CIGNA CORP
Form 10-Q
May 02, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

for the transition period from _____ to _____

Commission file number 1-08323

Cigna Corporation

(Exact name of registrant as specified in its charter)

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

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

(860) 226-6000

Registrant s telephone number, including area code

(860) 226-6741

Registrant s facsimile number, including area code

Not Applicable

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

Indicate by check mark		**YES**		**NO**
• whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.		R		o
• whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).		R		o

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

Large accelerated filer R	Accelerated filer o	Non-accelerated filer o	Smaller Reporting Company o

		YES		NO
• whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).		o		R

As of April 15, 2013, 285,322,450 shares of the issuer s common stock were outstanding.

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Cigna Corporation

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

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Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Cigna Corporation

Consolidated Statements of Income

(In millions, except per share amounts)	Unaudited Three Months Ended March 31, 2013	2012
Revenues		
Premiums and fees	$ 7,314	$ 6,107
Net investment income	287	288
Mail order pharmacy revenues	425	386
Other revenues	18	(40)
Realized investment gains (losses):		
Other-than-temporary impairments on fixed maturities, net	-	(3)
Other realized investment gains	139	16
Total realized investment gains	139	13
Total revenues	**8,183**	**6,754**
Benefits and Expenses		
Global Health Care medical claims expense	4,047	3,316
Other benefit expenses	1,862	825
Mail order pharmacy cost of goods sold	344	321
GMIB fair value (gain)	-	(67)
Other operating expenses	1,856	1,807
Total benefits and expenses	**8,109**	**6,202**

Income before Income Taxes		**74**		**552**
Income taxes (benefits):				
Current		(101)		135
Deferred		116		46
Total income taxes		**15**		**181**
Net Income		59		371
Less: Net Income Attributable to Redeemable Noncontrolling Interest		2		**-**
Shareholders Net Income	**$**	**57**	**$**	**371**
Shareholders Net Income Per Share:				
Basic	$	0.20	$	1.30
Diluted	$	0.20	$	1.28
Dividends Declared Per Share	**$**	**0.04**	**$**	**0.04**

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

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Cigna Corporation

Consolidated Statements of Comprehensive Income

(In millions, except per share amounts)	**Unaudited Three Months Ended March 31, 2013**	**2012**
Shareholders net income	$ 57	$ 371
Shareholders other comprehensive income (loss):		
Net unrealized appreciation (depreciation) on securities:		
Fixed maturities	(72)	23
Equity securities	2	1
Net unrealized appreciation (depreciation), on securities	(70)	24
Net unrealized appreciation (depreciation), derivatives	3	(5)
Net translation of foreign currencies	(58)	35
Postretirement benefits liability adjustment	40	11
Shareholders other comprehensive income (loss)	(85)	65
Shareholders comprehensive income (loss)	(28)	436
Comprehensive income (loss) attributable to noncontrolling interest:		
Net income attributable to redeemable noncontrolling interest	2	-
Other comprehensive (loss) attributable to redeemable noncontrolling interest	(3)	-
Total comprehensive income (loss)	**$ (29)**	**$ 436**

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

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Cigna Corporation

Consolidated Balance Sheets

(In millions, except per share amounts)	Unaudited As of March 31, 2013		As of December 31, 2012	
Assets				
Investments:				
Fixed maturities, at fair value (amortized cost, $14,531; $15,481)		$ 16,600		$ 17,705
Equity securities, at fair value (cost, $137; $121)		131		111
Commercial mortgage loans		2,811		2,851
Policy loans		1,504		1,501
Real estate		82		83
Other long-term investments		1,249		1,255
Short-term investments		122		154
Total investments		22,499		23,660
Cash and cash equivalents		3,306		2,978
Accrued investment income		277		258
Premiums, accounts and notes receivable, net		1,943		1,777
Reinsurance recoverables		7,514		6,256
Deferred policy acquisition costs		1,221		1,198
Property and equipment		1,109		1,120
Deferred income taxes, net		284		374
Goodwill		5,990		6,001
Other assets, including other intangibles		2,846		2,355
Separate account assets		7,950		7,757
Total assets		**$ 54,939**		**$ 53,734**
Liabilities				
Contractholder deposit funds		$ 8,512		$ 8,508
Future policy benefits		9,538		9,265
Unpaid claims and claim expenses		4,218		4,062
Global Health Care medical claims payable		2,000		1,856
Unearned premiums and fees		577		549
Total insurance and contractholder liabilities		24,845		24,240
Accounts payable, accrued expenses and other liabilities		6,976		6,667
Short-term debt		400		201
Long-term debt		4,995		4,986
Separate account liabilities		7,950		7,757
Total liabilities		**45,166**		**43,851**
Contingencies Note 17				
Redeemable noncontrolling interest		113		114
Shareholders Equity				
Common stock (par value per share, $0.25; shares issued, 366; authorized, 600)		92		92
Additional paid-in capital		3,305		3,295
Net unrealized appreciation, fixed maturities	$ 811		$ 883	
Net unrealized appreciation, equity securities	6		4	
Net unrealized depreciation, derivatives	(25)		(28)	
Net translation of foreign currencies	11		69	
Postretirement benefits liability adjustment	(1,559)		(1,599)	
Accumulated other comprehensive loss		(756)		(671)
Retained earnings		12,328		12,330
Less treasury stock, at cost		(5,309)		(5,277)

Total shareholders equity	9,660	9,769
Total liabilities and equity	$ 54,939	$ 53,734
Shareholders Equity Per Share	**$ 33.79**	**$ 34.18**

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

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Cigna Corporation

Consolidated Statements of Changes in Total Equity

Unaudited **For the three months ended March 31, 2013** *(In millions, except per share amounts)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders' Equity**	**Redeemable Noncontrolling Interest**
Balance at January 1, 2013	$ 92	$ 3,295	$ (671)	$ 12,330	$ (5,277)	$ 9,769	$ 114
Effect of issuing stock for employee benefit plans		10		(48)	65	27	
Other comprehensive loss			(85)			(85)	(3)
Net income				57		57	2
Common dividends declared (per share: $0.04)				(11)		(11)	
Repurchase of common stock					(97)	(97)	
Balance at March 31, 2013	**$ 92**	**$ 3,305**	**$ (756)**	**$ 12,328**	**$ (5,309)**	**$ 9,660**	**$ 113**

For the three months ended March 31, 2012 *(In millions, except per share amounts)*	**Common Stock**	**Additional Paid-in Capital**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Treasury Stock**	**Shareholders' Equity**	**Redeemable Noncontrolling Interest**
Balance at January 1, 2012	$ 92	$ 3,188	$ (787)	$ 10,787	$ (5,286)	$ 7,994	$
Effect of issuing stock for employee benefit plans		80		(24)	86	142	
Other comprehensive income			65			65	
Net income				371		371	
Common dividends declared (per share: $0.04)				(11)		(11)	
Repurchase of common stock						-	
Balance at March 31, 2012	**$ 92**	**$ 3,268**	**$ (722)**	**$ 11,123**	**$ (5,200)**	**$ 8,561**	**$**

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

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Cigna Corporation

Consolidated Statements of Cash Flows

	Unaudited Three Months Ended March 31,	
(In millions)	**2013**	**2012**
Cash Flows from Operating Activities		
Net income	$ 59	$ 371
Adjustments to reconcile net income to net cash (used in) / provided by operating activities:		
Depreciation and amortization	150	126
Realized investment gains	(139)	(13)
Deferred income taxes	116	46
Gains on sale of businesses	(4)	(5)
Net changes in assets and liabilities, net of non-operating effects:		
Premiums, accounts and notes receivable	(158)	(215)
Reinsurance recoverables	328	(30)
Deferred policy acquisition costs	(82)	(47)
Other assets	103	155
Insurance liabilities	750	637
Accounts payable, accrued expenses and other liabilities	(328)	(166)
Current income taxes	(110)	105
Cash used to effectively exit run-off reinsurance business	(1,475)	-
Other, net	(15)	(23)
Net cash (used in) / provided by operating activities	**(805)**	**941**
Cash Flows from Investing Activities		
Proceeds from investments sold:		
Fixed maturities	958	221
Equity securities	3	-
Commercial mortgage loans	46	165
Other (primarily short-term and other long-term investments)	221	300
Investment maturities and repayments:		
Fixed maturities	386	317
Equity securities	9	-
Commercial mortgage loans	9	36
Investments purchased:		
Fixed maturities	(383)	(831)
Equity securities	(27)	-
Commercial mortgage loans	(15)	(180)
Other (primarily short-term and other long-term investments)	(121)	(167)
Property and equipment purchases	(84)	(81)
Acquisitions and dispositions, net of cash acquired	(40)	(3,199)
Net cash provided by / (used in) investing activities	**962**	**(3,419)**
Cash Flows from Financing Activities		
Deposits and interest credited to contractholder deposit funds	363	261
Withdrawals and benefit payments from contractholder deposit funds	(332)	(231)
Change in cash overdraft position	(3)	22
Net change in short-term debt	198	123
Repayment of long-term debt	-	(326)
Repurchase of common stock	(77)	-
Issuance of common stock	36	45
Net cash provided by / (used in) financing activities	**185**	**(106)**
Effect of foreign currency rate changes on cash and cash equivalents	(14)	5

Net increase / (decrease) in cash and cash equivalents	328	(2,579)
Cash and cash equivalents, January 1,	2,978	4,690
Cash and cash equivalents, March 31,	$ 3,306	$ 2,111
Supplemental Disclosure of Cash Information:		
Income taxes paid, net of refunds	$ 12	$ 22
Interest paid	$ 70	$ 54

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

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CIGNA CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

Cigna Corporation was incorporated in the State of Delaware in 1981. Various businesses that are described in its Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (2012 Form 10-K) are conducted by its insurance and other subsidiaries. As used in this document, Cigna , the Company , we and our may refer to Cigna Corporation itself, one or more of its subsidiaries, or Cigna Corporation and its consolidated subsidiaries. The Consolidated Financial Statements include the accounts of Cigna Corporation and its significant subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation. These Consolidated Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

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

The interim consolidated financial statements are unaudited but include all adjustments (including normal recurring adjustments) necessary, in the opinion of management, for a fair statement of financial position and results of operations for the periods reported. The interim consolidated financial statements and notes should be read in conjunction with the Consolidated Financial Statements and Notes in the Company s 2012 Form 10-K.

The preparation of interim consolidated financial statements necessarily relies heavily on estimates. This and certain other factors, such as the seasonal nature of portions of the health care and related benefits business as well as competitive and other market conditions, call for caution in estimating full year results based on interim results of operations. Certain reclassifications have been made to prior period amounts to conform to the current presentation. In particular, as a result of the changes in segment reporting discussed further in Note 16, benefits expense amounts previously reported in Other Benefits Expense for the international health care business have been reclassified to Global Health Care Medical Claims Expense in the Consolidated Statement of Income for the three months ended March 31, 2012.

Note 2 Recent Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI) (Accounting Standards Update (ASU) 2013-02). Effective January 1, 2013, the Company adopted the Financial Accounting Standards Board s (FASB) updated guidance on the reporting of items of AOCI reclassified to net income. The updated guidance requires disclosures of the effect of items reclassified out of AOCI into net income on each individual line item in the statement of income. See Note 14 for the Company s updated disclosures.

Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). The FASB s new requirements to disclose information on both a gross and net basis for certain derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions that are either offset in accordance with specific criteria or subject to a master netting or similar arrangement became effective January 1, 2013. There were no effects to the Company s financial statements because no transactions or arrangements were subject to these new disclosure requirements.

Fees Paid to the Federal Government by Health Insurers (ASU 2011-06). In 2011, the FASB issued accounting guidance for the health insurance industry assessment (the fee) mandated by the Patient Protection and Affordable Care Act of 2010 (Health Care Reform). The fee will be levied on health insurers beginning in 2014 based on a ratio of an insurer s net health insurance premiums written for the previous calendar year compared to the U.S. health insurance industry total. In addition, because these fees will generally not be tax deductible, the Company s effective tax rate is expected to be adversely impacted in future periods. Under the guidance, the liability for the fee will be estimated and recorded in full each year beginning in 2014 when health insurance is first provided. A corresponding deferred cost will be recorded and amortized over the calendar year. The amount of the fees is expected to be material, although the Company is unable to estimate the impact of these fees on shareholders net income and the effective tax rate.

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Note 3 Acquisitions and Dispositions

The Company may from time to time acquire or dispose of assets, subsidiaries or lines of business. For further information on the effective exit from the guaranteed minimum death benefits (GMDB) and guaranteed minimum income benefits (GMIB) business, see Note 6. Other significant transactions are described below.

A. Joint Venture Agreement with Finansbank

On November 9, 2012, the Company acquired 51% of the total shares of Finans Emeklilik ve Hayat A.S. (Finans Emeklilik), a Turkish insurance company, from Finansbank A.S. (Finansbank), a Turkish retail bank, for a cash purchase price of approximately $116 million. Finansbank continues to hold 49% of the total shares. Finans Emeklilik operates in life insurance, accident insurance and pension product markets. The acquisition provides Cigna opportunities to reach and serve the growing middle class market in Turkey through Finansbank s network of retail banking branches.

In accordance with GAAP, the total purchase price, including the redeemable noncontrolling interest of $111 million, has been allocated to the tangible and intangible net assets acquired based on management s estimates of their fair value. Accordingly, approximately $113 million was allocated to identifiable intangible assets, primarily a distribution relationship and the value of business acquired (VOBA) that represents the present value of the estimated net cash flows from the long duration contracts in force, with the remaining $116 million recorded as goodwill. The identifiable intangible assets will be amortized over an estimated useful life of approximately 10 years. Goodwill has been allocated to the Global Supplemental Benefits segment and is not deductible for federal income tax purposes.

The redeemable noncontrolling interest is classified as temporary equity in the Company s Consolidated Balance Sheet because Finansbank has the right to require the Company to purchase its 49% interest for the value of its net assets and the inforce business in 15 years.

The condensed balance sheet at the acquisition date was as follows:

(In millions)		
Investments	$	23
Cash and cash equivalents		54
Value of business acquired (reported in Deferred policy acquisition costs in the Consolidated Balance Sheet)		26
Goodwill		116
Separate account assets		99
Other assets, including other intangibles		98
Total assets acquired		**416**
Insurance liabilities		58
Accounts payable, accrued expenses and other liabilities		32
Separate account liabilities		99

Total liabilities acquired		**189**
Redeemable noncontrolling interest		111
Net assets acquired	$	116

The results of Finans Emeklilik have been included in the Company s Consolidated Financial Statements from the date of acquisition. The pro forma effects on total revenues and net income assuming the acquisition had occurred as of January 1, 2012 were not material to the Company for the three months ended March 31, 2012.

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B. Acquisition of Great American Supplemental Benefits Group

On August 31, 2012, the Company acquired Great American Supplemental Benefits Group, one of the largest providers of supplemental health insurance products in the U.S. for $326 million, with cash from internal sources. The acquisition provides the Company with an increased presence in the Medicare supplemental benefits market. It also extends the Company s global direct-to-consumer retail channel as well as further enhances its distribution network of agents and brokers. Subsequent to the segment reporting changes in 2012, results of this business are reported in the Global Supplemental Benefits segment.

In accordance with GAAP, the total purchase price has been allocated to the tangible and intangible net assets acquired based on management s estimates of their fair value. Approximately $168 million was allocated to intangible assets, primarily the VOBA asset that will be amortized in proportion to premium recognized over the life of the contracts that is estimated to be 30 years. Amortization will be higher in early years and decline as policies lapse. Goodwill has been allocated to the Global Supplemental Benefits segment. Substantially all of the goodwill is tax deductible and will be amortized over the next 15 years for federal income tax purposes.

The condensed balance sheet at the acquisition date was as follows:

(In millions)		
Investments	$	211
Cash and cash equivalents		36
Reinsurance recoverables		448
Goodwill		168
Value of business acquired (reported in Deferred policy acquisition costs in the Consolidated Balance Sheet)		144
Other assets, including other intangibles		35
Total assets acquired		1,042
Insurance liabilities		707
Accounts payable, accrued expenses and other liabilities		9
Total liabilities acquired		716
Net assets acquired	$	326

The results of Great American Supplemental Benefits have been included in the Company s Consolidated Financial Statements from the date of acquisition. The pro forma effects on total revenues and net income assuming the acquisition had occurred as of January 1, 2012 were not material to the Company for the three months ended March 31, 2012.

C. Acquisition of HealthSpring, Inc.

On January 31, 2012 the Company acquired the outstanding shares of HealthSpring, Inc. (HealthSpring) for $55 per share in cash and Cigna stock awards, representing a cost of approximately $3.8 billion. HealthSpring provides Medicare Advantage coverage in 15 states and the District of Columbia, as well as a large, national stand-alone Medicare prescription drug business. The acquisition of HealthSpring strengthens the Company s ability to serve individuals across their life stages as well as deepens its presence in a number of geographic markets. The addition of HealthSpring brings industry leading physician partnership capabilities and creates the opportunity to deepen the Company s existing client and customer relationships, as well as facilitates a broader deployment of its range of health and wellness capabilities and product offerings. The

Company funded the acquisition with internal cash resources.

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Purchase price allocation. In accordance with GAAP, the total purchase price has been allocated to the tangible and intangible net assets acquired based on management s estimates of their fair values. Goodwill is not deductible for federal income tax purposes and is allocated to the Government operating segment. The condensed balance sheet of HealthSpring at the acquisition date was as follows:

(In millions)		
Investments	$	612
Cash and cash equivalents		492
Premiums, accounts and notes receivable		320
Goodwill		2,541
Intangible assets		795
Other		96
Total assets acquired		**4,856**
Insurance liabilities		505
Deferred income taxes		214
Debt		326
Total liabilities acquired		**1,045**
Net assets acquired	**$**	**3,811**

In accordance with debt covenants, HealthSpring s debt obligation was paid immediately following the acquisition. This repayment is reported as a financing activity in the statement of cash flows for the three months ended March 31, 2012.

The results of HealthSpring have been included in the Company s Consolidated Financial Statements from the date of the acquisition. Revenues of HealthSpring included in the Company s results for the three months ended March 31, 2012 were approximately $1.0 billion.

Pro forma information. The following table presents selected unaudited pro forma information for the Company assuming the acquisition of HealthSpring had occurred as of January 1, 2011. This pro forma information does not purport to represent what the Company s actual results would have been if the acquisition had occurred as of the date indicated or what such results would be for any future periods.

(In millions, except per share amounts)	**Three Months Ended March 31, 2012**	
Total revenues	$	7,277
Shareholders net income	$	381
Earnings per share:		
Basic	$	1.33
Diluted	$	1.32

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Note 4 Earnings Per Share (EPS)

Basic and diluted earnings per share were computed as follows:

(Dollars in millions, except per share amounts)	Basic	Effect of Dilution	Diluted
Three Months Ended March 31,			
2013			
Shareholders net income	**$ 57**		**$ 57**
Shares *(in thousands):*			
Weighted average	**283,804**		**283,804**
Common stock equivalents		**5,454**	**5,454**
Total shares	283,804	5,454	289,258
EPS	**$ 0.20**	**$ -**	**$ 0.20**
2012			
Shareholders net income	$ 371		$ 371
Shares *(in thousands):*			
Weighted average	285,159		285,159
Common stock equivalents		3,840	3,840
Total shares	285,159	3,840	288,999
EPS	$ 1.30	$ (0.02)	$ 1.28

The following outstanding employee stock options were not included in the computation of diluted earnings per share because their effect would have increased diluted earnings per share (antidilutive) as their exercise price was greater than the average share price of the Company s common stock for the period.

	Three Months Ended March 31,	
(In millions)	**2013**	**2012**
Antidilutive options	**-**	3.8

The Company held 80,302,892 shares of common stock in Treasury as of March 31, 2013, and 77,847,260 shares as of March 31, 2012.

Note 5 Global Health Care Medical Claims Payable

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

(In millions)	March 31, 2013	December 31, 2012
Incurred but not yet reported	$ 1,717	$ 1,541
Reported claims in process	190	243
Physician incentives and other medical expense payable	93	72
Medical claims payable	**$ 2,000**	**$ 1,856**

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Activity in medical claims payable was as follows:

	For the period ended	
(In millions)	**March 31, 2013**	**December 31, 2012**
Balance at January 1,	$ 1,856	$ 1,305
Less: Reinsurance and other amounts recoverable	242	249
Balance at January 1, net	1,614	1,056
Acquired net:	-	504
Incurred claims related to:		
Current year	4,164	14,428
Prior years	(117)	(200)
Total incurred	4,047	14,228
Paid claims related to:		
Current year	2,694	12,854
Prior years	1,162	1,320
Total paid	3,856	14,174
Ending Balance, net	1,805	1,614
Add: Reinsurance and other amounts recoverable	195	242
Ending Balance	**$ 2,000**	**$ 1,856**

Reinsurance and other amounts recoverable reflect amounts due from reinsurers and policyholders to cover incurred but not reported and pending claims for minimum premium products and certain administrative services only business where the right of offset does not exist. See Note 6 for additional information on reinsurance. For the three months ended March 31, 2013, actual experience differed from the Company s key assumptions resulting in favorable incurred claims related to prior years medical claims payable of $117 million, or 0.8% of the current year incurred claims as reported for the year ended December 31, 2012. Actual completion factors accounted for $47 million, or 0.3% of the favorability while actual medical cost trend resulted in the remaining $70 million, or 0.5%.

For the year ended December 31, 2012, actual experience differed from the Company s key assumptions, resulting in favorable incurred claims related to prior years medical claims payable of $200 million, or 2.2% of the current year incurred claims as reported for the year ended December 31, 2011. Actual completion factors accounted for $91 million, or 1.0% of favorability while actual medical cost trend resulted in the remaining $109 million, or 1.2%.

The impact of prior year development on shareholders net income was $48 million for the three months ended March 31, 2013 compared with $41 million for the three months ended March 31, 2012. The favorable effect of prior year development for both years primarily reflects low utilization of medical services, as well as the impact of the medical loss ratio (MLR) rebate accrual. The change in the amount of the incurred claims related to prior years in the medical claims payable liability does not directly correspond to an increase or decrease in the Company s shareholders net income recognized for the following reasons:

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

Second, as a result of the MLR provisions of the Patient Protection and Affordable Care Act, changes in medical claim estimates due to prior year development may be offset by a change in the MLR rebate accrual.

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Third, changes in reserves for the Company s retrospectively experience-rated business do not always impact shareholders net income. For the Company s retrospectively experience-rated business only adjustments to medical claims payable on accounts in deficit affect shareholders net income. An increase or decrease to medical claims payable on accounts in deficit, in effect, accrues to the Company and directly impacts shareholders net income. An account is in deficit when the accumulated medical costs and administrative charges, including profit charges, exceed the accumulated premium received. Adjustments to medical claims payable on accounts in surplus generally accrue directly to the policyholder with no impact on the Company s shareholders net income. An account is in surplus when the accumulated premium received exceeds the accumulated medical costs and administrative charges, including profit charges.

The determination of liabilities for Global Health Care medical claims payable requires the Company to make critical accounting estimates. See Note 2(N) to the Consolidated Financial Statements in the Company s 2012 Form 10-K.

Note 6 Reinsurance

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

Effective Exit of GMDB and GMIB Business

On February 4, 2013, the Company entered into an agreement with Berkshire Hathaway Life Insurance Company of Nebraska (Berkshire) to effectively exit the GMDB and GMIB business via a reinsurance transaction. Berkshire reinsured 100% of the Company s future claim payments, net of retrocessional arrangements in place prior to February 4, 2013. The reinsurance agreement is subject to an overall limit of approximately $3.8 billion plus future premiums collected under the contracts being reinsured that will be paid to Berkshire. The Company estimates that these future premium amounts will be from $0.1 to $0.3 billion and, accordingly, expects future claims of approximately $4 billion to be covered by the agreement.

This transaction resulted in an after-tax charge to shareholders net income in the first quarter of 2013 of $507 million ($781 million pre-tax reported as follows: $727 million in other benefits expense; $45 million in GMIB fair value (gain) loss; and $9 million in other operating expenses). The reinsurance premium due to Berkshire under the agreement was $2.2 billion, of which $1.5 billion was paid through March 31, 2013. The unpaid premium of $0.7 billion as of March 31, 2013 is included in Accounts payable, accrued expenses and other liabilities in the Consolidated Balance Sheet and was paid on April 18, 2013. The reinsurance premium was funded from the sale of investment assets, tax benefits related to the transaction and available parent cash.

Recoverables for GMDB and GMIB Business

The Company had reinsurance recoverables related to the GMDB business of approximately $1.4 billion and GMIB assets of $1.1 billion as of March 31, 2013. Approximately 80% of the combined GMDB recoverables and GMIB assets of $2.5 billion are secured by assets in trust, letters of credit, or funds withheld or are not subject to collection risk. Approximately $1.8 billion of the combined GMDB recoverables and GMIB assets relate to the February 4, 2013 reinsurance arrangement with Berkshire, including $0.7 billion for the cost of reinsurance (excess of premium over recorded reserves).

The following disclosures for the reinsured GMDB and GMIB business provide further context to prior year results as well as activity in the assets and liabilities including the impacts of the reinsurance transaction.

GMDB

The Company has historically estimated its liabilities for assumed and ceded GMDB exposures with an internal model using many scenarios and based on assumptions regarding lapse, future partial surrenders, claim mortality (deaths that result in claims), interest rates (mean investment performance and discount rate) and volatility. These assumptions are based on the Company s experience and future expectations over an extended period, consistent with the long-term nature of this product.

In 2000, the Company determined that the GMDB reinsurance business was premium deficient because the recorded future policy benefit reserve was less than the expected present value of future claims and expenses less the expected present value of future premiums and investment income using revised assumptions based on actual and expected experience. The Company tests for premium deficiency by reviewing its reserve each quarter using current market conditions and its long-term assumptions. Under

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premium deficiency accounting, if the recorded reserve is determined insufficient, an increase to the reserve is reflected as a charge to current period income. The premium attributable to GMDB from the reinsurance transaction with Berkshire was approximately $1.6 billion. Because this premium exceeded the recorded reserve on February 4, 2013, the Company recorded a reserve strengthening of $0.7 billion ($0.5 billion after-tax) in the first quarter of 2013. Subsequent to the reinsurance transaction on February 4, 2013, any such reserve increase will have a corresponding increase in the recorded reinsurance recoverable, provided that the increased recoverable remains within the overall limit (including the GMIB asset).

The Company s dynamic hedge programs were discontinued during the first quarter of 2013 due to the reinsurance agreement with Berkshire. These programs were used to reduce certain equity and interest rate exposures associated with this business. These hedge programs generated losses of $32 million for the three months ended March 31, 2013 and $87 million for the three months ended March 31, 2012 that were included in Other Revenues. Prior to the hedge programs being discontinued, amounts representing corresponding reductions in liabilities for GMDB contracts were included in benefits and expenses. As a result of discontinuing the hedge programs, the growth rate assumption for the underlying equity funds was changed to use long-term historical averages, resulting in a decrease in the gross reserve liability and the offsetting reinsurance recoverable.

For the full year ended December 31, 2012, a reserve strengthening of $43 million ($27 million after-tax) was due primarily to reductions to the lapse rate assumptions, adverse interest rate impacts, and, to a lesser extent, an increase in the volatility and correlation assumptions, partially offset by favorable equity market conditions. The adverse interest rate impacts reflect management s consideration of the anticipated impact of continued low short-term interest rates.

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

	For the period ended	
(In millions)	**March 31, 2013**	**December 31, 2012**
Balance at January 1	$ 1,090	$ 1,170
Add: Unpaid claims	24	40
Less: Reinsurance and other amounts recoverable	42	53
Balance at January 1, net	1,072	1,157
Add: Incurred benefits	702	17
Less: Paid benefits (including $1,647 premium for Berkshire)	1,672	102
Ending balance, net	102	1,072
Less: Unpaid claims	23	24
Add: Reinsurance and other amounts recoverable	1,371	42
Ending balance	**$ 1,450**	**$ 1,090**

Benefits paid and incurred are net of ceded amounts. For the three months ended March 31, 2013, incurred benefits reflect the February 4, 2013 reinsurance transaction. The remaining retained reserve in 2013 is to cover claims retained by the Company, as well as ongoing administrative expenses. Incurred benefits reflect the favorable or unfavorable impact of a rising or falling equity market on the liability, and include the charges discussed above.

The death benefit coverage in force for GMDB contracts assumed by the Company (and reinsured as of February 4, 2013) was $3.6 billion as of March 31, 2013 and $4 billion as of December 31, 2012. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the value of the underlying mutual fund investments for all contractholders (approximately 425,000 as of March 31, 2013 and

435,000 as of December 31, 2012). The aggregate value of the underlying mutual fund investments for these GMDB contracts, assuming no reinsurance, was $13.7 billion as of March 31, 2013 and $13.3 billion as of December 31, 2012.

GMIB

As discussed further in Note 8, because GMIB contracts are without significant life insurance risk, they are not accounted for as insurance products. Instead, the Company reports GMIB liabilities and assets as derivatives at fair value. The GMIB asset is classified in Other assets, including other intangibles and the GMIB liability is classified in Accounts payable, accrued expenses and other liabilities in the Consolidated Balance Sheet. Disclosures related to fair value are included in Note 8 and the derivative is further described under Note 10.

The February 4, 2013 transaction with Berkshire described above resulted in an increase in GMIB assets, representing the increased

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receivable from that transaction. As of March 31, 2013, GMIB assets include $0.5 billion from Berkshire.

In addition, the GMIB business had GMIB assets of $0.6 billion (classified in Other assets, including other intangibles in the Consolidated Balance Sheet) from two other retrocessionaires as of March 31, 2013.

Other Run-off

The Company s Run-off Reinsurance operations also assumed risks related to workers compensation and personal accident business, and purchased retrocessional coverage to reduce the risk of loss on these contracts. The reinsurance recoverables were $125 million as of March 31, 2013. Of this amount, approximately 99% are secured by assets in a trust or letters of credit.

Other Reinsurance

Supplemental benefits business. The Company had reinsurance recoverables of approximately $394 million as of March 31, 2013 and $402 million as of December 31, 2012 from Great American Life Insurance Company resulting from the acquisition of Great American s Supplemental Benefits business on August 31, 2012. The life insurance and annuity lines of business written by the acquired legal entities were fully reinsured by the seller as part of the transaction. The resulting reinsurance recoverables are secured primarily by fixed maturities with book value equal to or greater than 100% of the reinsured policy liabilities. These fixed maturities are held in a trust established for the benefit of the Company.

Retirement benefits business. The Company had reinsurance recoverables of $1.3 billion as of March 31, 2013 and December 31, 2012 from Prudential Retirement Insurance and Annuity Company resulting from the sale of the retirement benefits business, that was primarily in the form of a reinsurance arrangement. The reinsurance recoverable, that is reduced as the Company s reinsured liabilities are paid or directly assumed by the reinsurer, is secured primarily by fixed maturities whose book value is equal to or greater than 100% of the reinsured liabilities. These fixed maturities are held in a trust established for the benefit of the Company. As of March 31, 2013, the book value of the trust assets exceeded the recoverable.

Individual life and annuity reinsurance. The Company had reinsurance recoverables of $4 billion as of March 31, 2013 and December 31, 2012 from The Lincoln National Life Insurance Company and Lincoln Life & Annuity of New York resulting from the 1998 sale of the Company s individual life insurance and annuity business through indemnity reinsurance arrangements. The Lincoln National Life Insurance Company and Lincoln Life & Annuity of New York must maintain a specified minimum credit or claims paying rating, or they will be required to fully secure the outstanding balance. As of March 31, 2013, both companies had ratings sufficient to avoid triggering this contractual obligation.

Ceded Reinsurance: Ongoing operations. The Company s insurance subsidiaries have reinsurance recoverables from various reinsurance arrangements in the ordinary course of business for its Global Health Care, Global Supplemental Benefits and Group Disability and Life

segments as well as the non-leveraged and leveraged corporate-owned life insurance business. Reinsurance recoverables of $346 million as of March 31, 2013 are expected to be collected from more than 80 reinsurers.

The Company reviews its reinsurance arrangements and establishes reserves against the recoverables in the event that recovery is not considered probable. As of March 31, 2013, the Company s recoverables related to these segments were net of a reserve of $3 million.

Summary. The Company s reserves for underlying reinsurance exposures assumed by the Company, as well as for amounts recoverable from reinsurers and retrocessionaires for both ongoing operations and the run-off reinsurance operation, are considered appropriate as of March 31, 2013, based on current information. The Company bears the risk of loss if its reinsurers and retrocessionaires do not meet or are unable to meet their reinsurance obligations to the Company.

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

(In millions)	Three Months Ended March 31, 2013	2012
Ceded premiums and fees		
Individual life insurance and annuity business sold	$ 46	$ 51
Other	79	66
Total	$ 125	$ 117
Reinsurance recoveries		
Individual life insurance and annuity business sold	$ 88	$ 68
Other	(262)	54
Total	$ (174)	$ 122

As noted in the GMDB section above, recoveries for the three months ended March 31, 2013 are net of the impact of a decrease in reinsurance recoverables due to a change in the growth rate assumption, resulting from the discontinuance of the hedge programs following the reinsurance transaction with Berkshire.

Note 7 Realignment and Efficiency Plan

During the third quarter of 2012, in connection with the execution of its strategy, the Company committed to a series of actions to further improve its organizational alignment, operational effectiveness, and efficiency. As a result, the Company recognized charges in other operating expenses of $77 million pre-tax ($50 million after-tax) in the third quarter of 2012 consisting primarily of severance costs. Summarized below is activity in the liability for the three months ended March 31, 2013:

(In millions)	Severance	Real estate	Total
Balance, January 1, 2013	$ 67	$ 4	$ 71
Less: Payments	8	1	9
Balance, March 31, 2013	$ 59	$ 3	$ 62

The severance costs are expected to be substantially paid in 2013.

Note 8 Fair Value Measurements

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

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

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

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

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

Financial Assets and Financial Liabilities Carried at Fair Value

The following tables provide information as of March 31, 2013 and December 31, 2012 about the Company s financial assets and liabilities carried at fair value. Similar disclosures for separate account assets, which are also recorded at fair value on the Company s Consolidated Balance Sheets, are provided separately as gains and losses related to these assets generally accrue directly to policyholders.

March 31, 2013 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Financial assets at fair value:				
Fixed maturities:				
Federal government and agency	**$ 132**	**$ 715**	**$ -**	**$ 847**
State and local government	**-**	**2,401**	**-**	**2,401**
Foreign government	**-**	**1,218**	**24**	**1,242**
Corporate	**-**	**10,422**	**584**	**11,006**
Federal agency mortgage-backed	**-**	**107**	**-**	**107**
Other mortgage-backed	**-**	**82**	**1**	**83**
Other asset-backed	**-**	**269**	**645**	**914**
Total fixed maturities (1)	**132**	**15,214**	**1,254**	**16,600**
Equity securities	**6**	**91**	**34**	**131**
Subtotal	**138**	**15,305**	**1,288**	**16,731**
Short-term investments	**-**	**122**	**-**	**122**
GMIB assets (2)	**-**	**-**	**1,117**	**1,117**
Other derivative assets (3)	**-**	**7**	**-**	**7**
Total financial assets at fair value, excluding separate accounts	**$ 138**	**$ 15,434**	**$ 2,405**	**$ 17,977**

Financial liabilities at fair value:								
GMIB liabilities	**$**	**-**	**$**	**-**	**$**	**1,099**	**$**	**1,099**
Other derivative liabilities (3)		**-**		**28**		**-**		**28**
Total financial liabilities at fair value	**$**	**-**	**$**	**28**	**$**	**1,099**	**$**	**1,127**

(1) Fixed maturities included $810 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including $103 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represent retrocessional contracts in place from three external reinsurers that cover the exposures on these contracts.

(3) Other derivative assets included $6 million of interest rate and foreign currency swaps qualifying as cash flow hedges and $1 million of interest rate swaps not designated as accounting hedges. Other derivative liabilities reflected foreign currency and interest rate swaps qualifying as cash flow hedges. See Note 10 for additional information.

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December 31, 2012 *(In millions)*	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets at fair value:				
Fixed maturities:				
Federal government and agency	$ 156	$ 746	$ -	$ 902
State and local government	-	2,437	-	2,437
Foreign government	-	1,298	24	1,322
Corporate	-	11,201	695	11,896
Federal agency mortgage-backed	-	122	-	122
Other mortgage-backed	-	88	1	89
Other asset-backed	-	340	597	937
Total fixed maturities (1)	156	16,232	1,317	17,705
Equity securities	4	73	34	111
Subtotal	160	16,305	1,351	17,816
Short-term investments	-	154	-	154
GMIB assets (2)	-	-	622	622
Other derivative assets (3)	-	41	-	41
Total financial assets at fair value, excluding separate accounts	**$ 160**	**$ 16,500**	**$ 1,973**	**$ 18,633**
Financial liabilities at fair value:				
GMIB liabilities	$ -	$ -	$ 1,170	$ 1,170
Other derivative liabilities (3)	-	31	-	31
Total financial liabilities at fair value	$ -	$ 31	$ 1,170	$ 1,201

(1) Fixed maturities included $875 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including $108 million of appreciation for securities classified in Level 3.

(2) The GMIB assets represent retrocessional contracts in place from two external reinsurers that covered 55% of the exposures on these contracts.

(3) Other derivative assets included $5 million of interest rate and foreign currency swaps qualifying as cash flow hedges and $36 million of interest rate swaps not designated as accounting hedges. Other derivative liabilities reflected foreign currency and interest rate swaps qualifying as cash flow hedges. See Note 10 for additional information.

Level 1 Financial Assets

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

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

Level 2 Financial Assets and Financial Liabilities

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

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Fixed maturities and equity securities. Approximately 91% of the Company s investments in fixed maturities and equity securities are classified in Level 2 including most public and private corporate debt and equity securities, federal agency and municipal bonds, non-government mortgage-backed securities and preferred stocks. Because many fixed maturities do not trade daily, third-party pricing services and internal methods often use recent trades of securities with similar features and characteristics. When recent trades are not available, pricing models are used to determine these prices. These models calculate fair values by discounting future cash flows at estimated market interest rates. Such market rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities, based on the credit quality, industry and structure of the asset. Typical inputs and assumptions to pricing models include, but are not limited to, a combination of benchmark yields, reported trades, issuer spreads, liquidity, benchmark securities, bids, offers, reference data, and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include characteristics of the issuer, collateral attributes, prepayment speeds and credit rating.

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

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

Other derivatives classified in Level 2 represent over-the-counter instruments such as interest rate and foreign currency swap contracts. Fair values for these instruments are determined using market observable inputs including forward currency and interest rate curves and widely published market observable indices. Credit risk related to the counterparty and the Company is considered when estimating the fair values of these derivatives. However, the Company is largely protected by collateral arrangements with counterparties, and determined that no adjustment for credit risk was required as of March 31, 2013 or December 31, 2012. The nature and use of these other derivatives are described in Note 10.

Level 3 Financial Assets and Financial Liabilities

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

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

Fixed maturities and equity securities. Approximately 8% of fixed maturities and equity securities are priced using significant unobservable inputs and classified in this category, including:

(In millions)	March 31, 2013	December 31, 2012
Other asset and mortgage-backed securities - valued using pricing models	**$ 646**	$ 598
Corporate and government fixed maturities - valued using pricing models	**484**	596
Corporate fixed maturities - valued at transaction price	**124**	123
Equity securities - valued at transaction price	**34**	34
Total	**$ 1,288**	$ 1,351

Fair values of other asset and mortgage-backed securities, corporate and government fixed maturities are primarily determined using pricing models that incorporate the specific characteristics of each asset and related assumptions including the investment type and structure, credit quality, industry and maturity date in comparison to current market indices, spreads and liquidity of assets with similar characteristics. For other asset and mortgage-backed securities, inputs and assumptions to pricing may also include collateral attributes and prepayment speeds. Recent trades in the subject security or similar securities are assessed when available, and the Company may also review published research, as well as the issuer s financial statements, in its evaluation. Approximately 10% of fixed maturities classified in Level 3 represent single, unadjusted, non-binding broker quotes that are not considered market observable. Certain subordinated corporate fixed maturities and private equity investments, representing approximately 10% of securities included in Level 3, are valued at transaction price in the absence of market data indicating a change in the estimated fair values.

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Quantitative Information about Unobservable Inputs

The following tables summarize the fair value and significant unobservable inputs used in pricing Level 3 securities that were developed directly by the Company as of March 31, 2013 and December 31, 2012. The range and weighted average basis point amounts reflect the Company s best estimates of the unobservable adjustments a market participant would make to the market observable spreads (adjustment to discount rates) used to calculate the fair values in a discounted cash flow analysis.

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

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

As of March 31, 2013 *(In millions except basis points)*	**Fair Value**	**Unobservable Input**	**Unobservable Adjustment to Discount Rates Range (Weighted Average)** ***in Basis Points***
Other asset and mortgage-backed securities	$ 632	Liquidity	60-510 (140)
		Weighting of credit spreads	110-4,830 (430)
Corporate and government fixed maturities	$ 331	Liquidity	75-675 (170)

As of December 31, 2012 *(In millions except basis points)*	**Fair Value**	**Unobservable Input**	**Unobservable Adjustment to Discount Rates Range (Weighted Average)** ***in Basis Points***
Other asset and mortgage-backed securities	$ 584	Liquidity	60 - 410 (140)
		Weighting of credit spreads	50 - 4,540 (410)
Corporate and government fixed maturities	$ 439	Liquidity	20 - 640 (190)

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

Guaranteed minimum income benefit contracts. As discussed in Note 6, the Company effectively exited the GMIB business as a result of the February 4, 2013 agreement with Berkshire. Although these GMIB assets and liabilities must continue to be reported as derivatives at fair value, the only assumption that is expected to impact future net income is the risk of nonperformance. This assumption reflects a market participant s

view of the risk of the Company not fulfilling its GMIB obligations (GMIB liability), or the reinsurers credit risk (GMIB asset). Further details about the nonperformance risk assumption, together with other assumptions for the GMIB contracts, are discussed below.

The Company reports GMIB liabilities and assets as derivatives at fair value because cash flows of these liabilities and assets are affected by equity markets and interest rates, but are without significant life insurance risk and are settled in lump sum payments. Under the terms of these written and purchased contracts, the Company periodically receives and pays fees based on either contractholders account values or deposits increased at a contractual rate. The Company will also pay and receive cash depending on changes in account values and interest rates when contractholders first elect to receive minimum income payments. The Company estimates the fair value of the assets and liabilities for GMIB contracts with an internal model run over many scenarios using assumptions, including nonperformance risk.

The nonperformance risk adjustment is incorporated by adding an additional spread to the discount rate in the calculation of both (1) the GMIB liability to reflect a market participant s view of the risk of the Company not fulfilling its GMIB obligations, and (2) the

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GMIB asset to reflect a market participant s view of the reinsurers credit risk, after considering collateral. The estimated market-implied spread is company-specific for each party involved to the extent that company-specific market data is available and is based on industry averages for similarly-rated companies when company-specific data is not available. The spread is impacted by the credit default swap spreads of the specific parent companies, adjusted to reflect subsidiaries credit ratings relative to their parent company and any available collateral. The additional spread over LIBOR incorporated into the discount rate ranged from 5 to 130 basis points for the GMIB liability with a weighted average of 55 basis points and ranged from 0 to 90 basis points for the GMIB reinsurance asset with a weighted average of 30 basis points for that portion of the interest rate curve most relevant to these policies.

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

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

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

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

The following tables summarize the changes in financial assets and financial liabilities classified in Level 3 for the three months ended March 31, 2013 and 2012. These tables exclude separate account assets as changes in fair values of these assets accrue directly to policyholders. Gains and losses reported in these tables may include net changes in fair value that are attributable to both observable and unobservable inputs.

For the Three Months Ended March 31, 2013 *(In millions)*	**Fixed Maturitie & Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at January 1, 2013	$ 1,351	$ 622	$ (1,170)	$ (548)
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	(49)	49	-
Other	6	1	-	1
Total gains (losses) included in shareholders net income	6	(48)	49	1
Losses included in other comprehensive income	(1)	-	-	-
Losses required to adjust future policy benefits for settlement annuities (1)	(5)	-	-	-
Purchases, sales and settlements:				
Purchases	5	-	-	-
Sales	(12)	-	-	-
Settlements	(51)	543	22	565

Total purchases, sales and settlements		(58)		543		22		565
Transfers into/(out of) Level 3:								
Transfers into Level 3		54		-		-		-
Transfers out of Level 3		(59)		-		-		-
Total transfers into/(out of) Level 3		(5)		-		-		-
Balance at March 31, 2013	$	1,288	$	1,117	$	(1,099)	$	18
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	**$**	**2**	**$**	**(48)**	**$**	**49**	**$**	**1**

(1) Amounts do not accrue to shareholders.

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For the Three Months Ended March 31, 2012 *(In millions)*	**Fixed Maturities & Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at January 1, 2012	$ 1,002	$ 712	$ (1,333)	$ (621)
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)	-	(86)	153	67
Other	-	-	-	-
Total gains (losses) included in shareholders net income	-	(86)	153	67
Gains included in other comprehensive income	8	-	-	-
Losses required to adjust future policy benefits for settlement annuities (1)	(11)	-	-	-
Purchases, sales and settlements:				
Purchases	37	-	-	-
Settlements	(3)	(9)	18	9
Total purchases, sales and settlements	34	(9)	18	9
Transfers into/(out of) Level 3:				
Transfers into Level 3	73	-	-	-
Transfers out of Level 3	(34)	-	-	-
Total transfers into/(out of) Level 3	39	-	-	-
Balance at March 31, 2012	$ 1,072	$ 617	$ (1,162)	$ (545)
Total gains (losses) included in shareholders net income attributable to instruments held at the reporting date	$ -	$ (86)	$ 153	$ 67

(1) Amounts do not accrue to shareholders.

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

- Realized investment gains (losses) and net investment income for amounts related to fixed maturities and equity securities; and
- GMIB fair value (gain) loss for amounts related to GMIB assets and liabilities.

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

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

Transfers into or out of the Level 3 category occur when unobservable inputs, such as the Company s best estimate of what a market participant would use to determine a current transaction price, become more or less significant to the fair value measurement. For the three months ended March 31, 2013 and March 31, 2012, transfers between Level 2 and Level 3 primarily reflect the change in significance of the unobservable inputs used to value certain public and private corporate bonds, principally related to liquidity of the securities and credit risk of the issuers.

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

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Separate account assets

Fair values and changes in the fair values of separate account assets generally accrue directly to the policyholders and are excluded from the Company s revenues and expenses. As of March 31, 2013 and December 31, 2012 separate account assets were as follows:

March 31, 2013 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Guaranteed separate accounts (See Note 17)	$ 247	$ 310	$ -	$ 557
Non-guaranteed separate accounts (1)	1,880	4,502	1,011	7,393
Total separate account assets	**$ 2,127**	**$ 4,812**	**$ 1,011**	**$ 7,950**

(1) As of March 31, 2013, non-guaranteed separate accounts included $3.5 billion in assets supporting the Company s pension plans, including $960 million classified in Level 3.

December 31, 2012 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Guaranteed separate accounts (See Note 17)	$ 245	$ 324	$ -	$ 569
Non-guaranteed separate accounts (1)	1,925	4,258	1,005	7,188
Total separate account assets	$ 2,170	$ 4,582	$ 1,005	$ 7,757

(1) As of December 31, 2012, non-guaranteed separate accounts included $3.4 billion in assets supporting the Company s pension plans, including $956 million classified in Level 3.

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

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

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

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

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The following tables summarize the changes in separate account assets reported in Level 3 for the three months ended March 31, 2013 and March 31, 2012.

(In millions)	**Three Months Ended March 31, 2013**	**2012**
Balance at January 1	$ 1,005	$ 750
Policyholder gains (1)	7	18
Purchases, sales and settlements:		
Purchases	31	184
Sales	-	-
Settlements	(30)	(11)
Total purchases, sales and settlements	1	173
Transfers into/(out of) Level 3:		
Transfers into Level 3	-	3
Transfers out of Level 3	(2)	(1)
Total transfers into/(out of) Level 3	(2)	2
Balance at March 31,	**$ 1,011**	**$ 943**

(1) Included in this amount are gains of $7 million attributable to instruments still held at March 31, 2013 and gains of $12 million attributable to instruments still held at March 31, 2012.

Assets and Liabilities Measured at Fair Value under Certain Conditions

Some financial assets and liabilities are not carried at fair value each reporting period, but may be measured using fair value only under certain conditions, such as investments in real estate entities and commercial mortgage loans when they become impaired. During the three months ended March 31, 2013, there were no write-downs for real estate entities or commercial mortgage loans.

For the three months ended March 31, 2012, impaired mortgage loans representing less than 1% of total investments were written down to their fair values resulting in realized investment losses of $2 million after tax.

Fair Value Disclosures for Financial Instruments Not Carried at Fair Value

Most financial instruments that are subject to fair value disclosure requirements are carried in the Company s Consolidated Financial Statements at amounts that approximate fair value. The following table provides the fair values and carrying values of the Company s financial instruments not recorded at fair value that are subject to fair value disclosure requirements at March 31, 2013 and December 31, 2012.

(In millions)	**Classification in the Fair Value Hierarchy**	**March 31, 2013 Fair Value**	**March 31, 2013 Carrying Value**	**December 31, 2012 Fair Value**	**December 31, 2012 Carrying Value**
Commercial mortgage loans	Level 3	$ 2,943	$ 2,811	$ 2,999	$ 2,851
Contractholder deposit funds, excluding universal life products	Level 3	$ 1,084	$ 1,059	$ 1,082	$ 1,056

Long-term debt, including current maturities, excluding capital leases	Level 2	$ 5,767	$ 4,986	$ 5,821	$ 4,986

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

Commercial mortgage loans. The Company estimates the fair value of commercial mortgage loans generally by discounting the contractual cash flows at estimated market interest rates that reflect the Company s assessment of the credit quality of the loans. Market interest rates are derived by calculating the appropriate spread over comparable U.S. Treasury rates, based on the property type, quality rating and average life of the loan. The quality ratings reflect the relative risk of the loan, considering debt service coverage, the loan-to-value ratio and other factors. Fair values of impaired mortgage loans are based on the estimated fair value of the

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underlying collateral generally determined using an internal discounted cash flow model. The fair value measurements were classified in Level 3 because the cash flow models incorporate significant unobservable inputs.

***Contractholder deposit funds, excluding universal life products*.** Generally, these funds do not have stated maturities. Approximately 55% of these balances can be withdrawn by the customer at any time without prior notice or penalty. The fair value for these contracts is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. Most of the remaining contractholder deposit funds are reinsured by the buyers of the individual life and annuity and retirement benefits businesses. The fair value for these contracts is determined using the fair value of these buyers assets supporting these reinsured contracts. The Company had a reinsurance recoverable equal to the carrying value of these reinsured contracts. These instruments were classified in Level 3 because certain inputs are unobservable (supported by little or no market activity) and significant to their resulting fair value measurement.

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

Fair values of off-balance-sheet financial instruments were not material.

Note 9 Investments

Total Realized Investment Gains and Losses

The following total realized gains and losses on investments include other-than-temporary impairments on debt securities, but exclude amounts required to adjust future policy benefits for the run-off settlement annuity business:

	Three Months Ended March 31,	
(In millions)	**2013**	**2012**
Fixed maturities	$ 67	$ 12
Equity securities	3	4
Commercial mortgage loans	-	(3)
Real estate	-	(1)
Other investments, including derivatives	69	1
Realized investment gains before income taxes	139	13
Less income taxes	46	1
Net realized investment gains	**$ 93**	**$ 12**

Included in pre-tax realized investment gains (losses) above were changes in valuation reserves, asset write-downs and other-than-temporary impairments on fixed maturities as follows:

	Three Months Ended March 31,			
(In millions)		**2013**		**2012**
Credit-related (1)	**$**	**-**	$	(5)
Other		**-**		(1)
Total	**$**	**-**	**$**	**(6)**

(1) Credit related losses include other-than-temporary declines in fair value of fixed maturities and changes in valuation reserves related to commercial mortgage loans. There were no credit losses on fixed maturities for which a portion of the impairment was recognized in other comprehensive income.

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Fixed Maturities and Equity Securities

Securities in the following table are included in fixed maturities and equity securities on the Company s Consolidated Balance Sheets. These securities are carried at fair value with changes in fair value reported in other realized investment gains (losses) and interest and dividends reported in net investment income. The Company s hybrid investments include preferred stock or debt securities with call or conversion features.

(In millions)		**As of March 31, 2013**		**As of December 31, 2012**
Included in fixed maturities:				
Trading securities (amortized cost: $1; $1)	$	1	$	1
Hybrid securities (amortized cost: $15; $15)		15		15
Total	**$**	**16**	$	16
Included in equity securities:				
Hybrid securities (amortized cost: $76; $84)	$	63	$	70

The following information about fixed maturities excludes trading and hybrid securities. The amortized cost and fair value by contractual maturity periods for fixed maturities were as follows at March 31, 2013:

(In millions)		**Amortized Cost**		**Fair Value**
Due in one year or less	$	1,149	$	1,169
Due after one year through five years		5,042		5,472
Due after five years through ten years		4,695		5,319
Due after ten years		2,666		3,520
Mortgage and other asset-backed securities		963		1,104
Total	**$**	**14,515**	**$**	**16,584**

Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without penalties. Also, in some cases the Company may extend maturity dates.

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Gross unrealized appreciation (depreciation) on fixed maturities (excluding trading securities and hybrid securities with a fair value of $16 million at March 31, 2013 and December 31, 2012) by type of issuer is shown below.

	March 31, 2013			
(In millions)	**Amortized Cost**	**Unrealized Appreciation**	**Unrealized Depreciation**	**Fair Value**
Federal government and agency	$ 482	$ 365	$ -	$ 847
State and local government	2,148	254	(1)	2,401
Foreign government	1,125	118	(1)	1,242
Corporate	9,797	1,212	(18)	10,991
Federal agency mortgage-backed	106	1	-	107
Other mortgage-backed	77	10	(4)	83
Other asset-backed	780	135	(2)	913
Total	**$ 14,515**	**$ 2,095**	**$ (26)**	**$ 16,584**

(In millions)	December 31, 2012			
Federal government and agency	$ 509	$ 393	$ -	$ 902
State and local government	2,169	270	(2)	2,437
Foreign government	1,197	126	(1)	1,322
Corporate	10,590	1,308	(17)	11,881
Federal agency mortgage-backed	121	1	-	122
Other mortgage-backed	82	11	(4)	89
Other asset-backed	797	145	(6)	936
Total	**$ 15,465**	**$ 2,254**	**$ (30)**	**$ 17,689**

The above table includes investments with a fair value of $3 billion supporting the Company s run-off settlement annuity business, with gross unrealized appreciation of $816 million and gross unrealized depreciation of $6 million at March 31, 2013. Such unrealized amounts are required to support future policy benefit liabilities of this business and, as such, are not included in accumulated other comprehensive income. At December 31, 2012, investments supporting this business had a fair value of $3.1 billion, gross unrealized appreciation of $883 million and gross unrealized depreciation of $8 million.

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

	Three Months Ended March 31,	
(In millions)	**2013**	**2012**
Proceeds from sales	$ 961	$ 221
Gross gains on sales	$ 60	$ 15
Gross losses on sales	$ 2	$ -

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

- length of time and severity of decline;

- financial health and specific near term prospects of the issuer;

- changes in the regulatory, economic or general market environment of the issuer s industry or geographic region; and

- the Company s intent to sell or the likelihood of a required sale prior to recovery.

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Excluding trading and hybrid securities, as of March 31, 2013, fixed maturities with a decline in fair value from amortized cost (primarily corporate, and other asset and mortgage-backed securities) were as follows, including the length of time of such decline:

(In millions)	Fair Value	Amortized Cost	Unrealized Depreciation	Number of Issues
Fixed maturities:				
One year or less:				
Investment grade	$ 454	$ 461	$ (7)	168
Below investment grade	$ 117	$ 118	$ (1)	88
More than one year:				
Investment grade	$ 183	$ 194	$ (11)	59
Below investment grade	$ 28	$ 35	$ (7)	12

The unrealized depreciation of investment grade fixed maturities is due primarily to increases in market yields since purchase. There were no equity securities with a fair value significantly lower than cost as of March 31, 2013.

Commercial Mortgage Loans

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

Credit quality. The Company applies a consistent and disciplined approach to evaluating and monitoring credit risk, beginning with the initial underwriting of a mortgage loan and continuing throughout the investment holding period. Mortgage origination professionals employ an internal rating system developed from the Company s experience in real estate investing and mortgage lending. A quality rating, designed to evaluate the relative risk of the transaction, is assigned at each loan s origination and is updated each year as part of the annual portfolio loan review. The Company monitors credit quality on an ongoing basis, classifying each loan as a loan in good standing, potential problem loan or problem loan.

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

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The following tables summarize the credit risk profile of the Company s commercial mortgage loan portfolio based on loan-to-value and debt service coverage ratios, as of March 31, 2013 and December 31, 2012:

	March 31, 2013					
(In millions)	Debt Service Coverage Ratio					
Loan-to-Value Ratios	1.30x or Greater	1.20x to 1.29x	1.10x to 1.19x	1.00x to 1.09x	Less than 1.00x	Total
Below 50%	$ 295	$ 7	$ -	$ 50	$ -	$ 352
50% to 59%	589	104	25	52	-	770
60% to 69%	576	74	-	66	-	716
70% to 79%	116	142	132	22	16	428
80% to 89%	100	42	130	-	58	330
90% to 99%	14	30	-	-	58	102
100% or above	-	-	30	17	66	113
Total	**$ 1,690**	**$ 399**	**$ 317**	**$ 207**	**$ 198**	**$ 2,811**

	December 31, 2012					
(In millions)	Debt Service Coverage Ratio					
Loan-to-Value Ratios	1.30x or Greater	1.20x to 1.29x	1.10x to 1.19x	1.00x to 1.09x	Less than 1.00x	Total
Below 50%	$ 297	$ 8	$ -	$ 50	$ -	$ 355
50% to 59%	614	104	25	52	-	795
60% to 69%	562	75	-	66	-	703
70% to 79%	194	143	132	4	16	489
80% to 89%	45	42	131	18	58	294
90% to 99%	14	30	-	-	58	102
100% or above	-	-	30	17	66	113
Total	**$ 1,726**	**$ 402**	**$ 318**	**$ 207**	**$ 198**	**$ 2,851**

The Company s annual in-depth review of its commercial mortgage loan investments is the primary mechanism for identifying emerging risks in the portfolio. The most recent review was completed by the Company s investment professionals in the second quarter of 2012 and included an analysis of each underlying property s most recent annual financial statements, rent rolls, operating plans, budgets, a physical inspection of the property and other pertinent factors. Based on historical results, current leases, lease expirations and rental conditions in each market, the Company estimates the current year and future stabilized property income and fair value, and categorizes the investments as loans in good standing, potential problem loans or problem loans. Based on property valuations and cash flows estimated as part of this review, and considering updates for loans where material changes were subsequently identified, the portfolio s average loan-to-value ratio remained at 65% at March 31, 2013 when compared to December 31, 2012. The portfolio s average debt service coverage ratio was estimated to be 1.55 at March 31, 2013, an insignificant decrease from 1.56 at December 31, 2012.

Quality ratings are adjusted between annual reviews if new property information is received or events such as delinquency or a borrower s request for restructure cause management to believe that the Company s estimate of financial performance, fair value or the risk profile of the underlying property has been impacted.

During 2012, the Company restructured a $119 million problem mortgage loan, net of a valuation reserve, into two notes carried at $100 million and $19 million. The $100 million note was reclassified to impaired commercial mortgage loans with no valuation reserves and the $19 million note was classified as an other long-term investment. This modification was considered a troubled debt restructuring because the borrower was experiencing financial difficulties and an interest rate concession was granted. No valuation reserve was required because the fair value of the underlying property equaled the carrying value of the outstanding loan. Following the restructuring, the $100 million note was paid down by $46 million with the remaining $54 million note reclassified to good standing based on an improved quality rating due to significant improvements in its loan-to-value and debt service coverage ratios resulting from the annual loan review.

Other loans were modified during the three months ended March 31, 2013 and the twelve months ended December 31, 2012, but were

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not considered troubled debt restructures. The impact of modifications to these loans was not material to the Company s results of operations, financial condition or liquidity.

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

Problem and potential problem mortgage loans, net of valuation reserves, totaled $215 million at both March 31, 2013 and December 31, 2012. At March 31, 2013 and December 31, 2012, mortgage loans located in the South Atlantic region represented the most significant component of problem and potential problem mortgage loans, with no significant concentration by property type.

Impaired commercial mortgage loans. A commercial mortgage loan is considered impaired when it is probable that the Company will not collect all amounts due (principal and interest) according to the terms of the original loan agreement. The Company assesses each loan individually for impairment, using the information obtained from the quality review process discussed above. Impaired loans are carried at the lower of unpaid principal balance or the fair value of the underlying real estate. Certain commercial mortgage loans without valuation reserves are considered impaired because the Company will not collect all interest due according to the terms of the original agreements; however, the Company does expect to recover their remaining carrying value primarily because it is less than the fair value of the underlying real estate.

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

	March 31, 2013			**December 31, 2012**		
(In millions)	**Gross**	**Reserves**	**Net**	**Gross**	**Reserves**	**Net**
Impaired commercial mortgage loans with valuation reserves	$ 72	$ (7)	$ 65	$ 72	$ (7)	$ 65
Impaired commercial mortgage loans with no valuation reserves	60	-	60	60	-	60
Total	**$ 132**	**$ (7)**	**$ 125**	$ 132	$ (7)	$ 125