30,024	2,408,497	33,235	2,471,756
Total fixed maturity securities		1,046,253	50,151,964	1,183,247	52,381,464
Equity securities	3	598,576	36	64,268	662,880
Other long-term investments(1)	3 & 4	52,728	402,312	181,546	636,586
Short-term investments	3	434,734	97,319	—	532,053
Total investments		2,132,291	50,651,631	1,429,061	54,212,983
Cash	3	194,460	—	—	194,460
Other assets	3	31,743	—	—	31,743
Assets related to separate accounts					
Variable annuity	3	13,555,469	—	—	13,555,469
Variable universal life	3	1,077,842	—	—	1,077,842
Total assets measured at fair value on a recurring basis		$16,991,805	$50,651,631	$1,429,061	$69,072,497
Liabilities:					
Annuity account balances (2)	3	$—	$—	$78,463	$78,463
Other liabilities(1)	3 & 4	8,243	272,724	554,480	835,447
Total liabilities measured at fair value on a recurring basis		$8,243	$272,724	$632,943	$913,910

(1) Includes certain freestanding and embedded derivatives.
(2) Represents liabilities related to fixed indexed annuities.
(3) Fair Value through Net Income
(4) Fair Value through Other Comprehensive Income

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The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of December 31, 2017:

	Level 1	Level 2	Level 3	Total
	(Dollars In Thousands)			
Assets:				
Fixed maturity securities - available-for-sale				
Residential mortgage-backed securities	$—	$2,327,212	$—	$2,327,212
Commercial mortgage-backed securities	—	1,889,822	—	1,889,822
Other asset-backed securities	—	745,184	504,365	1,249,549
U.S. government-related securities	958,775	264,477	—	1,223,252
State, municipalities, and political subdivisions	—	1,741,645	—	1,741,645
Other government-related securities	—	287,282	—	287,282
Corporate securities	—	29,075,109	626,901	29,702,010
Redeemable preferred stock	72,471	18,620	—	91,091
Total fixed maturity securities - available-for-sale	1,031,246	36,349,351	1,131,266	38,511,863
Fixed maturity securities - trading				
Residential mortgage-backed securities	—	259,694	—	259,694
Commercial mortgage-backed securities	—	146,804	—	146,804
Other asset-backed securities	—	102,875	35,222	138,097
U.S. government-related securities	21,183	6,051	—	27,234
State, municipalities, and political subdivisions	—	326,925	—	326,925
Other government-related securities	—	63,925	—	63,925
Corporate securities	—	1,692,741	5,442	1,698,183
Redeemable preferred stock	3,327	—	—	3,327
Total fixed maturity securities - trading	24,510	2,599,015	40,664	2,664,189
Total fixed maturity securities	1,055,756	38,948,366	1,171,930	41,176,052
Equity securities	688,214	36	66,110	754,360
Other long-term investments(1)	51,102	417,969	136,004	605,075
Short-term investments	482,461	132,749	—	615,210
Total investments	2,277,533	39,499,120	1,374,044	43,150,697
Cash	252,310	—	—	252,310
Other assets	28,771	—	—	28,771
Assets related to separate accounts				
Variable annuity	13,956,071	—	—	13,956,071
Variable universal life	1,035,202	—	—	1,035,202
Total assets measured at fair value on a recurring basis	$17,549,887	$39,499,120	$1,374,044	$58,423,051
Liabilities:				
Annuity account balances(2)	$—	$—	$83,472	$83,472
Other liabilities(1)	5,755	240,927	760,890	1,007,572
Total liabilities measured at fair value on a recurring basis	$5,755	$240,927	$844,362	$1,091,044

(1) Includes certain freestanding and embedded derivatives.
(2) Represents liabilities related to fixed indexed annuities.

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Determination of fair values

The valuation methodologies used to determine the fair values of assets and liabilities reflect market participant assumptions and are based on the application of the fair value hierarchy that prioritizes observable market inputs over unobservable inputs. The Company determines the fair values of certain financial assets and financial liabilities based on quoted market prices, where available. The Company also determines certain fair values based on future cash flows discounted at the appropriate current market rate. Fair values reflect adjustments for counterparty credit quality, the Company's credit standing, liquidity, and where appropriate, risk margins on unobservable parameters. The following is a discussion of the methodologies used to determine fair values for the financial instruments as listed in the above table.

The fair value of fixed maturity, short-term, and equity securities is determined by management after considering one of three primary sources of information: third party pricing services, non-binding independent broker quotations, or pricing matrices. Security pricing is applied using a "waterfall" approach whereby publicly available prices are first sought from third party pricing services, the remaining unpriced securities are submitted to independent brokers for non-binding prices, or lastly, securities are priced using a pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. Third party pricing services price approximately 93.3% of the Company's available-for-sale and trading fixed maturity securities. Based on the typical trading volumes and the lack of quoted market prices for available-for-sale and trading fixed maturities, third party pricing services derive the majority of security prices from observable market inputs such as recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information outlined above. If there are no recent reported trades, the third party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Certain securities are priced via independent non-binding broker quotations, which are considered to have no significant unobservable inputs. When using non-binding independent broker quotations, the Company obtains one quote per security, typically from the broker from which we purchased the security. A pricing matrix is used to price securities for which the Company is unable to obtain or effectively rely on either a price from a third party pricing service or an independent broker quotation.

The pricing matrix used by the Company begins with current spread levels to determine the market price for the security. The credit spreads, assigned by brokers, incorporate the issuer's credit rating, liquidity discounts, weighted average of contracted cash flows, risk premium, if warranted, due to the issuer's industry, and the security's time to maturity. The Company uses credit ratings provided by nationally recognized rating agencies.

For securities that are priced via non-binding independent broker quotations, the Company assesses whether prices received from independent brokers represent a reasonable estimate of fair value through an analysis using internal and external cash flow models developed based on spreads and, when available, market indices. The Company uses a market-based cash flow analysis to validate the reasonableness of prices received from independent brokers. These analytics, which are updated daily, incorporate various metrics (yield curves, credit spreads, prepayment rates, etc.) to determine the valuation of such holdings. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon the analytics, the price received from the independent broker is adjusted accordingly. The Company did not adjust any quotes or prices received from brokers during the nine months ended September 30, 2018.

The Company has analyzed the third party pricing services' valuation methodologies and related inputs and has also evaluated the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs that is in accordance with the Fair Value Measurements and Disclosures Topic of the ASC. Based on this evaluation and investment class analysis, each price was classified into Level 1, 2, or 3. Most prices provided by third party pricing services are classified into Level 2 because the significant inputs used in pricing the securities are market observable and the observable inputs are corroborated by the Company. Since the matrix pricing of certain debt securities includes significant non-observable inputs, they are classified as Level 3.

Asset-Backed Securities

This category mainly consists of residential mortgage-backed securities, commercial mortgage-backed securities, and other asset-backed securities (collectively referred to as asset-backed securities or “ABS”). As of September 30, 2018, the Company held $7.1 billion of ABS classified as Level 2. These securities are priced from information provided by a third party pricing service and independent broker quotes. The third party pricing services and brokers mainly value securities using both a market and income approach to valuation. As part of this valuation process they consider the following characteristics of the item being measured to be relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, and 7) credit ratings of the securities.

After reviewing these characteristics of the ABS, the third party pricing service and brokers use certain inputs to determine the value of the security. For ABS classified as Level 2, the valuation would consist of predominantly market observable inputs such as, but not limited to: 1) monthly principal and interest payments on the underlying assets, 2) average life of the security, 3) prepayment speeds, 4) credit spreads, 5) treasury and swap yield curves, and 6) discount margin. The Company reviews the methodologies and valuation techniques (including the ability to observe inputs) in assessing the information received from external pricing services and in consideration of the fair value presentation.

As of September 30, 2018, the Company held $549.7 million of Level 3 ABS, which included $521.7 million of other asset-backed securities classified as available-for-sale and $28.0 million of other asset-backed securities classified as trading. These securities are predominantly ARS whose underlying collateral is at least 97% guaranteed by the FFELP. The Company prices its ARS using an income approach valuation model. As part of the valuation process the Company reviews the following characteristics of the ARS in determining the relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, 7) credit ratings of the securities, 8) liquidity premium, and 9) paydown rate. In periods where market activity increases and there are transactions at a price that is not the result of a distressed or forced sale we consider those prices as part of our valuation. If the market activity during a period is solely the result of the issuer redeeming positions we consider those transactions in our valuation, but still consider them to be level three measurements due to the nature of the transaction.

Corporate Securities, U.S. Government-Related Securities, States, Municipals, and Political Subdivisions, and Other Government-Related Securities

As of September 30, 2018, the Company classified approximately $43.1 billion of corporate securities, U.S. government-related securities, states, municipals, and political subdivisions, and other government-related securities as Level 2. The fair value of the Level 2 securities is predominantly priced by broker quotes and a third party pricing service. The Company has reviewed the valuation techniques of the brokers and third party pricing service and has determined that such techniques used Level 2 market observable inputs. The following characteristics of the securities are considered to be the primary relevant inputs to the valuation: 1) weighted average coupon rate, 2) weighted-average years to maturity, 3) seniority, and 4) credit ratings. The Company reviews the methodologies and valuation techniques (including the ability to observe inputs) in assessing the information received from external pricing services and in consideration of the fair value presentation.

The brokers and third party pricing service utilize valuation models that consist of a hybrid income and market approach to valuation. The pricing models utilize the following inputs: 1) principal and interest payments, 2) treasury yield curve, 3) credit spreads from new issue and secondary trading markets, 4) dealer quotes with adjustments for issues with early redemption features, 5) liquidity premiums present on private placements, and 6) discount margins from dealers in the new issue market.

As of September 30, 2018, the Company classified approximately $633.5 million of securities as Level 3 valuations. Level 3 securities primarily represent investments in illiquid bonds for which no price is readily available. To determine a price, the Company uses a discounted cash flow model with both observable and unobservable inputs. These inputs are entered into an industry standard pricing model to determine the final price of the security. These inputs include: 1) principal and interest payments, 2) coupon rate, 3) sector and issuer level spread over treasury, 4) underlying collateral, 5) credit ratings, 6) maturity, 7) embedded options, 8) recent new issuance, 9) comparative bond analysis, and 10) an illiquidity premium.

Equities

As of September 30, 2018, the Company held approximately $64.3 million of equity securities classified as Level 2 and Level 3. Of this total, $63.4 million represents Federal Home Loan Bank (“FHLB”) stock. The Company believes that the cost of the FHLB stock approximates fair value.

Other Long-term Investments and Other Liabilities

Other long-term investments and other liabilities consist entirely of free-standing and embedded derivative financial instruments. Refer to Note 7, Derivative Financial Instruments for additional information related to derivatives. Derivative financial instruments are valued using exchange prices, independent broker quotations, or pricing valuation models, which utilize market data inputs. Excluding embedded derivatives, as of September 30, 2018, 100% of derivatives based upon notional values were priced using exchange prices or independent broker quotations. Inputs used to value derivatives include, but are not limited to, interest swap rates, credit spreads, interest rate and equity market volatility indices, equity index levels, and treasury rates. The Company performs monthly analysis on derivative valuations that includes both quantitative and qualitative analyses.

Derivative instruments classified as Level 1 generally include futures and options, which are traded on active exchange markets.

Derivative instruments classified as Level 2 primarily include swaps, options, and swaptions, which are traded over-the-counter. Level 2 also includes certain centrally cleared derivatives. These derivative valuations are determined using independent broker quotations, which are corroborated with observable market inputs.

Derivative instruments classified as Level 3 were embedded derivatives and include at least one significant non-observable input. A derivative instrument containing Level 1 and Level 2 inputs will be classified as a Level 3 financial instrument in its entirety if it has at least one significant Level 3 input.

The Company utilizes derivative instruments to manage the risk associated with certain assets and liabilities. However, the derivative instruments may not be classified within the same fair value hierarchy level as the associated assets and liabilities. Therefore, the changes in fair value on derivatives reported in Level 3 may not reflect the offsetting impact of the changes in fair value of the associated assets and liabilities.

The embedded derivatives are carried at fair value in “other long-term investments” and “other liabilities” on the Company’s consolidated condensed balance sheet. The changes in fair value are recorded in earnings as “Realized investment gains (losses) - Derivative financial instruments”. Refer to Note 7, Derivative Financial Instruments for more information related to each embedded derivatives gains and losses.

The fair value of the guaranteed living withdrawal benefits ("GLWB") embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using multiple risk neutral stochastic equity scenarios and policyholder behavior assumptions. The risk neutral scenarios are generated using the current swap curve and projected equity

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volatilities and correlations. The projected equity volatilities are based on a blend of historical volatility and near-term equity market implied volatilities. The equity correlations are based on historical price observations. For policyholder behavior assumptions, expected lapse and utilization assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the Ruark 2015 ALB table with attained age factors varying from 91.1% - 106.6%. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR plus a credit spread (to represent the Company's non-performance risk). As a result of using significant unobservable inputs, the GLWB embedded derivative is categorized as Level 3. Policyholder assumptions are reviewed on an annual basis.

The balance of the FIA embedded derivative is impacted by policyholder cash flows associated with the FIA product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the FIA embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior assumptions, expected lapse and withdrawal assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the 2015 Ruark ALB mortality table modified with company experience, with attained age factors varying from 87% - 100%. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company's non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the FIA embedded derivative is categorized as Level 3.

The balance of the indexed universal life ("IUL") embedded derivative is impacted by policyholder cash flows associated with the IUL product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the IUL embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior assumptions, expected lapse and withdrawal assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the SOA 2015 VBT Primary Tables modified with company experience, with attained age factors varying from 37% - 577%. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company's non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the IUL embedded derivative is categorized as Level 3.

The Company has assumed and ceded certain blocks of policies under modified coinsurance agreements in which the investment results of the underlying portfolios inure directly to the reinsurers. As a result, these agreements contain embedded derivatives that are reported at fair value. Changes in their fair value are reported in earnings. The investments supporting these agreements are designated as "trading securities"; therefore changes in their fair value are also reported in earnings. As of September 30, 2018, the fair value of the embedded derivative is based upon the relationship between the statutory policy liabilities (net of policy loans) of $2.3 billion and the statutory unrealized gain (loss) of the securities of $60.0 million. As a result, changes in the fair value of the embedded derivatives are largely offset by the changes in fair value of the related investments and each are reported in earnings. The fair value of the embedded derivative is considered a Level 3 valuation due to the unobservable nature of the policy liabilities.

Annuity Account Balances

The Company records a certain legacy block of FIA reserves at fair value. Based on the characteristics of these reserves, the Company believes that the fund value approximates fair value. The fair value measurement of these reserves is considered a Level 3 valuation due to the unobservable nature of the fund values. The Level 3 fair value as of September 30, 2018 is $78.5 million.

Separate Accounts

Separate account assets are invested in open-ended mutual funds and are included in Level 1.

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Valuation of Level 3 Financial Instruments

The following table presents the valuation method for material financial instruments included in Level 3, as well as the unobservable inputs used in the valuation of those financial instruments:

	Fair Value As of September 30, 2018 (Dollars In Thousands)	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets:				
Other asset-backed securities	$ 502,020	Liquidation	Liquidation value	$90 - $97 ($94.92)
		Discounted cash flow	Liquidity premium	0.0% - 1.40% (0.62%)
			Paydown rate	11.09% - 13.15% (12.38%)
Corporate securities	621,392	Discounted cash flow	Spread over treasury	0.90% - 4.23% (1.51%)
Liabilities:(1)				
Embedded derivatives - GLWB(2)	$ 37,794	Actuarial cash flow model	Mortality	87% to 100% of Ruark 2015 ALB table
			Lapse	Ruark Predictive Model
			Utilization	99%. 10% of policies have a one-time over-utilization of 400%
			Nonperformance risk	0.13% - 0.88%
Embedded derivative - FIA	256,912	Actuarial cash flow model	Expenses	$145 per policy
			Withdrawal rate	1.5% prior to age 70, 100% of the RMD for ages 70+
			Mortality	1994 MGDB table with company experience
			Lapse	1.0% - 30.0%, depending on duration/surrender charge period
			Nonperformance risk	0.13% - 0.88%
Embedded derivative - IUL	95,739	Actuarial cash flow model	Mortality	37% - 577% of 2015 VBT Primary Tables
			Lapse	0.5% - 10.0%, depending on duration/distribution channel and smoking class
			Nonperformance risk	0.13% - 0.88%

(1) Excludes modified coinsurance arrangements.

(2) The fair value for the GLWB embedded derivative is presented as a net liability.

The chart above excludes Level 3 financial instruments that are valued using broker quotes and for which book value approximates fair value.

The Company has considered all reasonably available quantitative inputs as of September 30, 2018, but the valuation techniques and inputs used by some brokers in pricing certain financial instruments are not shared with the Company. This resulted in $60.5 million of financial instruments being classified as Level 3 as of September 30, 2018. Of the $60.5 million, $47.7 million are other asset-backed securities, $12.1 million are corporate securities, and $0.7 million are equity securities.

In certain cases, the Company has determined that book value materially approximates fair value. As of September 30, 2018, the Company held $63.6 million of financial instruments where book value approximates fair value which was predominantly FHLB stock.

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The following table presents the valuation method for material financial instruments included in Level 3, as well as the unobservable inputs used in the valuation of those financial instruments:

	Fair Value As of December 31, 2017 (Dollars In Thousands)	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets:				
Other asset-backed securities	$ 504,228	Liquidation	Liquidation value	$90 - $97 ($94.91)
		Discounted Cash Flow	Liquidity premium	0.06% - 1.17% (0.75%)
			Paydown rate	11.31% - 11.97% (11.54%)
Corporate securities	617,770	Discounted cash flow	Spread over treasury	0.81% - 3.95% (1.06%)
Liabilities:[1]				
Embedded derivatives - GLWB[2]	$ 111,760	Actuarial cash flow model	Mortality	91.1% to 106.6% of Ruark 2015 ALB table
			Lapse	1.0% - 30.0%, depending on product/duration/funded status of guarantee
			Utilization	99%. 10% of policies have a one-time over-utilization of 400%
			Nonperformance risk	0.11% - 0.79%
Embedded derivative - FIA	218,676	Actuarial cash flow model	Expenses	$146 per policy
			Withdrawal rate	1.5% prior to age 70, 100% of the RMD for ages 70+
			Mortality	1994 MGDB table with company experience
			Lapse	1.0% - 30.0%, depending on duration/surrender charge period
			Nonperformance risk	0.11% - 0.79%
Embedded derivative - IUL	80,212	Actuarial cash flow model	Mortality	34% - 152% of 2015 VBT Primary Tables
			Lapse	0.5% - 10.0%, depending on duration/distribution channel and smoking class
			Nonperformance risk	0.11% - 0.79%

(1) Excludes modified coinsurance arrangements.

(2) The fair value for the GLWB embedded derivative is presented as a net liability.

The chart above excludes Level 3 financial instruments that are valued using broker quotes and for which book value approximates fair value.

The Company had considered all reasonably available quantitative inputs as of December 31, 2017, but the valuation techniques and inputs used by some brokers in pricing certain financial instruments are not shared with the Company. This resulted in $50.4 million of financial instruments being classified as Level 3 as of December 31, 2017. Of the $50.4 million, $35.4 million are other asset-backed securities, $14.6 million are corporate securities, and $0.4 million are equity securities.

In certain cases the Company has determined that book value materially approximates fair value. As of December 31, 2017, the Company held $65.7 million of financial instruments where book value approximates fair value which was predominantly FHLB stock.

The asset-backed securities classified as Level 3 are predominantly ARS. A change in the paydown rate (the projected annual rate of principal reduction) of the ARS can significantly impact the fair value of these securities. A decrease in the paydown rate would increase the projected weighted average life of the ARS and increase the sensitivity of the ARS' fair value to changes in interest rates. An increase in the liquidity premium would result in a decrease in the fair value of the securities, while a decrease in the liquidity premium would increase the fair value of these securities. The liquidation values for these securities are sensitive to the issuer's available cash flows and ability to redeem the securities, as well as the current holders' willingness to liquidate at the specified price.

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The fair value of corporate bonds classified as Level 3 is sensitive to changes in the interest rate spread over the corresponding U.S. Treasury rate. This spread represents a risk premium that is impacted by company-specific and market factors. An increase in the spread can be caused by a perceived increase in credit risk of a specific issuer and/or an increase in the overall market risk premium associated with similar securities. The fair values of corporate bonds are sensitive to changes in spread. When holding the treasury rate constant, the fair value of corporate bonds increases when spreads decrease, and decreases when spreads increase.

The fair value of the GLWB embedded derivative is sensitive to changes in the discount rate which includes the Company's nonperformance risk, volatility, lapse, and mortality assumptions. The volatility assumption is an observable input as it is based on market inputs. The Company's nonperformance risk, lapse, and mortality are unobservable. An increase in the three unobservable assumptions would result in a decrease in the fair value of the liability and conversely, if there is a decrease in the assumptions the fair value would increase. The fair value is also dependent on the assumed policyholder utilization of the GLWB where an increase in assumed utilization would result in an increase in the fair value of the liability and conversely, if there is a decrease in the assumption, the fair value would decrease.

The fair value of the FIA embedded derivative is predominantly impacted by observable inputs such as discount rates and equity returns. However, the fair value of the FIA embedded derivative is sensitive to non-performance risk, which is unobservable. The value of the liability increases with decreases in the discount rate and non-performance risk and decreases with increases in the discount rate and nonperformance risk. The value of the liability increases with increases in equity returns and the liability decreases with a decrease in equity returns.

The fair value of the IUL embedded derivative is predominantly impacted by observable inputs such as discount rates and equity returns. However, the fair value of the IUL embedded derivative is sensitive to non-performance risk, which is unobservable. The value of the liability increases with decreases in the discount rate and non-performance risk and decreases with increases in the discount rate and non-performance risk. The value of the liability increases with increases in equity returns and the liability decreases with a decrease in equity returns.

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The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the three months ended September 30, 2018, for which the Company has used significant unobservable inputs (Level 3):

		Total Realized and Unrealized Gains		Total Realized and Unrealized Losses								
	Beginning Balance	Included in Earnings	Included in Other Comprehensive Income	Included in Earnings	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	End Bal
	(Dollars In Thousands)											
Assets:												
Fixed maturity securities available-for-sale												
Residential mortgage-backed securities	$21,780	$—	$—	$—	$(538)	$—	$—	$—	$—	$(21,281)	$39	$—
Commercial mortgage-backed securities	47,227	—	—	—	(1,212)	—	(151)	—	—	(26,372)	(25)	19,
Other asset-backed securities	515,701	—	17	(62)	(14,802)	—	(24)	—	—	—	1,431	502
Corporate securities	644,811	—	1,422	—	(4,044)	15,000	(47,935)	—	—	19,903	(873)	628
Total fixed maturity securities - available-for-sale	1,229,519	—	1,439	(62)	(20,596)	15,000	(48,110)	—	—	(27,750)	572	1,1
Fixed maturity securities - trading												
Other asset-backed securities	24,852	84	—	(76)	—	4,128	(926)	—	—	—	(50)	28,
Corporate securities	5,254	—	—	(6)	—	—	—	—	—	—	(25)	5,2
Total fixed maturity securities - trading	30,106	84	—	(82)	—	4,128	(926)	—	—	—	(75)	33,
Total fixed maturity securities	1,259,625	84	1,439	(144)	(20,596)	19,128	(49,036)	—	—	(27,750)	497	1,1

Equity securities	66,083	287	—	—	—	—	(2,102)	—	—	—	—	64,
Other long-term investments[1]	156,674	24,872	—	—	—	—	—	—	—	—	—	181
Total investments	1,482,382	25,243	1,439	(144)	(20,596)	19,128	(51,138)	—	—	(27,750)	497	1,4
Total assets measured at fair value on a recurring basis	$1,482,382	$25,243	$1,439	$(144)	$(20,596)	$19,128	$(51,138)	$—	$—	$(27,750)	$497	$1,
Liabilities:												
Annuity account balances[2]	$80,098	$—	$—	$(896)	$—	$—	$—	$40	$2,571	$—	$—	$78
Other liabilities[1]	572,916	70,887	—	(52,451)	—	—	—	—	—	—	—	554
Total liabilities measured at fair value on a recurring basis	$653,014	$70,887	$—	$(53,347)	$—	$—	$—	$40	$2,571	$—	$—	$63

(1) Represents certain freestanding and embedded derivatives.
(2) Represents liabilities related to fixed indexed annuities.

For the three months ended September 30, 2018, there were $19.9 million securities transferred into Level 3.

For the three months ended September 30, 2018, there were $47.7 million securities transferred into Level 2. This amount was transferred from Level 3. These transfers resulted from securities that were priced internally using significant unobservable inputs where market observable inputs were not available in previous periods but were priced by independent pricing services or brokers as of September 30, 2018.

For the three months ended September 30, 2018, there were no transfers from Level 2 to Level 1.

For the three months ended September 30, 2018, there were no transfers from Level 1 into Level 2.

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The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the nine months ended September 30, 2018, for which the Company has used significant unobservable inputs (Level 3):

		Total Realized and Unrealized Gains		Total Realized and Unrealized Losses							
	Beginning Balance	Included in Earnings	Included in Other Comprehensive Income	Included in Earnings	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Oth
	(Dollars In Thousands)										
Assets:											
Fixed maturity securities available-for-sale											
Residential mortgage-backed securities	$—	$—	$—	$—	$(995)	$22,225	$—	$—	$—	$(21,281)	$5
Commercial mortgage-backed securities	—	—	—	—	(2,496)	48,621	(245)	—	—	(26,372)	(41
Other asset-backed securities	504,365	—	11,884	(62)	(16,449)	—	(47)	—	—	222	2,3
Corporate securities	626,901	—	8,483	—	(22,973)	93,491	(86,388)	—	—	12,009	(3,
Total fixed maturity securities - available-for-sale	1,131,266	—	20,367	(62)	(42,913)	164,337	(86,680)	—	—	(35,422)	(88
Fixed maturity securities - trading											
Other asset-backed securities	35,222	278	—	(3,674)	—	8,728	(12,595)	—	—	164	(11
Corporate securities	5,442	—	—	(145)	—	—	—	—	—	—	(74
Total fixed maturity securities - trading	40,664	278	—	(3,819)	—	8,728	(12,595)	—	—	164	(18
Total fixed maturity securities	1,171,930	278	20,367	(3,881)	(42,913)	173,065	(99,275)	—	—	(35,258)	(1,(

Equity securities	66,110	288	—	(64)	—	36	(2,102)	—	—	—	—
Other long-term investments[1]	136,004	46,557	—	(1,015)	—	—	—	—	—	—	—
Short-term investments	—	—	—	—	—	—	—	—	—	—	—
Total investments	1,374,044	47,123	20,367	(4,960)	(42,913)	173,101	(101,377)	—	—	(35,258)	(1,
Total assets measured at fair value on a recurring basis	$1,374,044	$47,123	$20,367	$(4,960)	$(42,913)	$173,101	$(101,377)	$—	$—	$(35,258)	$(1
Liabilities:											
Annuity account balances[2]	$83,472	$—	$—	$(2,749)	$—	$—	$—	$570	$8,328	$—	$—
Other liabilities[1]	760,890	328,343	—	(121,933)	—	—	—	—	—	—	—
Total liabilities measured at fair value on a recurring basis	$844,362	$328,343	$—	$(124,682)	$—	$—	$—	$570	$8,328	$—	$—

(1) Represents certain freestanding and embedded derivatives.
(2) Represents liabilities related to fixed indexed annuities.
For the nine months ended September 30, 2018, there were $30.9 million securities transferred into Level 3.
For the nine months ended September 30, 2018, there were $66.2 million securities transferred into Level 2. This amount was transferred from Level 3. These transfers resulted from securities that were priced internally using significant unobservable inputs where market observable inputs were not available in previous periods but were priced by independent pricing services or brokers as of September 30, 2018.
For the nine months ended September 30, 2018, there were no transfers from Level 2 to Level 1.
For the nine months ended September 30, 2018, there were no transfers from Level 1 into Level 2.

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The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the three months ended September 30, 2017, for which the Company has used significant unobservable inputs (Level 3):

		Total Realized and Unrealized Gains		Total Realized and Unrealized Losses								
	Beginning Balance	Included in Earnings	Included in Other Comprehensive Income	Included in Earnings	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Endi Balan
	(Dollars In Thousands)											
Assets:												
Fixed maturity securities available-for-sale												
Residential mortgage-backed securities	$11,862	$—	$83	$—	$—	$—	$—	$—	$—	$(11,944)	$(1)	$—
Commercial mortgage-backed securities	—	—	—	—	—	—	—	—	—	—	—	—
Other asset-backed securities	552,963	—	1,682	—	(2,285)	100	(109)	—	—	—	798	553,1
Corporate securities	662,654	—	8,301	—	(2,222)	5,071	(42,242)	—	—	(5,486)	(1,523)	624,5
Total fixed maturity securities - available-for-sale	1,227,479	—	10,066	—	(4,507)	5,171	(42,351)	—	—	(17,430)	(726)	1,177
Fixed maturity securities - trading												
Other asset-backed securities	54,923	—	—	(353)	—	—	(19,188)	—	—	—	108	35,49
Corporate securities	5,520	27	—	—	—	—	—	—	—	—	(23)	5,524
Total fixed maturity securities - trading	60,443	27	—	(353)	—	—	(19,188)	—	—	—	85	41,01
Total fixed maturity securities	1,287,922	27	10,066	(353)	(4,507)	5,171	(61,539)	—	—	(17,430)	(641)	1,218

Equity securities	66,300	—	31	—	—	—	(169)	—	—	—	—	66,16
Other long-term investments[1]	120,023	10,331	—	(2)	—	—	—	—	—	—	—	130,3
Total investments	1,474,245	10,358	10,097	(355)	(4,507)	5,171	(61,708)	—	—	(17,430)	(641)	1,415
Total assets measured at fair value on a recurring basis	$1,474,245	$10,358	$10,097	$(355)	$(4,507)	$5,171	$(61,708)	$—	$—	$(17,430)	$(641)	$1,4
Liabilities:												
Annuity account balances[2]	$86,094	$—	$—	$(977)	$—	$—	$—	$9	$2,052	$—	$—	$85,
Other liabilities[1]	702,218	12,201	—	(46,396)	—	—	—	—	—	—	—	736,4
Total liabilities measured at fair value on a recurring basis	$788,312	$12,201	$—	$(47,373)	$—	$—	$—	$9	$2,052	$—	$—	$821

(1) Represents certain freestanding and embedded derivatives.
(2) Represents liabilities related to fixed indexed annuities.
For the three months ended September 30, 2017, there were no securities transferred into Level 3.
For the three months ended September 30, 2017, $17.4 million of securities were transferred into Level 2. This amount was transferred from Level 3. These transfers resulted from securities that were priced internally using significant unobservable inputs where market observable inputs were not available in previous periods but were priced by independent pricing services or brokers as of September 30, 2017.
For the three months ended September 30, 2017, there were no securities transferred into Level 1.
For the three months ended September 30, 2017, there were no securities transferred into Level 2.

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The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the nine months ended September 30, 2017, for which the Company has used significant unobservable inputs (Level 3):

		Total Realized and Unrealized Gains		Total Realized and Unrealized Losses								
	Beginning Balance	Included in Earnings	Included in Other Comprehensive Income	Included in Earnings	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Ending Balance
	(Dollars In Thousands)											
Assets:												
Fixed maturity securities available-for-sale												
Residential mortgage-backed securities	$3	$—	$83	$—	$—	$11,862	$(3)	$—	$—	$(11,944)	$(1)	$—
Commercial mortgage-backed securities	—	—	—	—	—	—	—	—	—	—	—	—
Other asset-backed securities	562,604	—	5,212	—	(7,373)	100	(2,136)	—	—	(6,643)	1,385	553,149
Corporate securities	664,046	—	26,099	—	(2,764)	85,822	(135,192)	—	—	(10,353)	(3,105)	624,553
Total fixed maturity securities - available-for-sale	1,226,653	—	31,394	—	(10,137)	97,784	(137,331)	—	—	(28,940)	(1,721)	1,177,70
Fixed maturity securities - trading												
Other asset-backed securities	84,563	3,679	—	(1,154)	—	—	(52,516)	—	—	—	918	35,490
Corporate securities	5,492	101	—	—	—	—	—	—	—	—	(69)	5,524
Total fixed maturity securities - trading	90,055	3,780	—	(1,154)	—	—	(52,516)	—	—	—	849	41,014
Total fixed maturity	1,316,708	3,780	31,394	(1,154)	(10,137)	97,784	(189,847)	—	—	(28,940)	(872)	1,218,7

securities												
Equity securities	69,010	—	52	(2,630)	—	—	(273)	—	—	3	—	66,162
Other long-term investments[1]	124,325	21,452	—	(15,425)	—	—	—	—	—	—	—	130,352
Total investments	1,510,043	25,232	31,446	(19,209)	(10,137)	97,784	(190,120)	—	—	(28,937)	(872)	1,415,23
Total assets measured at fair value on a recurring basis	$1,510,043	$25,232	$31,446	$(19,209)	$(10,137)	$97,784	$(190,120)	$—	$—	$(28,937)	$(872)	$1,415,2
Liabilities:												
Annuity account balances[2]	$87,616	$—	$—	$(2,973)								