



**Protective Life Corporation
Financial Statements and Notes
September 30, 2020**

PROTECTIVE LIFE CORPORATION
FINANCIAL STATEMENTS AND NOTES
FOR QUARTERLY PERIOD ENDED SEPTEMBER 30, 2020

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PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF INCOME
(Unaudited)

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars In Thousands)		(Dollars In Thousands)	
Revenues				
Premiums and policy fees	\$ 1,052,564	\$ 1,028,082	\$ 2,972,052	\$ 2,904,293
Reinsurance ceded	(291,756)	(316,983)	(697,828)	(975,356)
Net of reinsurance ceded	760,808	711,099	2,274,224	1,928,937
Net investment income	784,910	785,285	2,366,232	2,197,020
Realized gains (losses) - investments/derivatives	88,852	(24,812)	(182,259)	(67,280)
Other income	146,967	147,139	447,311	392,839
Total revenues	1,781,537	1,618,711	4,905,508	4,451,516
Benefits and expenses				
Benefits and settlement expenses, net of reinsurance ceded: (three and nine months 2020 - \$247,133 and \$565,645; three and nine months 2019 - \$227,027 and \$742,213)	1,262,388	1,172,297	3,746,707	3,149,050
Amortization of deferred policy acquisition costs and value of business acquired	109,552	61,319	144,939	125,502
Other operating expenses, net of reinsurance ceded: (three and nine months 2020 - \$55,828 and \$176,137; three and nine months 2019 - \$58,555 and \$164,970)	247,112	257,252	739,236	744,132
Total benefits and expenses	1,619,052	1,490,868	4,630,882	4,018,684
Income before income tax	162,485	127,843	274,626	432,832
Income tax expense	33,358	27,217	55,231	85,811
Net income	\$ 129,127	\$ 100,626	\$ 219,395	\$ 347,021

See Notes to Consolidated Condensed Financial Statements

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

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars In Thousands)		(Dollars In Thousands)	
Net income	\$ 129,127	\$ 100,626	\$ 219,395	\$ 347,021
Other comprehensive income (loss):				
Change in net unrealized gains (losses) on investments, net of income tax: (three and nine months 2020 - \$128,390 and \$336,934; three and nine months 2019 - \$227,013 and \$793,599)	482,990	854,000	1,267,512	2,985,443
Reclassification adjustment for investment amounts included in net income (loss), net of income tax: (three and nine months 2020 - \$7,513 and \$15,952; three and nine months 2019 - \$(1,022) and \$(1,521))	28,264	(3,846)	60,012	(5,722)
Change in net unrealized gains (losses) for which a credit loss has been recognized in operations, net of income tax: (three and nine months 2020 - \$7,290 and \$6,821)	27,426	—	25,659	—
Change in net unrealized gains (losses) relating to other-than-temporary impaired investments for which a portion has been recognized in operations, net of income tax: (three and nine months 2019 - \$(5,318) and \$1,146)	—	(20,008)	—	4,308
Change in accumulated gain (loss) - derivatives, net of income tax: (three and nine months 2020 - \$405 and \$(233); three and nine months 2019 - \$(893) and \$(2,157))	1,524	(3,362)	(877)	(8,116)
Reclassification adjustment for derivative amounts included in net income (loss), net of income tax: (three and nine months 2020 - \$84 and \$645; three and nine months 2019 - \$157 and \$285)	317	589	2,427	1,075
Change in postretirement benefits liability adjustment, net of income tax: (three and nine months 2020 - \$116 and \$349; three and nine months 2019 - \$0)	437	—	1,311	—
Total other comprehensive income	540,958	827,373	1,356,044	2,976,988
Total comprehensive income	\$ 670,085	\$ 927,999	\$ 1,575,439	\$ 3,324,009

See Notes to Consolidated Condensed Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS

	As of	
	September 30, 2020 (Unaudited)	December 31, 2019
(Dollars In Thousands)		
Assets		
Fixed maturities, at fair value (amortized cost: 2020 - \$65,033,482; 2019 - \$63,474,559; allowance for credit losses: 2020 - \$19,399)	\$ 70,529,653	\$ 66,260,305
Fixed maturities, at amortized cost (fair value: 2020 - \$2,990,170; 2019 - \$3,025,790)	2,680,324	2,823,881
Equity securities, at fair value (cost: 2020 - \$557,501; 2019 - \$571,431)	601,427	591,673
Commercial mortgage loans, net of allowance for credit losses (allowance for credit losses: 2020 - \$175,050; 2019 - \$4,884)	9,765,312	9,379,401
Investment real estate, net of accumulated depreciation (2020 - \$329; 2019 - \$202)	10,195	10,321
Policy loans	1,640,147	1,675,121
Other long-term investments	2,843,219	2,445,882
Short-term investments	1,252,349	1,513,350
Total investments	89,322,626	84,699,934
Cash	569,811	243,527
Accrued investment income	725,254	717,211
Accounts and premiums receivable	137,618	136,092
Reinsurance receivables, net of allowance for credit losses (allowance for credit losses: 2020 - \$111,712; 2019 - \$3,733)	4,313,550	4,464,514
Deferred policy acquisition costs and value of business acquired	3,469,036	3,517,123
Goodwill	825,511	825,511
Other intangibles, net of accumulated amortization (2020 - \$297,783; 2019 - \$254,054)	553,449	583,840
Property and equipment, net of accumulated depreciation (2020 - \$56,221; 2019 - \$51,153)	214,087	216,895
Other assets	370,052	375,121
Assets related to separate accounts:		
Variable annuity	11,487,408	12,730,090
Variable universal life	1,144,474	1,135,666
Reinsurance assumed	12,091,466	11,443,105
Total assets	\$ 125,224,342	\$ 121,088,629

See Notes to Consolidated Condensed Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(continued)

	As of	
	September 30, 2020	December 31, 2019
	(Unaudited)	
	(Dollars In Thousands)	
Liabilities		
Future policy benefits and claims	\$ 54,075,275	\$ 53,945,025
Unearned premiums	881,181	897,037
Total policy liabilities and accruals	54,956,456	54,842,062
Stable value product account balances	6,017,259	5,443,752
Annuity account balances	15,213,466	14,289,907
Other policyholders' funds	1,715,231	1,576,856
Other liabilities	5,032,486	3,611,643
Income tax payable	40,338	36,881
Deferred income taxes	1,639,012	1,306,413
Non-recourse funding obligations	2,684,028	2,825,553
Secured financing liabilities	232,826	335,480
Debt	1,918,877	1,665,734
Subordinated debt	605,664	605,562
Liabilities related to separate accounts:		
Variable annuity	11,487,408	12,730,090
Variable universal life	1,144,474	1,135,666
Reinsurance assumed	12,091,466	11,443,105
Total liabilities	114,778,991	111,848,704
Commitments and contingencies - Note 11		
Shareowner's equity		
Common Stock: 2020 and 2019 - \$0.01 par value; shares authorized: 5,000; shares issued: 1,000	—	—
Additional paid-in-capital	5,804,059	5,804,059
Retained earnings	1,901,479	2,052,097
Accumulated other comprehensive income (loss):		
Net unrealized gains (losses) on investments, net of income tax: (2020 - \$738,384; 2019 - \$385,498)	2,777,729	1,450,205
Net unrealized losses on investments for which a credit loss has been recognized in operations, net of income tax: (2020 - \$(183))	(688)	—
Net unrealized losses relating to other-than-temporary impaired investments for which a portion has been recognized in operations, net of income tax: (2019 - \$(7,004))	—	(26,347)
Accumulated gain (loss) - derivatives, net of income tax: (2020 - \$(1,710); 2019 - \$(2,123))	(6,439)	(7,989)
Postretirement benefits liability adjustment, net of income tax: (2020 - \$(8,181); 2019 - \$(8,530))	(30,789)	(32,100)
Total shareowner's equity	10,445,351	9,239,925
Total liabilities and shareowner's equity	\$ 125,224,342	\$ 121,088,629

See Notes to Consolidated Condensed Financial Statements

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

	<u>Common Stock</u>	<u>Additional Paid-In- Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareowner's Equity</u>
	(Dollars In Thousands)				
Balance, June 30, 2020	\$ —	\$ 5,804,059	\$ 1,772,352	\$ 2,198,855	\$ 9,775,266
Net income			129,127		129,127
Other comprehensive income				540,958	540,958
Comprehensive income					670,085
Balance, September 30, 2020	<u>\$ —</u>	<u>\$ 5,804,059</u>	<u>\$ 1,901,479</u>	<u>\$ 2,739,813</u>	<u>\$ 10,445,351</u>

	<u>Common Stock</u>	<u>Additional Paid-In- Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareowner's Equity</u>
	(Dollars In Thousands)				
Balance, December 31, 2019	\$ —	\$ 5,804,059	\$ 2,052,097	\$ 1,383,769	\$ 9,239,925
Net income			219,395		219,395
Other comprehensive income				1,356,044	1,356,044
Comprehensive income					1,575,439
Cumulative effect adjustments			(138,281)		(138,281)
Dividends to parent			(231,732)		(231,732)
Balance, September 30, 2020	<u>\$ —</u>	<u>\$ 5,804,059</u>	<u>\$ 1,901,479</u>	<u>\$ 2,739,813</u>	<u>\$ 10,445,351</u>

See Notes to Consolidated Condensed Financial Statements

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

	<u>Common Stock</u>	<u>Additional Paid- In- Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareowner's Equity</u>
	(Dollars In Thousands)				
Balance, June 30, 2019	\$ —	\$ 5,804,059	\$ 1,835,028	\$ 723,849	\$ 8,362,936
Net income			100,626		100,626
Other comprehensive income				827,373	827,373
Comprehensive income					927,999
Balance, September 30, 2019	<u>\$ —</u>	<u>\$ 5,804,059</u>	<u>\$ 1,935,654</u>	<u>\$ 1,551,222</u>	<u>\$ 9,290,935</u>

	<u>Common Stock</u>	<u>Additional Paid- In- Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Shareowner's Equity</u>
	(Dollars In Thousands)				
Balance, December 31, 2018	\$ —	\$ 5,554,059	\$ 1,639,441	\$ (1,425,766)	\$ 5,767,734
Net income			347,021		347,021
Other comprehensive income				2,976,988	2,976,988
Comprehensive income					3,324,009
Cumulative effect adjustments			(50,808)		(50,808)
Capital contributions from parent		250,000			250,000
Balance, September 30, 2019	<u>\$ —</u>	<u>\$ 5,804,059</u>	<u>\$ 1,935,654</u>	<u>\$ 1,551,222</u>	<u>\$ 9,290,935</u>

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

	For The Nine Months Ended September 30,	
	2020	2019
	(Dollars In Thousands)	
Cash flows from operating activities		
Net income	\$ 219,395	\$ 347,021
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Realized losses - investments/derivatives	182,259	67,280
Amortization of DAC and VOBA	144,939	125,502
Capitalization of DAC	(355,330)	(341,883)
Depreciation and amortization expense	58,439	56,312
Deferred income tax	10,704	(205,151)
Accrued income tax	3,457	(78,910)
Interest credited to universal life and investment products	1,155,732	954,213
Policy fees assessed on universal life and investment products	(1,338,402)	(1,269,614)
Change in reinsurance receivables	54,920	287,080
Change in accrued investment income and other receivables	7,384	(562)
Change in policy liabilities and other policyholders' funds of traditional life and health products	(749,915)	(545,433)
Trading securities:		
Maturities and principal reductions of investments	69,276	82,603
Sale of investments	493,059	327,852
Cost of investments acquired	(719,682)	(270,800)
Other net change in trading securities	19,577	(57,240)
Amortization of premiums and accretion of discounts on investments and commercial mortgage loans	235,425	238,181
Change in other liabilities	465,060	505,388
Other, net	(8,745)	(188,415)
Net cash (used in) provided by operating activities	\$ (52,448)	\$ 33,424

See Notes to Consolidated Condensed Financial Statements

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

	For The Nine Months Ended September 30,	
	2020	2019
	(Dollars In Thousands)	
Cash flows from investing activities		
Maturities and principal reductions of investments, available-for-sale	\$ 3,258,579	\$ 1,364,815
Sale of investments, available-for-sale	2,614,072	3,164,002
Cost of investments acquired, available-for-sale	(7,414,986)	(4,841,261)
Commercial mortgage loans:		
New lendings	(1,053,802)	(968,656)
Repayments	484,313	723,325
Change in investment real estate, net	126	(319)
Change in policy loans, net	34,974	53,056
Change in other long-term investments, net	220,450	81,809
Change in short-term investments, net	247,106	(722,615)
Net unsettled security transactions	105,366	(154,791)
Purchase of property, equipment, and intangibles	(25,425)	(24,511)
Payment for business acquisition, net of cash acquired	—	(777,807)
Net cash used in investing activities	(1,529,227)	(2,102,953)
Cash flows from financing activities		
Borrowings under line of credit arrangement, debt, and subordinated debt	\$ 420,000	\$ 1,000,000
Principal payments on line of credit arrangement, debt, and subordinated debt	(165,000)	(9,325)
Secured financing liabilities	(102,655)	(142,575)
Dividends to shareowner	(231,732)	—
Capital contributions from parent	—	250,000
Deposits to universal life and investment contracts	5,040,986	4,258,248
Withdrawals from universal life and investment contracts	(3,053,347)	(3,166,505)
Other financing activities, net	(293)	(729)
Net cash provided by financing activities	1,907,959	2,189,114
Change in cash	326,284	119,585
Cash at beginning of period	243,527	173,714
Cash at end of period	\$ 569,811	\$ 293,299

See Notes to Consolidated Condensed Financial Statements

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

1. BASIS OF PRESENTATION

Basis of Presentation

On February 1, 2015, Protective Life Corporation (the “Company”) became a wholly owned subsidiary of The Dai-ichi Life Insurance Company, Limited, a *kabushiki kaisha* organized under the laws of Japan (now known as Dai-ichi Life Holdings, Inc., “Dai-ichi Life”), when DL Investment (Delaware), Inc., a wholly owned subsidiary of Dai-ichi Life, merged with and into the Company (the “Merger”). Prior to February 1, 2015, the Company’s stock was publicly traded on the New York Stock Exchange. Subsequent to the Merger, the Company remained as an SEC registrant within the United States until January 23, 2020, when it suspended its reporting obligations with the SEC under the Securities Exchange Act of 1934. The Company is a holding company with subsidiaries that provide financial services through the production, distribution, and administration of insurance and investment products. The Company markets individual life insurance, credit life and disability insurance, guaranteed investment contracts, guaranteed funding agreements, fixed and variable annuities, and extended service contracts throughout the United States. The Company also maintains a separate segment devoted to the acquisition of insurance policies from other companies. Founded in 1907, Protective Life Insurance Company (“PLICO”) is the Company’s largest operating subsidiary.

These consolidated condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for the interim periods presented herein. In the opinion of management, the accompanying consolidated condensed financial statements reflect all adjustments (consisting only of normal recurring items) necessary for a fair presentation of the results for the interim periods presented. Operating results for the three and nine months ended September 30, 2020, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2020. The year-end consolidated condensed financial data included herein was derived from audited financial statements but this report does not include all disclosures required by GAAP.

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

During the nine months ended September 30, 2020, the Company identified certain cash flows presented in its investing and financing activities that were determined to be non-cash items. The Company determined that the reclassifications were not material to the financial statements for any period. These amounts have been corrected in the consolidated condensed statements of cash flows for the nine months ended September 30, 2019.

During the third quarter of 2020, the Company recorded certain adjustments related to prior periods to correct errors pertaining to the calculation of policyholder reserves and ceded reinsurance premiums. These adjustments resulted in a decrease to benefit and settlement expenses of \$33.1 million; an increase to deferred policy acquisition costs amortization expense of \$13.5 million; and a decrease to ceded premiums and other ceded operating expenses of \$10.2 million and \$3.2 million respectively in the consolidated financial statements. The result of these adjustments, in total, was to increase income before income taxes by \$26.6 million and \$14.4 million for the three months and nine months ended September 30, 2020, respectively. The Company concluded that the adjustments were not quantitatively or qualitatively material to previously reported periods or the 2020 estimated income or earnings trends. As a result, the adjustments were recorded by the Company within the consolidated condensed financial statements as of and for the three month and nine month periods ended September 30, 2020.

Beginning in the first quarter of 2020, the uncontained outbreak of the novel coronavirus, which causes the disease termed COVID-19, created significant economic and social disruption and impacted various operational and financial aspects of the Company’s business. While not all of the impacts of COVID-19 are identifiable or quantifiable, during the nine months ended September 30, 2020, there has been deterioration in actual and forecasted macroeconomic variables that has adversely impacted the fair values of certain of the Company’s investments and its allowance for credit losses on commercial mortgage loans. The

Company has also recorded an increase associated with guaranteed benefits on certain of its variable annuity contracts, while realizing gains from derivatives held to hedge these guaranteed benefits. Additionally, there has been an increase in life insurance claims attributed to COVID-19.

Entities Included

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant Accounting Policies

For a full description of the Company's significant accounting policies, refer to Note 2 in the Company's consolidated financial statements for the year ended December 31, 2019. There were no significant changes to the Company's accounting policies during the nine months ended September 30, 2020, except the items noted below.

Allowance for Credit Losses – Fixed Maturity and Structured Investments

Each quarter the Company reviews investments with unrealized losses to determine whether such impairments are the result of credit losses. The Company analyzes various factors to make such determination including, but are not limited to: 1) actions taken by rating agencies, 2) default by the issuer, 3) the significance of the decline, 4) an assessment of the Company's intent to sell the security (including a more likely than not assessment of whether the Company will be required to sell the security) before recovering the security's amortized cost, 5) an economic analysis of the issuer's industry, and 6) the financial strength, liquidity, and recoverability of the issuer. Management performs a security by security review each quarter to evaluate whether a credit loss has occurred.

For securities which the Company does not intend to sell and does not expect to be required to sell before recovering the security's amortized cost basis, analysis of expected cash flows is used to measure the amount of the credit loss. To the extent the amortized cost basis of the security exceeds the present value of future cash flows expected to be collected, this difference represents a credit loss. Beginning on January 1, 2020, credit losses are recorded in *realized gains (losses) - investments/derivatives* with a corresponding adjustment to the allowance for credit losses, except that the credit loss recognized cannot exceed the difference between the book value and fair value of the security as of the date of the analysis. In future periods, recoveries in the present value of expected cash flows are recorded as a reversal of the previously recognized allowance for credit losses with an offsetting adjustment to *realized gains (losses) - investments/derivatives*. See, "Accounting Pronouncements Recently Adopted" below for additional information. The Company considers contractual cash flows and all known market data related to cash flows when developing its estimates of expected cash flows. The Company uses the effective interest rate implicit in the security at the date of acquisition to discount expected cash flows. For floating rate securities, the Company's policy is to lock in the interest rate at the first instance of an impairment. Estimates of expected cash flows are not probability-weighted but reflect the Company's best estimate based on past events, current conditions, and reasonable and supportable forecasts of future events. Debt securities that the Company intends to sell or expects to be required to sell before recovery are written down to fair value with the change recognized in *realized gains (losses) - investments/derivatives*.

The Company presents accrued interest receivable separately from other components of the amortized cost basis of its fixed maturity and structured investments and has made an accounting policy election not to measure an allowance for credit losses for accrued interest receivable. The Company's policy is to write off uncollectible accrued interest receivables through a reversal of interest income in the period in which a credit loss is identified.

Allowance for Credit Losses – Commercial Mortgage Loans and Unfunded Commitments

The Company's commercial mortgage loans are stated at unpaid principal balance, adjusted for any unamortized premium or discount, and net of the allowance for credit losses ("ACL"). Beginning January 1, 2020, the ACL represents the

Company's best estimate of expected credit losses over the contractual term of the loans. The allowance for credit losses for unfunded loan commitments is recognized as a component of *other liabilities* on the consolidated condensed balance sheet. Changes in the allowance for credit losses for both funded and unfunded commercial mortgage loans are recognized in *realized gains (losses) - investments/derivatives*.

The Company uses a loan-level probability of default ("PD") and loss given default ("LGD") model to calculate the allowance for credit losses for substantially all of its commercial mortgage loans and unfunded loan commitments. Guidance in Accounting Standards Codification ("ASC") Topic 326-20 - *Credit Losses* requires collective assessment of financial assets with similar risk characteristics. Consistent with this guidance, the model used by the Company (the "CML Model") incorporates historical default data for a large number of loans with similar characteristics to the Company's commercial mortgage loans in the measurement of the allowance for credit losses. Relevant risk characteristics include debt service coverage ratio ("DSCR"), loan-to-value ratio ("LTV"), geographic location, and property type. This historical default data is applied through the CML Model to forecast loan-level risk parameters including PD and LGD which provide the basis for the determination of expected losses.

The CML Model incorporates both current conditions and reasonable and supportable forecasts when estimating the PD and LGD values that are used as the basis for calculating expected losses. Current conditions are incorporated by considering market-specific information, such as vacancy rates and property prices, to reflect the current position in the market cycle. To incorporate reasonable and supportable forecasts, loan-level risk parameters produced by the CML Model are conditioned by multiple probability-weighted macroeconomic forecast scenarios. CML Model results are also subject to adjustments based on other qualitative considerations to reflect management's best estimate of the impact of future events and circumstances on the allowance for credit losses.

PDs and LGDs are forecasted over a reasonable and supportable forecast period, which is reassessed on a quarterly basis. After the reasonable and supportable forecast period, the CML Model reverts to the Company's own historical loss history at a portfolio segment level. The historical loss data used for reversion will be assessed annually in the third quarter, along with certain other model inputs and assumptions.

All or a portion of a loan may be written off at such point that a) the Company no longer expects to receive cash payments, b) the present value of future expected payments of a renegotiated loan is less than the current principal balance, or c) at such time that the Company is party to foreclosure or bankruptcy proceedings associated with the borrower and does not expect to recover the principal balance of the loan. A write-off is recorded by eliminating the allowance against the commercial mortgage loan and recording the renegotiated loan or the collateral property related to the loan as investment real estate on the balance sheet, which is carried at the lower of the appraised fair value of the property or the unpaid principal balance of the loan, less estimated selling costs associated with the property.

Certain loans which meet the definition of collateral dependent (as outlined in the Financial Accounting Standards Board "FASB" ASC Topic 326-20) are identified as part of the Company's ongoing loan surveillance process. Loans are considered to be collateral dependent if foreclosure is deemed probable, or if a borrower is in financial difficulty and repayment is expected to be provided substantially through the operation or sale of the underlying collateral. The allowance for credit losses for loans identified as collateral dependent is measured based on the fair value of the underlying collateral, less costs to sell.

The Company presents accrued interest receivable separately from other components of the amortized cost basis of its commercial mortgage loans and has made an accounting policy election not to measure an allowance for credit losses for accrued interest receivable. It is the Company's policy to cease to carry accrued interest on loans that are over 90 days delinquent. For loans less than 90 days delinquent, interest is accrued unless it is determined that the accrued interest is not collectible. In each scenario, accrued income is reversed through investment income. See Note 9, *Commercial Mortgage Loans*, for additional information.

Allowance for Credit Losses – Reinsurance Receivables

Beginning January 1, 2020, in accordance with FASB ASC Topic 326-20, the Company establishes an allowance for credit losses related to amounts receivable from reinsurers (the “Reinsurance ACL”). Changes in the Reinsurance ACL are recognized as a component of *benefits and settlement expenses*. The Reinsurance ACL is remeasured on a quarterly basis using an internally developed PD and LGD model. Key inputs to the calculation are a conditional probability of insurer liquidation by issuer credit rating and exposure at default derived from a runoff projection of ceded reserves by reinsurer to forecast future loss amounts. Management’s position is that the rate of return implicit in the financial asset (i.e. the ceded reserves) is associated with the discount rate used to value the underlying insurance reserves; that is, the rate of return on the asset portfolio(s) supporting the reserves. For reinsurance receivable exposures that do not share similar risk characteristics with other receivables, including those associated with counterparties that have experienced significant credit deterioration, the Company measures the allowance for credit losses individually, based on facts and circumstances associated with the specific reinsurer or transaction.

The Reinsurance ACL was \$99.8 million as of January 1, 2020 upon adoption of ASU No. 2016-13 - Credit Losses. During the nine months ended September 30, 2020, the Reinsurance ACL increased slightly to \$111.7 million. There were no write-offs or recoveries during the nine months ended September 30, 2020.

The Company had total reinsurance receivables of \$4.3 billion as of September 30, 2020, which includes both ceded policy benefit reserves and receivables for claims. Receivables for claims represented approximately 11% of total reinsurance receivables as of September 30, 2020. Receivables for claims are short-term in nature, and generally carry minimal credit risk. Of reserves ceded as of September 30, 2020, approximately 56% were receivables from reinsurers rated by A.M. Best Company. Of the total rated by A.M. Best, 74% were rated A+ or better, 16% were rated A, and 10% were rated A- or lower. The Company monitors the concentration of credit risk the Company has with any reinsurer, as well as the financial condition of its reinsurers, on an ongoing basis. Certain of the Company’s reinsurance receivables are supported by letters of credit, funds held or trust agreements.

Accounting Pronouncements Recently Adopted

Accounting Standards Update (“ASU” or “Update”) No. 2016-13 - Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments. The amendments in this Update introduce a new current expected credit loss (“CECL”) model for certain financial assets, including commercial mortgage loans and reinsurance receivables. For assets within the scope of the new model, an entity will recognize as an allowance against earnings its estimate of the contractual cash flows not expected to be collected on day one of the asset’s acquisition. The allowance may be reversed through earnings if a security recovers in value. This differs from the current impairment model, which requires recognition of credit losses when they have been incurred and recognizes a security’s subsequent recovery in value in other comprehensive income. The Update also makes targeted changes to the current impairment model for available-for-sale (“AFS”) debt securities, which comprise the majority of the Company’s invested assets. Similar to the CECL model, credit loss impairments will be recorded in an allowance against earnings that may be reversed for subsequent recoveries in value. The amendments in this Update, along with related amendments in ASU No. 2018-19, ASU No. 2019-04, and ASU No. 2019-11 - *Codification Improvements to Topic 326, Financial Instruments-Credit Losses*, were effective for annual and interim periods beginning after December 15, 2019 on a modified retrospective basis. A vendor-provided credit loss model is utilized to measure the allowance for the majority of the Company’s commercial mortgage loans and unfunded commercial mortgage loan commitments, and the Company utilizes an internally-developed model to measure the allowance for amounts recoverable from reinsurers. The Company applied the revisions in the Update through a cumulative effect adjustment to retained earnings as of January 1, 2020. The cumulative effect adjustment resulted in a decrease in retained earnings of \$138.3 million, net of the impact to deferred taxes, deferred acquisition costs (“DAC”), value of business acquired (“VOBA”) and other items. The Company continues to apply the previous guidance to 2019 and prior periods.

Accounting Pronouncements Not Yet Adopted

ASU No. 2018-12 - Financial Services - Insurance (Topic 944): Targeted Improvements to Accounting for Long-Duration Contracts. The amendments in this Update are designed to make improvements to the existing recognition, measurement, presentation, and disclosure requirements for certain long-duration contracts issued by an insurance company. The new amendments require insurance entities to provide a more current measure of the liability for future policy benefits for traditional and limited-payment contracts by regularly refining the liability for actual past experience and updated future assumptions. This differs from current requirements where assumptions are locked-in at contract issuance for these contract types. In addition, the updated liability will be discounted using an upper-medium grade (low-credit-risk) fixed income instrument yield that reflects the characteristics of the liability which differs from currently used rates based on the invested assets supporting the liability. In addition, the amendments introduce new requirements to assess market-based insurance contract options and guarantees for Market Risk Benefits and measure them at fair value. This Update also requires insurance entities to amortize deferred acquisition costs on a constant-level basis over the expected life of the contract. Finally, this Update requires new disclosures including liability rollforwards and information about significant inputs, judgments, assumptions, and methods used in the measurement. In November 2020, FASB issued ASU No. 2020-11 - *Financial Services - Insurance (Topic 944); Effective Date and Early Application* which deferred the effective date to periods beginning after December 31, 2022. The Company is currently reviewing its policies, processes, and applicable systems to determine the impact this standard will have on its operations and financial results.

ASU No. 2019-12 – Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. The amendments in this Update remove certain exceptions to the general principles in Topic 740 related to intraperiod tax allocations, interim tax calculations, and outside basis differences. The amendments also clarify and amend guidance in certain other areas of Topic 740 in order to eliminate diversity in practice. The amendments in this Update are effective for public business entities in fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. This Update is not expected to have a material impact on the Company’s operations and financial results.

3. SIGNIFICANT TRANSACTIONS

Great-West Life & Annuity Insurance Company

On January 23, 2019, PLICO entered into a Master Transaction Agreement (the “GWL&A Master Transaction Agreement”) with Great-West Life & Annuity Insurance Company (“GWL&A”), Great-West Life & Annuity Insurance Company of New York (“GWL&A of NY”), The Canada Life Assurance Company (“CLAC”) and The Great-West Life Assurance Company (“GWL” and, together with GWL&A, GWL&A of NY and CLAC, the “Sellers”), pursuant to which PLICO will acquire via reinsurance (the “Transaction”) substantially all of the Sellers’ individual life insurance and annuity business (the “GW Individual Life Business”).

On June 3, 2019, PLICO and PLAIC completed the Transaction (the “Closing”). Pursuant to the GWL&A Master Transaction Agreement PLICO and PLAIC entered into reinsurance agreements (the “GWL&A Reinsurance Agreements”) and related ancillary documents at the GWL&A Closing. On the terms and subject to the conditions of the GWL&A Reinsurance Agreements, the Sellers ceded to PLICO and PLAIC, effective as of the date of the GWL&A Closing, substantially all of the insurance policies related to the Individual Life Business on a 100% indemnity basis net of reinsurance recoveries. The aggregate ceding commission for the reinsurance of the Individual Life Business paid at the GWL&A Closing was \$765.7 million. All policies issued in states other than New York were ceded to PLICO under reinsurance agreements between the applicable Seller and PLICO, and all policies issued in New York were ceded to PLAIC under a reinsurance agreement between GWL&A of NY and PLAIC. In addition, there were certain pending items related to the Master Transaction Agreement, which remained subject to negotiation as of September 30, 2020. On October 30, 2020, the Company reached a final settlement on all of the remaining pending items. As the one year purchase price measurement period had concluded, the Company will recognize approximately \$90 million in income before income tax during the quarter ended December 31, 2020 related to the final settlement. To support its obligations under the GWL&A Reinsurance Agreements, PLICO established trust accounts for the benefit of GWL&A, CLAC and GWL, and PLAIC established a trust account for the benefit of GWL&A of NY. The Sellers retained a block of participating policies, which are administered by the Company.

The GWL&A Master Transaction Agreement and other transaction documents contain certain customary representations and warranties made by each of the parties, and certain customary covenants regarding the Sellers and the Individual Life Business, and provide for indemnification, among other things, for breaches of those representations, warranties, and covenants. The terms of the GWL&A Reinsurance Agreements resulted in an acquisition of the Individual Life Business by the Company in accordance with ASC Topic 805, *Business Combinations*.

The following table details the final allocation of assets acquired and liabilities assumed from the Individual Life Business reinsurance transaction as of the date of the GWL&A Closing.

	Fair Value as of June 1, 2019
	(Dollars In Thousands)
ASSETS	
Fixed maturities	\$ 8,697,966
Commercial mortgage loans	1,386,228
Policy loans	44,002
Other long-term investments	1,521,965
Total investments	11,650,161
Cash	34,835
Accrued investment income	101,452
Reinsurance receivables	62
Accounts and premiums receivable	1,642
Value of business acquired	535,421
Other intangibles	21,300
Other assets	5,525
Assets related to separate accounts	9,583,217
Total assets	21,933,615
LIABILITIES	
Future policy benefits and claims	\$ 11,022,177
Annuity account balances	220,064
Other policyholders' funds	220,147
Other liabilities	75,367
Liabilities related to separate accounts	9,583,217
Total liabilities	21,120,972
NET ASSETS ACQUIRED	\$ 812,643

Assets related to separate accounts and liabilities related to separate accounts represent amounts receivable and payable for variable annuity and variable universal life products reinsured on a modified co-insurance basis.

The following unaudited pro forma condensed consolidated results of operations assumes that the aforementioned transactions of the Individual Life Business were completed as of January 1, 2019. The unaudited pro forma condensed results of operations are presented solely for informational purposes and are not necessarily indicative of the consolidated condensed results of operations that might have been achieved had the transaction been completed as of the date indicated:

	Unaudited	
	For The Three Months Ended September 30, 2019	For The Nine Months Ended September 30, 2019
	(Dollars In Thousands)	
Revenue	\$ 1,618,711	\$ 4,822,409
Net income	\$ 100,626	\$ 364,116

4. MONY CLOSED BLOCK OF BUSINESS

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

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

Summarized financial information for the Closed Block as of September 30, 2020, and December 31, 2019, is as follows:

	As of	
	September 30, 2020	December 31, 2019
(Dollars In Thousands)		
Closed block liabilities		
Future policy benefits, policyholders’ account balances and other policyholder liabilities	\$ 5,458,772	\$ 5,836,815
Policyholder dividend obligation	473,380	278,505
Other liabilities	8,328	11,247
Total closed block liabilities	<u>5,940,480</u>	<u>6,126,567</u>
Closed block assets		
Fixed maturities, available-for-sale, at fair value	\$ 4,827,002	\$ 4,682,731
Commercial mortgage loans	69,422	72,829
Policy loans	633,609	640,134
Cash and other invested assets	24,614	44,877
Other assets	96,865	107,177
Total closed block assets	<u>5,651,512</u>	<u>5,547,748</u>
Excess of reported closed block liabilities over closed block assets	288,968	578,819
Portion of above representing accumulated other comprehensive income:		
Net unrealized gains (losses) - investments/derivatives net of policyholder dividend obligation: 2020 - \$383,309 and 2019 - \$167,285; and net of income tax: 2020 - \$(80,495) and 2019 - \$(35,130)	—	—
Future earnings to be recognized from closed block assets and closed block liabilities	<u>\$ 288,968</u>	<u>\$ 578,819</u>

Reconciliation of the policyholder dividend obligation is as follows:

	For The Nine Months Ended September 30	
	2020	2019
	(Dollars In Thousands)	
Policyholder dividend obligation, beginning balance	\$ 278,505	\$ —
Applicable to net revenue (losses)	(21,150)	(19,548)
Change in net unrealized gains (losses) - investments/derivatives allocated to the policyholder dividend obligation	216,025	339,413
Policyholder dividend obligation, ending balance	<u>\$ 473,380</u>	<u>\$ 319,865</u>

Closed Block revenues and expenses were as follows:

	For The Three Months Ended September 30		For The Nine Months Ended September 30	
	2020	2019	2020	2019
	(Dollars In Thousands)			
Revenues				
Premiums and other income	\$ 36,394	\$ 37,652	\$ 109,656	\$ 115,202
Net investment income	50,557	52,018	152,609	154,808
Net investment gains (losses)	(499)	1,104	(1,284)	693
Total revenues	<u>86,452</u>	<u>90,774</u>	<u>260,981</u>	<u>270,703</u>
Benefits and other deductions				
Benefits and settlement expenses	80,797	84,531	242,474	250,410
Other operating expenses	284	229	877	836
Total benefits and other deductions	<u>81,081</u>	<u>84,760</u>	<u>243,351</u>	<u>251,246</u>
Net revenues before income taxes	5,371	6,014	17,630	19,457
Income tax expense	1,242	1,263	3,396	4,086
Net revenues	<u>\$ 4,129</u>	<u>\$ 4,751</u>	<u>\$ 14,234</u>	<u>\$ 15,371</u>

5. INVESTMENT OPERATIONS

Realized gains (losses) - investments includes realized gains and losses from the sale of investments, changes in fair value of equity securities, net credit losses, and trading securities. Realized gains and losses on investments are calculated on the basis of specific identification on the trade date. Realized gains (losses) - derivatives includes certain derivative and embedded derivative gains and losses and gains and losses on reinsurance-related embedded derivatives.

Net realized gains (losses) - investments/derivatives are summarized as follows:

	For The Three Months Ended September 30		For The Nine Months Ended September 30	
	2020	2019	2020	2019
	(Dollars In Thousands)			
Fixed maturities	\$ 2,682	\$ 15,686	\$ 44,576	\$ 21,901
Equity securities	10,518	6,310	23,877	44,723
Modco trading portfolios	44,918	67,674	108,223	252,147
Net credit losses recognized in operations ⁽¹⁾	(38,459)	—	(120,540)	—
Net impairment losses recognized in operations ⁽²⁾	—	(10,818)	—	(14,658)
Commercial mortgage loans	(2,174)	(1,575)	(101,256)	(1,435)
Other investments	(1,066)	314	(2,826)	165
Realized gains (losses) - investments	16,419	77,591	(47,946)	302,843
Realized gains (losses) - derivatives ⁽³⁾	72,433	(102,403)	(134,313)	(370,123)
Realized gains (losses) - investments/derivatives	\$ 88,852	\$ (24,812)	\$ (182,259)	\$ (67,280)

(1) Represents net credit losses recognized under FASB ASC 326

(2) Represents other-than-temporary impairment losses recognized under FASB ASC 320

(3) See Note 7, *Derivative Financial Instruments*

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

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars In Thousands)			
Gross realized gains	\$ 2,751	\$ 20,155	\$ 49,467	\$ 34,837
Gross realized losses:				
Credit losses ⁽¹⁾	\$ (38,459)	\$ —	\$ (120,540)	\$ —
Impairment losses ⁽²⁾	\$ —	\$ (10,818)	\$ —	\$ (14,658)
Other realized losses	\$ (69)	\$ (4,469)	\$ (4,891)	\$ (12,936)

(1) Represents net credit losses recognized under FASB ASC 326

(2) Represents other-than-temporary impairment losses recognized in prior periods under FASB ASC 320

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

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
(Dollars In Thousands)				
Securities in an unrealized gain position:				
Fair value proceeds	\$ 515,432	\$ 679,514	\$ 1,454,809	\$ 1,819,526
Gains realized	\$ 2,751	\$ 20,155	\$ 49,467	\$ 34,837
Securities in an unrealized loss position:				
Fair value proceeds	\$ 8,228	\$ 37,488	\$ 33,062	\$ 375,617
Losses realized	\$ (69)	\$ (4,469)	\$ (4,891)	\$ (12,936)

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

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
(Dollars In Thousands)				
Gains (losses) recognized during the period on equity securities still held	\$ 10,445	\$ 6,958	\$ 23,685	\$ 45,118
Net gains (losses) recognized on equity securities sold during the period	73	(648)	192	(395)
Net gains (losses) recognized during the period on equity securities	\$ 10,518	\$ 6,310	\$ 23,877	\$ 44,723

The amortized cost, gross unrealized gains, losses, allowance for expected credit losses, and fair value of the Company's investments classified as available-for-sale are as follows:

As of September 30, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Allowance for Expected Credit Losses	Fair Value
(Dollars In Thousands)					
Fixed maturities:					
Residential mortgage-backed securities	\$ 6,646,364	\$ 211,665	\$ (889)	\$ —	\$ 6,857,140
Commercial mortgage-backed securities	2,491,748	121,387	(27,458)	—	2,585,677
Other asset-backed securities	1,562,104	40,536	(17,756)	(645)	1,584,239
U.S. government-related securities	1,204,690	28,822	(3,219)	—	1,230,293
Other government-related securities	570,911	74,289	(2,662)	—	642,538
States, municipals, and political subdivisions	4,052,531	505,479	(2,953)	—	4,555,057
Corporate securities	45,655,816	4,877,928	(290,995)	(18,754)	50,223,995
Redeemable preferred stocks	65,933	1,396	—	—	67,329
	<u>62,250,097</u>	<u>5,861,502</u>	<u>(345,932)</u>	<u>(19,399)</u>	<u>67,746,268</u>
Short-term investments	1,175,027	—	—	—	1,175,027
	<u>\$ 63,425,124</u>	<u>\$ 5,861,502</u>	<u>\$ (345,932)</u>	<u>\$ (19,399)</u>	<u>\$ 68,921,295</u>

As of December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars In Thousands)				
Fixed maturities:				
Residential mortgage-backed securities	\$ 5,822,510	\$ 125,631	\$ (6,322)	\$ 5,941,819
Commercial mortgage-backed securities	2,616,292	54,661	(3,367)	2,667,586
Other asset-backed securities	1,764,120	32,041	(14,926)	1,781,235
U.S. government-related securities	1,032,048	5,664	(5,316)	1,032,396
Other government-related securities	550,125	51,157	(1,990)	599,292
States, municipals, and political subdivisions	4,415,008	225,072	(1,230)	4,638,850
Corporate securities	44,659,652	2,613,972	(288,729)	46,984,895
Redeemable preferred stocks	87,237	3,677	(4,249)	86,665
	<u>60,946,992</u>	<u>3,111,875</u>	<u>(326,129)</u>	<u>63,732,738</u>
Short-term investments	1,422,137	—	—	1,422,137
	<u>\$ 62,369,129</u>	<u>\$ 3,111,875</u>	<u>\$ (326,129)</u>	<u>\$ 65,154,875</u>

The Company holds certain investments pursuant to certain modified coinsurance (“Modco”) arrangements. The fixed maturities, equity securities, and short-term investments held as part of these arrangements are classified as trading securities. The fair value of the investments held pursuant to these Modco arrangements are as follows:

	As of	
	September 30, 2020	December 31, 2019
(Dollars In Thousands)		
Fixed maturities:		
Residential mortgage-backed securities	\$ 207,507	\$ 209,521
Commercial mortgage-backed securities	208,036	201,284
Other asset-backed securities	150,290	143,361
U.S. government-related securities	36,991	47,067
Other government-related securities	29,571	28,775
States, municipals, and political subdivisions	288,085	293,791
Corporate securities	1,850,471	1,590,936
Redeemable preferred stocks	12,434	12,832
	<u>2,783,385</u>	<u>2,527,567</u>
Equity securities	16,742	6,656
Short-term investments	77,322	91,213
	<u>\$ 2,877,449</u>	<u>\$ 2,625,436</u>

The amortized cost and fair value of available-for-sale and held-to-maturity fixed maturities as of September 30, 2020, by expected maturity, are shown below. Expected maturities of securities without a single maturity date are allocated based on estimated rates of prepayment that may differ from actual rates of prepayment.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars In Thousands)				
Due in one year or less	\$ 2,223,690	\$ 2,233,763	\$ —	\$ —
Due after one year through five years	11,511,554	12,029,864	—	—
Due after five years through ten years	15,048,118	16,267,864	—	—
Due after ten years	33,466,735	37,214,777	2,680,324	2,990,170
	<u>\$ 62,250,097</u>	<u>\$ 67,746,268</u>	<u>\$ 2,680,324</u>	<u>\$ 2,990,170</u>

The following chart is a rollforward of the available-for-sale allowance for expected credit losses on fixed maturities held by the Company:

	For The Three Months Ended September 30, 2020			For The Nine Months Ended September 30, 2020		
	Corporate Securities	Other Asset- Backed Securities	Total	Corporate Securities	Other Asset- Backed Securities	Total
	(Dollars In Thousands)					
Beginning Balance	\$ 81,426	\$ 655	\$ 82,081	\$ —	\$ —	\$ —
Additions for securities for which allowance was not previously recorded	—	—	—	62,442	658	63,100
Adjustments on previously recorded allowances due to change in expected cash flows	945	—	945	19,929	—	19,929
Reductions on previously recorded allowances due to disposal of security in the current period	—	(10)	(10)	—	(13)	(13)
Write-offs of previously recorded allowances due to intent or requirement to sell	(63,617)	—	(63,617)	(63,617)	—	(63,617)
Ending Balance	<u>\$ 18,754</u>	<u>\$ 645</u>	<u>\$ 19,399</u>	<u>\$ 18,754</u>	<u>\$ 645</u>	<u>\$ 19,399</u>

The following table includes the gross unrealized losses for which an allowance for credit losses has not been recorded and fair value of the Company's AFS fixed maturities aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2020:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(Dollars In Thousands)					
Residential mortgage-backed securities	\$ 176,534	\$ (653)	\$ 6,895	\$ (236)	\$ 183,429	\$ (889)
Commercial mortgage-backed securities	358,921	(21,707)	28,103	(5,751)	387,024	(27,458)
Other asset-backed securities	379,311	(6,209)	312,368	(11,547)	691,679	(17,756)
U.S. government-related securities	251,534	(3,193)	787	(26)	252,321	(3,219)
Other government-related securities	23,328	(1,900)	6,776	(762)	30,104	(2,662)
States, municipals, and political subdivisions	107,322	(2,901)	4,895	(52)	112,217	(2,953)
Corporate securities	2,869,258	(152,908)	1,082,884	(138,087)	3,952,142	(290,995)
Redeemable preferred stocks	—	—	—	—	—	—
	<u>\$ 4,166,208</u>	<u>\$ (189,471)</u>	<u>\$ 1,442,708</u>	<u>\$ (156,461)</u>	<u>\$ 5,608,916</u>	<u>\$ (345,932)</u>

Commercial mortgage-backed securities ("CMBS") had gross unrealized losses greater than twelve months of \$5.8 million as of September 30, 2020. Factors such as the credit enhancement within the deal structure, the average life of the securities, and the performance of the underlying collateral support the recoverability of these investments.

The other asset-backed securities have a gross unrealized loss greater than twelve months of \$11.5 million as of September 30, 2020, excluding losses of \$0.6 million that were considered credit related. This category predominately includes student loan backed auction rate securities (“ARS”) whose underlying collateral is at least 97% guaranteed by the Federal Family Education Loan Program (“FFELP”). At this time, the Company has no reason to believe that the U.S. Department of Education would not honor the FFELP guarantee, if it were necessary.

The other government-related securities had gross unrealized losses greater than twelve months of \$0.8 million, as of September 30, 2020. These declines were related to changes in interest rates.

The corporate securities category had gross unrealized losses greater than twelve months of \$138.1 million as of September 30, 2020, excluding losses of \$18.7 million that were considered credit related. The overall deterioration in the macroeconomic environment as a result of the impact of COVID-19 as well as the continued pressure on commodity prices has negatively affected the values of certain of our investments. The largest impacts have been in the oil & gas, real estate, and consumer and retail industries. For the nine months ended September 30, 2020, we have recognized \$120.5 million of impairments for the Company which primarily reflect declines in the value of certain oil and gas securities.

As of September 30, 2020, the Company had a total of 646 positions that were in an unrealized loss position, including 5 positions for which an allowance for credit losses was established. For unrealized losses for which an allowance for credit losses was not established, the Company does not consider these unrealized loss positions to be credit-related. This is based on the aggregate factors discussed previously and because the Company has the ability and intent to hold these investments until the fair values recover. The Company does not intend to sell or expect to be required to sell the securities before recovering the Company’s amortized cost of the securities.

The following table includes the gross unrealized losses and fair value of the Company’s investments that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2019:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(Dollars In Thousands)					
Residential mortgage-backed securities	\$ 851,333	\$ (4,231)	\$ 221,529	\$ (2,091)	\$ 1,072,862	\$ (6,322)
Commercial mortgage-backed securities	385,574	(1,796)	115,566	(1,571)	501,140	(3,367)
Other asset-backed securities	482,547	(6,516)	214,058	(8,410)	696,605	(14,926)
U.S. government-related securities	383,451	(3,373)	353,517	(1,943)	736,968	(5,316)
Other government-related securities	22,962	(669)	6,230	(1,321)	29,192	(1,990)
States, municipals, and political subdivisions	56,470	(1,001)	12,907	(229)	69,377	(1,230)
Corporate securities	3,176,488	(68,289)	2,893,816	(220,440)	6,070,304	(288,729)
Redeemable preferred stocks	—	—	16,689	(4,249)	16,689	(4,249)
	<u>\$ 5,358,825</u>	<u>\$ (85,875)</u>	<u>\$ 3,834,312</u>	<u>\$ (240,254)</u>	<u>\$ 9,193,137</u>	<u>\$ (326,129)</u>

As of September 30, 2020, the Company had securities in its available-for-sale portfolio which were rated below investment grade of \$2.3 billion and had an amortized cost of \$2.4 billion. Approximately \$383.7 million of below investment grade securities held by the Company were not publicly traded. In addition, included in the Company’s trading portfolio, the Company held \$125.0 million of securities which were rated below investment grade.

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

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2020	2019	2020	2019
	(Dollars In Thousands)			
Fixed maturities	\$ 788,058	\$ 1,310,979	\$ 2,156,561	\$ 4,410,162

The amortized cost and fair value of the Company's investments classified as held-to-maturity as of September 30, 2020 and December 31, 2019, are as follows:

As of September 30, 2020	Amortized Cost	Gross Unrecognized Holding Gains	Gross Unrecognized Holding Losses	Fair Value
	(Dollars In Thousands)			
Fixed maturities:				
Securities issued by affiliates:				
Red Mountain, LLC	\$ 822,324	\$ 140,435	\$ —	\$ 962,759
Steel City, LLC	1,858,000	169,411	—	2,027,411
	<u>\$ 2,680,324</u>	<u>\$ 309,846</u>	<u>\$ —</u>	<u>\$ 2,990,170</u>

As of December 31, 2019	Amortized Cost	Gross Unrecognized Holding Gains	Gross Unrecognized Holding Losses	Fair Value
	(Dollars In Thousands)			
Fixed maturities:				
Securities issued by affiliates:				
Red Mountain, LLC	\$ 795,881	\$ 81,022	\$ —	\$ 876,903
Steel City, LLC	2,028,000	120,887	—	2,148,887
	<u>\$ 2,823,881</u>	<u>\$ 201,909</u>	<u>\$ —</u>	<u>\$ 3,025,790</u>

During the three and nine months ended September 30, 2020 and 2019, the Company recorded no credit losses on held-to-maturity securities.

The Company's held-to-maturity securities are issued by affiliates of the Company which are considered variable interest entities. The Company is not the primary beneficiary of these entities and thus the securities are not eliminated in consolidation. These securities are collateralized by non-recourse funding obligations issued by captive insurance companies that are affiliates of the Company. See Note 14, *Subsequent Events* for additional information on Red Mountain, LLC and Steel City, LLC.

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

- **Level 1:** Unadjusted quoted prices for identical assets or liabilities in an active market.
- **Level 2:** Quoted prices in markets that are not active or significant inputs that are observable either directly or indirectly. Level 2 inputs include the following:
 - a) Quoted prices for similar assets or liabilities in active markets;
 - b) Quoted prices for identical or similar assets or liabilities in non-active markets;
 - c) Inputs other than quoted market prices that are observable; and
 - d) Inputs that are derived principally from or corroborated by observable market data through correlation or other means.
- **Level 3:** Prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. They reflect management's own estimates about the assumptions a market participant would use in pricing the asset or liability.

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of September 30, 2020:

	Measurement Category	Level 1	Level 2	Level 3	Total
(Dollars In Thousands)					
Assets:					
Fixed maturity securities - available-for-sale					
Residential mortgage-backed securities	4	\$ —	\$ 6,857,140	\$ —	\$ 6,857,140
Commercial mortgage-backed securities	4	—	2,574,992	10,685	2,585,677
Other asset-backed securities	4	—	1,149,743	434,496	1,584,239
U.S. government-related securities	4	728,554	501,739	—	1,230,293
Other government-related securities	4	—	642,538	—	642,538
States, municipals, and political subdivisions	4	—	4,555,057	—	4,555,057
Corporate securities	4	—	48,866,451	1,357,544	50,223,995
Redeemable preferred stocks	4	67,329	—	—	67,329
Total fixed maturity securities - AFS		795,883	65,147,660	1,802,725	67,746,268
Fixed maturity securities - trading					
Residential mortgage-backed securities	3	—	207,507	—	207,507
Commercial mortgage-backed securities	3	—	208,036	—	208,036
Other asset-backed securities	3	—	87,848	62,442	150,290
U.S. government-related securities	3	21,761	15,230	—	36,991
Other government-related securities	3	—	29,571	—	29,571
States, municipals, and political subdivisions	3	—	288,085	—	288,085
Corporate securities	3	—	1,832,592	17,879	1,850,471
Redeemable preferred stocks	3	12,434	—	—	12,434
Total fixed maturity securities - trading		34,195	2,668,869	80,321	2,783,385
Total fixed maturity securities		830,078	67,816,529	1,883,046	70,529,653
Equity securities	3	514,848	—	86,579	601,427
Other long-term investments ⁽¹⁾	3 & 4	73,934	1,013,846	207,764	1,295,544
Short-term investments	3	1,169,523	82,826	—	1,252,349
Total investments		2,588,383	68,913,201	2,177,389	73,678,973
Cash	3	569,811	—	—	569,811
Other assets	3	40,072	—	—	40,072
Assets related to separate accounts					
Variable annuity	3	11,487,408	—	—	11,487,408
Variable universal life	3	1,144,474	—	—	1,144,474
Total assets measured at fair value on a recurring basis		\$15,830,148	\$68,913,201	\$ 2,177,389	\$86,920,738
Liabilities:					
Annuity account balances ⁽²⁾	3	\$ —	\$ —	\$ 67,591	\$ 67,591
Other liabilities ⁽¹⁾	3 & 4	9,480	530,179	2,330,212	2,869,871
Total liabilities measured at fair value on a recurring basis		\$ 9,480	\$ 530,179	\$ 2,397,803	\$ 2,937,462

(1) Includes certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

(3) Fair Value through Net Income (Loss)

(4) Fair Value through Other Comprehensive Income (Loss)

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of December 31, 2019:

	Measurement Category	Level 1	Level 2	Level 3	Total
(Dollars In Thousands)					
Assets:					
Fixed maturity securities - available-for-sale					
Residential mortgage-backed securities	4	\$ —	\$ 5,941,819	\$ —	\$ 5,941,819
Commercial mortgage-backed securities	4	—	2,657,557	10,029	2,667,586
Other asset-backed securities	4	—	1,360,016	421,219	1,781,235
U.S. government-related securities	4	662,581	369,815	—	1,032,396
Other government-related securities	4	—	4,638,850	—	4,638,850
State, municipals, and political subdivisions	4	—	599,292	—	599,292
Corporate securities	4	—	45,611,181	1,373,714	46,984,895
Redeemable preferred stocks	4	69,976	16,689	—	86,665
Total fixed maturity securities - AFS		<u>732,557</u>	<u>61,195,219</u>	<u>1,804,962</u>	<u>63,732,738</u>
Fixed maturity securities - trading					
Residential mortgage-backed securities	3	—	209,521	—	209,521
Commercial mortgage-backed securities	3	—	201,284	—	201,284
Other asset-backed securities	3	—	77,954	65,407	143,361
U.S. government-related securities	3	24,810	22,257	—	47,067
Other government-related securities	3	—	293,791	—	293,791
State, municipals, and political subdivisions	3	—	28,775	—	28,775
Corporate securities	3	—	1,579,565	11,371	1,590,936
Redeemable preferred stocks	3	12,832	—	—	12,832
Total fixed maturity securities - trading		<u>37,642</u>	<u>2,413,147</u>	<u>76,778</u>	<u>2,527,567</u>
Total fixed maturity securities		770,199	63,608,366	1,881,740	66,260,305
Equity securities	3	517,482	36	74,155	591,673
Other long-term investments ⁽¹⁾	3&4	52,225	733,425	176,195	961,845
Short-term investments	3	1,447,870	65,480	—	1,513,350
Total investments		2,787,776	64,407,307	2,132,090	69,327,173
Cash	3	243,527	—	—	243,527
Other assets	3	36,766	—	—	36,766
Assets related to separate accounts					
Variable annuity	3	12,730,090	—	—	12,730,090
Variable universal life	3	1,135,666	—	—	1,135,666
Total assets measured at fair value on a recurring basis		<u>\$ 16,933,825</u>	<u>\$ 64,407,307</u>	<u>\$ 2,132,090</u>	<u>\$ 83,473,222</u>
Liabilities:					
Annuity account balances ⁽²⁾	3	\$ —	\$ —	\$ 69,728	\$ 69,728
Other liabilities ⁽¹⁾	3&4	19,561	439,062	1,331,722	1,790,345
Total liabilities measured at fair value on a recurring basis		<u>\$ 19,561</u>	<u>\$ 439,062</u>	<u>\$ 1,401,450</u>	<u>\$ 1,860,073</u>

(1) Includes certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

(3) Fair Value through Net Income (Loss)

(4) Fair Value through Other Comprehensive Income (Loss)

Determination of Fair Values

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

The fair value of fixed maturity, short-term, and equity securities is determined by management after considering one of three primary sources of information: third-party pricing services, non-binding independent broker quotations, or pricing matrices. Security pricing is applied using a "waterfall" approach whereby publicly available prices are first sought from third-party pricing services, the remaining unpriced securities are submitted to independent brokers for non-binding prices, or lastly, securities are priced using a pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. Third-party pricing services price 92.7% of the Company's available-for-sale and trading fixed maturity securities. Based on the typical trading volumes and the lack of quoted market prices for available-for-sale and trading fixed maturities, third-party pricing services derive the majority of security prices from observable market inputs such as recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information outlined above. If there are no recent reported trades, the third-party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Certain securities are priced via independent non-binding broker quotations. When using non-binding independent broker quotations, when available the Company obtains two quotes per security. Where multiple broker quotes are obtained, the Company reviews the quotes and selects the quote that provides the best estimate of the price a market participant would pay for these specific assets in an arm's length transaction. A pricing matrix is used to price securities for which the Company is unable to obtain or effectively rely on either a price from a third-party pricing service or an independent broker quotation.

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

For securities that are priced via non-binding independent broker quotations, the Company assesses whether prices received from independent brokers represent a reasonable estimate of fair value. The Company's assessment incorporates various metrics (yield curves, credit spreads, prepayment rates, etc.) along with other information available to the Company from both internal and external sources to determine the valuation of such holdings. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon the analytics, the price received from the independent broker is adjusted accordingly. The Company did not adjust any quotes or prices received from brokers during the nine months ended September 30, 2020.

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

Asset-Backed Securities

This category mainly consists of residential mortgage-backed securities, commercial mortgage-backed securities, and other asset-backed securities (collectively referred to as asset-backed securities or “ABS”). As of September 30, 2020, the Company held \$11.1 billion of ABS classified as Level 2. These securities are priced from information provided by a third-party pricing service and independent broker quotes. The third-party pricing services and brokers mainly value securities using both a market and income approach to valuation. As part of this valuation process they consider the following characteristics of the item being measured to be relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, and 7) credit ratings of the securities.

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

As of September 30, 2020, the Company held \$507.6 million of Level 3 ABS, which included \$445.2 million of other asset-backed securities classified as available-for-sale and \$62.4 million of other asset-backed securities classified as trading. These securities are predominantly ARS whose underlying collateral is at least 97% guaranteed by the FFELP. The Company prices its ARS using an income approach valuation model. As part of the valuation process the Company reviews the following characteristics of the ARS in determining the relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, 7) credit ratings of the securities, 8) liquidity premium, and 9) paydown rate. In periods where market activity increases and there are transactions at a price that is not the result of a distressed or forced sale we consider those prices as part of our valuation. If the market activity during a period is solely the result of the issuer redeeming positions we consider those transactions in our valuation, but still consider them to be Level 3 measurements due to the nature of the transaction.

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

As of September 30, 2020, the Company classified approximately \$56.7 billion of corporate securities, redeemable preferred stocks, U.S. government-related securities, states, municipals, and political subdivisions, and other government-related securities as Level 2. The fair value of the Level 2 securities is predominantly priced by broker quotes and a third-party pricing service. The Company has reviewed the valuation techniques of the brokers and third-party pricing service and has determined that such techniques used Level 2 market observable inputs. The following characteristics of the securities are considered to be the primary relevant inputs to the valuation: 1) weighted average coupon rate, 2) weighted average years to maturity, 3) seniority, and 4) credit ratings. The Company reviews the methodologies and valuation techniques (including the ability to observe inputs) in assessing the information received from external pricing services and in consideration of the fair value presentation.

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

As of September 30, 2020, the Company classified approximately \$1.4 billion of securities as Level 3 valuations. Level 3 securities primarily represent investments in illiquid bonds for which no price is readily available. To determine a price, the Company uses a discounted cash flow model with both observable and unobservable inputs. These inputs are entered into an industry standard pricing model to determine the final price of the security. These inputs include: 1) principal and interest

payments, 2) coupon rate, 3) sector and issuer level spread over treasury, 4) underlying collateral, 5) credit ratings, 6) maturity, 7) embedded options, 8) recent new issuance, 9) comparative bond analysis, and 10) an illiquidity premium.

Equities

As of September 30, 2020, the Company held approximately \$86.6 million of equity securities classified as Level 3. Of this total, \$80.3 million represents Federal Home Loan Bank (“FHLB”) stock. The Company believes that the cost of the FHLB stock approximates fair value.

Other Long-Term Investments and Other Liabilities

Derivative Financial Instruments

Other long-term investments and other liabilities include free-standing and embedded derivative financial instruments. Refer to Note 7, *Derivative Financial Instruments* for additional information related to derivatives. Derivative financial instruments are valued using exchange prices, independent broker quotations, or pricing valuation models, which utilize market data inputs. Excluding embedded derivatives, as of September 30, 2020, 99.6% of derivatives based upon notional values were priced using exchange prices or independent broker quotations. Inputs used to value derivatives include, but are not limited to, interest swap rates, credit spreads, interest rate and equity market volatility indices, equity index levels, and treasury rates. The Company performs monthly analysis on derivative valuations that includes both quantitative and qualitative analyses.

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

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

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

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

Embedded derivatives are carried at fair value in *other long-term investments* and *other liabilities* on the Company’s consolidated condensed balance sheet. The changes in fair value of embedded derivatives are recorded as *Realized gains (losses) - investments/derivatives*. Refer to Note 7, *Derivative Financial Instruments* for more information.

The fair value of the guaranteed living withdrawal benefits (“GLWB”) embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using multiple risk neutral stochastic equity scenarios and policyholder behavior assumptions. The risk neutral scenarios are generated using the current swap curve and projected equity volatilities and correlations. The projected equity volatilities are based on a blend of historical volatility and near-term equity market implied volatilities. The equity correlations are based on historical price observations. For policyholder behavior assumptions, expected lapse and utilization assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the Ruark 2015 ALB table, with attained age factors varying from 88.0% - 100.0% based on company experience. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR plus a credit spread (to represent the Company’s non-performance risk). For expected lapse and utilization, assumptions are used and updated for actual experience, as necessary, using an internal predictive model developed by the Company. As a result of using significant unobservable inputs, the GLWB embedded derivative is categorized as Level 3. Policyholder assumptions are reviewed on an annual basis.

The balance of the fixed indexed annuity (“FIA”) embedded derivative is impacted by policyholder cash flows associated with the FIA product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the FIA embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior, assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the 2015 Ruark ALB mortality table, with attained age factors varying from 88.0% - 100.0% based on company experience. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company’s non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the FIA embedded derivative is categorized as Level 3.

The balance of the indexed universal life (“IUL”) embedded derivative is impacted by policyholder cash flows associated with the IUL product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the IUL embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior assumptions, expected lapse and withdrawal assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the SOA 2015 VBT Primary Tables, with attained age factors varying from 36.0% - 161.0% based on company experience. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company’s non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the IUL embedded derivative is categorized as Level 3.

The Company has assumed and ceded certain blocks of policies under modified coinsurance agreements in which the investment results of the underlying portfolios inure directly to the reinsurers. Funds withheld arrangements related to such agreements contain embedded derivatives that are reported at fair value. Changes in their fair value are reported in *realized gains (losses) - investments/derivatives*. The fair value of embedded derivatives related to funds withheld under modified coinsurance agreements are a function of the unrealized gains or losses on the underlying assets and are calculated in a manner consistent with the terms of the agreements. The investments supporting certain of these agreements are designated as “trading securities”; therefore changes in their fair value are also reported in *realized gains (losses) - investments*. The fair value of embedded derivatives is estimated based on market standard valuation methodology and is considered a Level 3 valuation.

Annuity Account Balances

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

Separate Accounts

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

Valuation of Level 3 Financial Instruments

The following table presents the valuation method for material financial instruments included in Level 3, as well as the unobservable inputs used in the valuation of those financial instruments as of September 30, 2020:

	Fair Value (Dollars In Thousands)	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets:				
Commercial mortgage-backed securities	\$ 10,685	Discounted cash flow	Spread over treasury	2.78%
Other asset-backed securities	434,496	Liquidation	Liquidation value	\$95.75 - \$97.00 (\$96.40)
		Discounted cash flow	Liquidity premium	0.51% - 2.33% (1.61%)
			Paydown rate	8.75% - 12.55% (11.38%)
Corporate securities	1,357,544	Discounted cash flow	Spread over treasury	0.60% - 4.75% (2.24%)
Liabilities:⁽¹⁾				
Embedded derivatives - GLWB ⁽²⁾	\$ 1,098,930	Actuarial cash flow model	Mortality	88% to 100% of Ruark 2015 ALB table
			Lapse	PL-RBA Predictive Model
			Utilization	PL-RBA Predictive Model
			Nonperformance risk	0.22% - 0.88%
Embedded derivative - FIA	582,083	Actuarial cash flow model	Expenses	\$207 per policy
			Withdrawal rate	0.4% - 2.4% prior to age 72, RMD for ages 72+ or WB withdrawal rate. Assume underutilized RMD for non-WB policies ages 72-88
			Mortality	88% to 100% of Ruark 2015 ALB table
			Lapse	0.2% - 50%, depending on duration/surrender charge period. Dynamically adjusted for WB moneyiness and projected market rates vs credited rates.
			Nonperformance risk	0.22% - 0.88%
Embedded derivative - IUL	194,228	Actuarial cash flow model	Mortality	36% - 161% of 2015 VBT Primary Tables 94% - 248% of duration 8 point in scale 2015 VBT Primary Tables, depending on type of business
			Lapse	0.375% - 10.0%, depending on on duration/distribution channel and smoking class
			Nonperformance risk	0.22% - 0.88%

(1) Excludes modified coinsurance arrangements.

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

The chart above excludes Level 3 financial instruments that are valued using broker quotes and for which book value approximates fair value. Unobservable inputs were weighted by the relative fair value of instruments, except for other asset-backed securities which were weighted by the relative par amounts.

The Company has considered all reasonably available quantitative inputs as of September 30, 2020, but the valuation techniques and inputs used by some brokers in pricing certain financial instruments are not shared with the Company. This resulted in \$98.1 million of financial instruments being classified as Level 3 as of September 30, 2020 of which \$79.3 million are other

asset-backed securities, \$12.8 million are corporate securities, and \$6.0 million are equity securities.

In certain cases, the Company has determined that book value materially approximates fair value. As of September 30, 2020, the Company held \$80.3 million of financial instruments where book value approximates fair value which was predominantly FHLB stock.

The following table presents the valuation method for material financial instruments included in Level 3, as well as the unobservable inputs used in the valuation of those financial instruments as of December 31, 2019:

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
(Dollars In Thousands)				
Assets:				
Commercial mortgage-backed securities	\$ 10,029	Discounted cash flow	Spread over treasury	2.5%
Other asset-backed securities	421,112	Liquidation	Liquidation value	\$95.39 - \$99.99 (\$97.95)
		Discounted cash flow	Liquidity premium	0.34% - 2.28% (1.44%)
			Paydown rate	8.99% - 12.45% (11.28%)
Corporate securities	1,384,806	Discounted cash flow	Spread over treasury	0.00% - 4.03% (1.60%)
Liabilities:⁽¹⁾				
Embedded derivatives - GLWB ⁽²⁾	\$ 418,057	Actuarial cash flow model	Mortality	87% to 100% of Ruark 2015 ALB table
			Lapse	Internal Predictive Model
			Utilization	Internal Predictive Model
			Nonperformance risk	0.12% - 0.82%
Embedded derivative - FIA	336,826	Actuarial cash flow model	Expenses	\$195 per policy
			Withdrawal rate	0.4%-1.2% prior to age 70 RMD for ages 70+ or WB withdrawal rate Assume underutilized RMD for non-WB policies ages 70-81
			Mortality	87% to 100% of Ruark 2015 ALB table
			Lapse	0.5% - 50.0%, depending on duration/surrender charge period. Dynamically adjusted for WB moneyness and projected market rates vs credited rates.
			Nonperformance risk	0.12% - 0.82%
Embedded derivative - IUL	151,765	Actuarial cash flow model	Mortality	37% - 156% of 2015 VBT Primary Tables 94% - 248% of duration 8 point in scale 2015 VBT primary tables, depending on type of business
			Lapse	0.5% - 10.0%, depending on duration/distribution channel and smoking class
			Nonperformance risk	0.12% - 0.82%

(1) Excludes modified coinsurance arrangements.

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

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

The Company had considered all reasonably available quantitative inputs as of December 31, 2019, but the valuation techniques and inputs used by some brokers in pricing certain financial instruments are not shared with the Company. This resulted in \$76.8 million of financial instruments being classified as Level 3 as of December 31, 2019 of which \$65.4 million are other asset-backed securities and \$11.4 million are corporate securities.

In certain cases the Company has determined that book value materially approximates fair value. As of December 31, 2019, the Company held \$73.2 million of financial instruments where book value approximates fair value which was predominantly FHLB stock.

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

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

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

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

The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the three months ended September 30, 2020, for which the Company has used significant unobservable inputs (Level 3):

	Total Realized and Unrealized Gains			Total Realized and Unrealized Losses			Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Ending Balance	Total Gains (losses) included in Operations related to Instruments still held at the Reporting
	Beginning Balance	Included in Operations	Included in Other Comprehensive Income (Loss)	Included in Operations	Included in Other Comprehensive Income (Loss)									
(Dollars In Thousands)														
Assets:														
Fixed maturity securities AFS														
Residential mortgage-backed securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Commercial mortgage-backed securities	9,971	—	740	—	1	—	(21)	—	—	—	(6)	10,685	—	
Other asset-backed securities	430,964	—	4,383	(12)	(525)	—	(517)	—	—	—	203	434,496	—	
Corporate securities	1,365,963	—	27,591	—	(2,937)	62,185	(125,885)	—	—	31,172	(545)	1,357,544	—	
Total fixed maturity securities - AFS	1,806,898	—	32,714	(12)	(3,461)	62,185	(126,423)	—	—	31,172	(348)	1,802,725	—	
Fixed maturity securities - trading														
Other asset-backed securities	60,622	2,706	—	(382)	—	1,031	(1,571)	—	—	—	36	62,442	2,681	
Corporate securities	12,158	286	—	(12)	—	5,477	—	—	—	—	(30)	17,879	273	
Total fixed maturity securities - trading	72,780	2,992	—	(394)	—	6,508	(1,571)	—	—	—	6	80,321	2,954	
Total fixed maturity securities	1,879,678	2,992	32,714	(406)	(3,461)	68,693	(127,994)	—	—	31,172	(342)	1,883,046	2,954	
Equity securities	78,813	780	—	—	—	6,950	—	—	—	36	—	86,579	780	
Other long-term investments ⁽¹⁾	175,790	104,935	—	(72,961)	—	—	—	—	—	—	—	207,764	31,974	
Total investments	2,134,281	108,707	32,714	(73,367)	(3,461)	75,643	(127,994)	—	—	31,208	(342)	2,177,389	35,708	
Total assets measured at fair value on a recurring basis	\$ 2,134,281	\$ 108,707	\$ 32,714	\$ (73,367)	\$ (3,461)	\$ 75,643	\$ (127,994)	\$ —	\$ —	\$ 31,208	\$ (342)	\$ 2,177,389	\$ 35,708	
Liabilities:														
Annuity account balances ⁽²⁾	\$ 68,064	\$ —	\$ —	\$ (744)	\$ —	\$ —	\$ —	\$ 37	\$ 1,254	\$ —	\$ —	\$ 67,591	\$ —	
Other liabilities⁽¹⁾	2,388,160	301,433	—	(243,485)	—	—	—	—	—	—	—	2,330,212	57,948	
Total liabilities measured at fair value on a recurring basis	\$ 2,456,224	\$ 301,433	\$ —	\$ (244,229)	\$ —	\$ —	\$ —	\$ 37	\$ 1,254	\$ —	\$ —	\$ 2,397,803	\$ 57,948	

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the three months ended September 30, 2020, there were \$31.2 million of securities transferred into Level 3 from Level 2. These transfers resulted from securities that were priced by independent pricing services or brokers in previous periods but were priced internally using significant unobservable inputs where market observable inputs were not available as of September 30, 2020.

The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the nine months ended September 30, 2020, for which the Company has used significant unobservable inputs (Level 3):

	Total Realized and Unrealized Gains			Total Realized and Unrealized Losses			Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Ending Balance	Total Gains (losses) included in Operations related to Instruments still held at the Reporting
	Beginning Balance	Included in Operations	Included in Other Comprehensive Income (Loss)	Included in Operations	Included in Other Comprehensive Income (Loss)									
(Dollars In Thousands)														
Assets:														
Fixed maturity securities AFS														
Residential mortgage-backed securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Commercial mortgage-backed securities	10,029	—	1,520	—	(784)	—	(62)	—	—	—	(18)	10,685	—	
Other asset-backed securities	421,219	—	4,495	(33)	(12,978)	—	(1,034)	—	—	22,187	640	434,496	—	
Corporate securities	1,373,714	—	112,592	—	(82,132)	365,449	(497,587)	—	—	88,107	(2,599)	1,357,544	—	
Total fixed maturity securities - AFS	1,804,962	—	118,607	(33)	(95,894)	365,449	(498,683)	—	—	110,294	(1,977)	1,802,725	—	
Fixed maturity securities - trading														
Other asset-backed securities	65,407	4,174	—	(8,696)	—	4,250	(2,023)	—	—	(766)	96	62,442	2,681	
Corporate securities	11,371	773	—	(427)	—	8,798	(2,141)	—	—	(408)	(87)	17,879	273	
Total fixed maturity securities - trading	76,778	4,947	—	(9,123)	—	13,048	(4,164)	—	—	(1,174)	9	80,321	2,954	
Total fixed maturity securities	1,881,740	4,947	118,607	(9,156)	(95,894)	378,497	(502,847)	—	—	109,120	(1,968)	1,883,046	2,954	
Equity securities	74,155	1,207	—	(1,412)	—	7,373	—	—	—	5,256	—	86,579	780	
Other long-term investments(1)	176,195	189,498	—	(157,929)	—	—	—	—	—	—	—	207,764	31,569	
Total investments	2,132,090	195,652	118,607	(168,497)	(95,894)	385,870	(502,847)	—	—	114,376	(1,968)	2,177,389	35,303	
Total assets measured at fair value on a recurring basis	\$ 2,132,090	\$ 195,652	\$ 118,607	\$ (168,497)	\$ (95,894)	\$ 385,870	\$ (502,847)	\$ —	\$ —	\$ 114,376	\$ (1,968)	\$ 2,177,389	\$ 35,303	
Liabilities:														
Annuity account balances(2)	\$ 69,728	\$ —	\$ —	\$ (1,811)	\$ —	\$ —	\$ —	\$ 366	\$ 4,314	\$ —	\$ —	\$ 67,591	\$ —	
Other liabilities(1)	1,331,722	649,205	—	(1,647,695)	—	—	—	—	—	—	—	2,330,212	(998,490)	
Total liabilities measured at fair value on a recurring basis	\$ 1,401,450	\$ 649,205	\$ —	\$ (1,649,506)	\$ —	\$ —	\$ —	\$ 366	\$ 4,314	\$ —	\$ —	\$ 2,397,803	\$ (998,490)	

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the nine months ended September 30, 2020, there were \$115.5 million of securities transferred into Level 3 from Level 2. These transfers resulted from securities that were priced by independent pricing services or brokers in previous periods but were priced internally using significant unobservable inputs where market observable inputs were not available as of September 30, 2020.

For the nine months ended September 30, 2020, there were \$1.2 million of securities transferred into Level 2 from Level 3.

The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the three months ended September 30, 2019, for which the Company has used significant unobservable inputs (Level 3):

	Total Realized and Unrealized Gains		Total Realized and Unrealized Losses		Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Ending Balance	Total Gains (losses) included in Operations related to Instruments still held at the Reporting
	Beginning Balance	Included in Operations	Included in Other Comprehensive Income (Loss)	Included in Operations								
(Dollars In Thousands)												
Assets:												
Fixed maturity securities AFS												
Residential mortgage-backed securities	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Commercial mortgage-backed securities	9,366	—	294	—	—	(19)	—	—	—	(6)	9,635	—
Other asset-backed securities	418,310	—	865	(14)	(3,276)	(8)	—	—	—	185	416,062	—
Corporate securities	1,328,491	—	22,910	—	(3,408)	9,150	(72,215)	—	—	41,319	(1,135)	1,325,112
Total fixed maturity securities - AFS	1,756,167	—	24,069	(14)	(6,684)	9,150	(72,242)	—	—	41,319	(956)	1,750,809
Fixed maturity securities - trading												
Other asset-backed securities	62,180	294	—	(34)	—	(879)	—	—	—	(34)	61,527	274
Corporate securities	5,294	67	—	—	—	1,700	—	—	—	(25)	7,036	6,906
Total fixed maturity securities - trading	67,474	361	—	(34)	—	1,700	(879)	—	—	(59)	68,563	7,180
Total fixed maturity securities	1,823,641	361	24,069	(48)	(6,684)	10,850	(73,121)	—	—	41,319	(1,015)	1,819,372
Equity securities	69,627	192	—	(1)	—	—	—	—	—	—	69,818	191
Other long-term investments ⁽¹⁾	110,923	57,037	—	—	—	—	—	—	—	—	167,960	57,037
Total investments	2,004,191	57,590	24,069	(49)	(6,684)	10,850	(73,121)	—	—	41,319	(1,015)	2,057,150
Total assets measured at fair value on a recurring basis	\$ 2,004,191	\$ 57,590	\$ 24,069	\$ (49)	\$ (6,684)	\$ 10,850	\$ (73,121)	\$ —	\$ —	\$ 41,319	\$ (1,015)	\$ 2,057,150
Liabilities:												
Annuity account balances ⁽²⁾	\$ 72,585	\$ —	\$ —	\$ (523)	\$ —	\$ —	\$ —	\$ 91	\$ 1,379	\$ —	\$ —	\$ 71,638
Other liabilities ⁽¹⁾	1,097,077	—	—	(344,191)	—	33,684	—	—	—	—	—	(344,191)
Total liabilities measured at fair value on a recurring basis	\$ 1,169,662	\$ —	\$ —	\$ (344,714)	\$ —	\$ 33,684	\$ —	\$ 91	\$ 1,379	\$ —	\$ —	\$ 1,546,590

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the three months ended September 30, 2019, there were \$52.1 million of securities transferred into Level 3. These transfers resulted from securities that were priced by independent pricing services or brokers in previous periods but were priced internally using significant unobservable inputs where market observable inputs were not available as of September 30, 2019.

For the three months ended September 30, 2019, there were \$10.8 million of securities transferred into Level 2 from Level 3.

The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the nine months ended September 30, 2019, for which the Company has used significant unobservable inputs (Level 3):

	Total Realized and Unrealized Gains			Total Realized and Unrealized Losses			Purchases	Sales	Issuances	Settlements	Transfers in/out of Level 3	Other	Ending Balance	Total Gains (losses) included in Operations related to Instruments still held at the Reporting
	Beginning Balance	Included in Operations	Included in Other Comprehensive Income (Loss)	Included in Operations	Included in Other Comprehensive Income (Loss)									
(Dollars In Thousands)														
Assets:														
Fixed maturity securities AFS														
Commercial mortgage-backed securities	\$ —		\$ 310			\$ 9,359	\$ (26)			\$ —	\$ (8)	\$ 9,635	\$ —	
Other asset-backed securities	421,642	446	11,525	(71)	(8,075)		(10,023)			—	618	416,062	—	
Corporate securities	638,276	82	66,866		(6,917)	704,777	(157,171)		80,574	—	(1,375)	1,325,112	—	
Total fixed maturity securities - AFS	1,059,918	528	78,701	(71)	(14,992)	714,136	(167,220)	—	80,574	—	(765)	1,750,809	—	
Fixed maturity securities - trading														
Other asset-backed securities	26,056	4,300	—	(3,618)	—	15,463	(6,771)	—	26,267	—	(170)	61,527	(2,442)	
Corporate securities	6,242	236	—	(31)	—	1,700	(1,035)	—	—	—	(76)	7,036	5,274	
Total fixed maturity securities - trading	32,298	4,536	—	(3,649)	—	17,163	(7,806)	—	26,267	—	(246)	68,563	2,832	
Total fixed maturity securities	1,092,216	5,064	78,701	(3,720)	(14,992)	731,299	(175,026)	—	106,841	—	(1,011)	1,819,372	2,832	
Equity securities	64,325	431	—	(17)	—	5,079	—	—	—	—	—	69,818	345	
Other long-term investments(1)	112,344	83,959	—	(29,922)	—	1,579	—	—	—	—	—	167,960	54,037	
Short-term investments	—	—	—	—	—	—	—	—	—	—	—	—	—	
Total investments	1,268,885	89,454	78,701	(33,659)	(14,992)	737,957	(175,026)	—	106,841	—	(1,011)	2,057,150	57,214	
Total assets measured at fair value on a recurring basis	\$ 1,268,885	\$ 89,454	\$ 78,701	\$ (33,659)	\$ (14,992)	\$ 737,957	\$ (175,026)	\$ —	\$ 106,841	\$ —	\$ (1,011)	\$ 2,057,150	\$ 57,214	
Liabilities:														
Annuity account balances(2)	76,119	—	—	(1,675)	—	—	—	158	6,132	—	—	71,820	—	
Other liabilities(1)	629,942	12,034	—	(786,156)	—	70,888	—	—	—	—	—	1,474,952	(774,122)	
Total liabilities measured at fair value on a recurring basis	\$ 706,061	\$ 12,034	\$ —	\$ (787,831)	\$ —	\$ 70,888	\$ —	\$ 158	\$ 6,132	\$ —	\$ —	\$ 1,546,772	\$ (774,122)	

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the nine months ended September 30, 2019, there were \$138.2 million securities transferred into Level 3.

For the nine months ended September 30, 2019, there were \$31.4 million securities transferred into Level 2 from Level 3. These transfers resulted from securities that were priced internally using significant unobservable inputs where market observable inputs were not available in previous periods but were priced by independent pricing services or brokers as of September 30, 2019.

Total realized and unrealized gains (losses) on Level 3 assets and liabilities are reported in either *realized gains (losses) - investments/derivatives* within the consolidated condensed statements of income (loss) or in *change in net unrealized gains*

(losses) on investments within the consolidated condensed statements of comprehensive income (loss) based on the appropriate accounting treatment for the item.

Purchases, sales, issuances, and settlements, net, represent the activity that occurred during the period that results in a change of the asset or liability but does not represent changes in fair value for the instruments held at the beginning of the period. Such activity primarily relates to purchases and sales of fixed maturity securities and issuances and settlements of fixed indexed annuities.

The amount of total gains (losses) for assets and liabilities still held as of the reporting date primarily represents changes in fair value of trading securities and certain derivatives that exist as of the reporting date and the change in fair value of fixed indexed annuities.

Estimated Fair Value of Financial Instruments

The carrying amounts and estimated fair values of the Company’s financial instruments as of the periods shown below are as follows:

	Fair Value Level	As of			
		September 30, 2020		December 31, 2019	
		Carrying Amounts	Fair Values	Carrying Amounts	Fair Values
(Dollars In Thousands)					
Assets:					
Commercial mortgage loans ⁽¹⁾	3	\$ 9,765,312	\$ 10,522,036	\$ 9,379,401	\$ 9,584,487
Policy loans	3	1,640,147	1,640,147	1,675,121	1,675,121
Fixed maturities, held-to-maturity ⁽²⁾	3	2,680,324	2,990,170	2,823,881	3,025,790
Other long-term investments ⁽³⁾	2	1,286,291	1,206,966	1,216,996	1,246,889
Liabilities:					
Stable value product account balances	3	\$ 6,017,259	\$ 6,180,630	\$ 5,443,752	\$ 5,551,195
Future policy benefits and claims ⁽⁴⁾	3	1,604,174	1,615,924	1,701,324	1,705,235
Other policyholders’ funds ⁽⁵⁾	3	103,280	107,319	127,084	130,259
Debt:⁽⁶⁾					
Bank borrowings ⁽⁷⁾	3	\$ 854,727	\$ 855,000	\$ 599,672	\$ 600,000
Senior Notes	2	1,063,454	1,154,594	1,065,095	1,109,064
Subordinated debentures	2	495,664	501,330	495,562	509,405
Subordinated funding obligations	3	110,000	117,216	110,000	113,286
Non-recourse funding obligations ⁽⁸⁾	3	2,684,028	2,987,524	2,825,553	3,057,814

Except as noted below, fair values were estimated using quoted market prices.

- (1) The carrying amount is net of allowance for credit losses.
- (2) Securities purchased from unconsolidated affiliates, Red Mountain, LLC and Steel City, LLC.
- (3) Other long-term investments represents a Modco receivable, which is related to invested assets such as fixed income and structured securities, which are legally owned by the ceding company. The fair value is determined in a manner consistent with other similar invested assets held by the Company.
- (4) Single premium immediate annuity and structured annuities without life contingencies.
- (5) Supplementary contracts without life contingencies.
- (6) Excludes capital lease obligations of \$0.7 million and \$1.0 million as of September 30, 2020 and December 31, 2019, respectively.
- (7) Includes the Term Loan Credit Agreement.
- (8) As of September 30, 2020 and December 31, 2019, carrying amount of \$2.7 billion and \$3.0 billion and a fair value of \$2.9 billion and \$3.0 billion related to non-recourse funding obligations issued by Golden Gate and Golden Gate V, respectively.

Fair Value Measurements

Commercial mortgage loans

The Company estimates the fair value of commercial mortgage loans using an internally developed model. This model includes inputs derived by the Company based on assumed discount rates relative to the Company's current commercial mortgage loan lending rate and an expected cash flow analysis based on a review of the commercial mortgage loan terms. The model also contains the Company's determined representative risk adjustment assumptions related to credit and liquidity risks.

Policy loans

The Company believes the fair value of policy loans approximates book value. Policy loans are funds provided to policyholders in return for a claim on the policy. The funds provided are limited to the cash surrender value of the underlying policy. The nature of policy loans is to have a negligible default risk as the loans are fully collateralized by the value of the policy. Policy loans do not have a stated maturity and the balances and accrued interest are repaid either by the policyholder or with proceeds from the policy. Due to the collateralized nature of policy loans and unpredictable timing of repayments, the Company believes the carrying value of policy loans approximates fair value.

Fixed maturities, held-to-maturity

The Company estimates the fair value of its fixed maturity, held-to-maturity securities using internal discounted cash flow models. The discount rates used in the model are based on a current market yield for similar financial instruments.

Other long-term investments

In addition to free-standing and embedded derivative financial instruments discussed above, other long-term investments includes approximately \$1.3 billion of amounts receivable under certain modified coinsurance agreements as of September 30, 2020 and December 31, 2019. These amounts represent funds withheld in connection with certain reinsurance agreements in which the Company acts as the reinsurer. Under the terms of these agreements, assets equal to statutory reserves are withheld and legally owned by the ceding company, and any excess or shortfall is settled periodically. In some cases, these modified coinsurance agreements contain embedded derivatives which are discussed in more detail above. The fair value of amounts receivable under modified coinsurance agreements, including the embedded derivative component, correspond to the fair value of the underlying assets withheld.

Stable value product and other investment contract balances

The Company estimates the fair value of stable value product account balances and other investment contract balances (included in *Future policy benefits and claims* as well as *Other policyholders' funds* line items on our consolidated condensed balance sheet) using models based on discounted expected cash flows. The discount rates used in the models are based on a current market rate for similar financial instruments.

Debt

Bank borrowings

The Company believes the carrying value of its bank borrowings approximates fair value as the borrowings pay a floating interest rate plus a spread based on the rating of the Company's senior debt which the Company believes approximates a market interest rate.

Senior notes and subordinated debentures

The Company estimates the fair value of its Senior Notes and Subordinated debentures using quoted market prices from third-party pricing services, where available. The Company also determines certain fair values based on future cash flows discounted at the appropriate current market rate.

Funding obligations

The Company estimates the fair value of its subordinated and non-recourse funding obligations using internal discounted cash flow models. The discount rates used in the model are based on a current market yield for similar financial instruments.

7. DERIVATIVE FINANCIAL INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies

The Company utilizes a risk management strategy that incorporates the use of derivative financial instruments to reduce exposure to certain risks, including but not limited to, interest rate risk, currency exchange risk, volatility risk, and equity market risk. These strategies are developed through the Company's analysis of data from financial simulation models and other internal and industry sources, and are then incorporated into the Company's risk management program.

Derivative instruments expose the Company to credit and market risk and could result in material changes from period to period. The Company attempts to minimize its credit in connection with its overall asset/liability management programs and risk management strategies. In addition, all derivative programs are monitored by our risk management department.

Derivatives Related to Interest Rate Risk Management

Derivative instruments that are used as part of the Company's interest rate risk management strategy include interest rate swaps, interest rate futures, interest rate caps, and interest rate swaptions.

Derivatives Related to Foreign Currency Exchange Risk Management

Derivative instruments that are used as part of the Company's foreign currency exchange risk management strategy include foreign currency swaps, foreign currency futures, foreign equity futures, and foreign equity options.

Derivatives Related to Risk Mitigation of Certain Annuity Contracts

The Company may use the following types of derivative contracts to mitigate its exposure to certain guaranteed benefits related to variable annuity ("VA") contracts, fixed indexed annuities, and indexed universal life contracts:

- Foreign Currency Futures
- Variance Swaps
- Interest Rate Futures
- Equity Options
- Equity Futures
- Credit Derivatives
- Interest Rate Swaps
- Interest Rate Swaptions
- Volatility Futures
- Volatility Options
- Total Return Swaps
- Foreign Currency Options

Accounting for Derivative Instruments

GAAP requires that all derivative instruments be recognized in the balance sheet at fair value. The Company records its derivative financial instruments in the consolidated balance sheet in *other long-term investments* and *other liabilities*. The change in the fair value of derivative financial instruments is reported either in the statement of income (loss) or in other comprehensive income (loss), depending upon whether it qualified for and also has been properly identified as being part of a hedging relationship, and also on the type of hedging relationship that exists.

It is the Company's policy not to offset assets and liabilities associated with open derivative contracts. However, the Chicago Mercantile Exchange ("CME") rules characterize variation margin transfers as settlement payments, as opposed to

adjustments to collateral. As a result, derivative assets and liabilities associated with centrally cleared derivatives for which the CME serves as the central clearing party are presented as if these derivatives had been settled as of the reporting date.

For a derivative financial instrument to be accounted for as an accounting hedge, it must be identified and documented as such on the date of designation. For cash flow hedges, the effective portion of their realized gain or loss is reported as a component of other comprehensive income (loss) and reclassified into operations in the same period during which the hedged item impacts operations. Any remaining gain or loss, the ineffective portion, is recognized in current operations. For fair value hedge derivatives, their gain or loss as well as the offsetting loss or gain attributable to the hedged risk of the hedged item is recognized in current operations. Effectiveness of the Company's hedge relationships is assessed on a quarterly basis.

The Company reports changes in fair values of derivatives that are not part of a qualifying hedge relationship through operations in the period of change. Changes in the fair value of these derivatives are recognized in *realized gains (losses) - investments/derivatives* in the consolidated condensed statements of income.

Derivative Instruments Designated and Qualifying as Hedging Instruments

Cash-Flow Hedges

- To hedge a fixed rate note denominated in a foreign currency, the Company entered into a fixed-to-fixed foreign currency swap in order to hedge the foreign currency exchange risk associated with the note. The cash flows received on the swap are identical to the cash flows paid on the note.
- To hedge a floating rate note, the Company entered into an interest rate swap to exchange the floating rate on the note for a fixed rate in order to hedge the interest rate risk associated with the note. The cash flows received on the swap are identical to the cash flow variability paid on the note.

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

The Company uses various other derivative instruments for risk management purposes that do not qualify for hedge accounting treatment. Changes in the fair value of these derivatives are recognized in *realized gains (losses) - investments/derivatives* in the consolidated condensed statements of income.

Derivatives Related to Variable Annuity Contracts

- The Company uses equity futures, equity options, total return swaps, interest rate futures, interest rate swaps, interest rate swaptions, currency futures, currency options, volatility futures, volatility options, and variance swaps to mitigate the risk related to certain guaranteed minimum benefits, including GLWB, within its VA products. In general, the cost of such benefits varies with the level of equity and interest rate markets, foreign currency levels, and overall volatility.
- The Company markets certain VA products with a GLWB rider. The GLWB component is considered an embedded derivative, not considered to be clearly and closely related to the host contract.

Derivatives Related to Fixed Annuity Contracts

- The Company uses equity futures and options to mitigate the risk within its fixed indexed annuity products. In general, the cost of such benefits varies with the level of equity and overall volatility.
- The Company markets certain fixed indexed annuity products. The FIA component is considered an embedded derivative as it is, not considered to be clearly and closely related to the host contract.

Derivatives Related to Indexed Universal Life Contracts

- The Company uses equity futures and options to mitigate the risk within its indexed universal life products. In general, the cost of such benefits varies with the level of equity markets.

- The Company markets certain IUL products. The IUL component is considered an embedded derivative as it is not considered to be clearly and closely related to the host contract.

Other Derivatives

- The Company uses various swaps and other types of derivatives to manage risk related to other exposures.
- The Company is involved in various modified coinsurance and funds withheld arrangements which contain embedded derivatives. Changes in their fair value are recorded in *realized gains (losses) - investments/derivatives* in the consolidated condensed statements of income. The investment portfolios that support the related modified coinsurance reserves and funds withheld arrangements had fair value changes which substantially offset the gains or losses on these embedded derivatives.

The following table sets forth realized gains and losses - derivatives for the periods shown:

Realized gains (losses) - derivative financial instruments

	<u>For The</u> <u>Three Months Ended</u> <u>September 30.</u>		<u>For The</u> <u>Nine Months Ended</u> <u>September 30.</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
	(Dollars In Thousands)			
Derivatives related to VA contracts:				
Interest rate futures	\$ 2,257	\$ 727	\$ (3,565)	\$ (16,575)
Equity futures	(1,187)	5,220	131,912	37,517
Currency futures	(9,536)	9,181	1,438	11,028
Equity options	(41,584)	(3,957)	66,647	(97,354)
Interest rate swaps	(57,657)	149,766	363,644	342,561
Total return swaps	(31,465)	(1,950)	30,680	(50,522)
Embedded derivative - GLWB	190,627	(224,091)	(680,868)	(378,409)
Total derivatives related to VA contracts	51,455	(65,104)	(90,112)	(151,754)
Derivatives related to FIA contracts:				
Embedded derivative	(12,553)	(4,335)	(48,414)	(67,968)
Equity futures	518	962	(6,550)	964
Equity options	24,870	4,785	15,031	60,026
Other derivatives	483	—	258	—
Total derivatives related to FIA contracts	13,318	1,412	(39,675)	(6,978)
Derivatives related to IUL contracts:				
Embedded derivative	15,648	6,261	1,409	(18,395)
Equity futures	(230)	91	(2,374)	347
Equity options	6,535	586	583	9,372
Total derivatives related to IUL contracts	21,953	6,938	(382)	(8,676)
Embedded derivative - Modco reinsurance treaties	(19,723)	(44,027)	(14,962)	(199,704)
Other derivatives	5,430	(1,622)	10,818	(3,011)
Total realized gains (losses) - derivatives	<u>\$ 72,433</u>	<u>\$ (102,403)</u>	<u>\$ (134,313)</u>	<u>\$ (370,123)</u>

The following table presents the components of the gain or loss on derivatives that qualify as a cash flow hedging relationship.

Gain (Loss) on Derivatives in Cash Flow Hedging Relationship

	<u>Amount of Gains (Losses) Deferred in Accumulated Other Comprehensive Income (Loss) on Derivatives (Effective Portion)</u>	<u>Amount and Location of Gains (Losses) Reclassified from Accumulated Other Comprehensive Income (Effective Portion) Benefits and settlement expenses (Dollars In Thousands)</u>	<u>Amount and Location of Gains (Losses) Recognized in Income (Loss) on Derivatives (Ineffective Portion) Realized gains (losses) - investments/derivatives</u>
For The Three Months Ended September 30, 2020			
Foreign currency swaps	\$ 808	\$ (224)	\$ —
Interest rate swaps	1,121	(177)	—
Total	<u>\$ 1,929</u>	<u>\$ (401)</u>	<u>\$ —</u>
For The Three Months Ended September 30, 2019			
Foreign currency swaps	\$ (4,163)	\$ (373)	\$ —
Interest rate swaps	(93)	(373)	—
Total	<u>\$ (4,256)</u>	<u>\$ (746)</u>	<u>\$ —</u>
For The Nine Months Ended September 30, 2020			
Foreign currency swaps	\$ (1,316)	\$ (841)	\$ —
Interest rate swaps	206	(2,231)	—
Total	<u>\$ (1,110)</u>	<u>\$ (3,072)</u>	<u>\$ —</u>
For The Nine Months Ended September 30, 2019			
Foreign currency swaps	\$ (7,789)	\$ (767)	\$ —
Interest rate swaps	(2,484)	(593)	—
Total	<u>\$ (10,273)</u>	<u>\$ (1,360)</u>	<u>\$ —</u>

Based on expected cash flows of the underlying hedged items, the Company expects to reclassify \$1.0 million out of accumulated other comprehensive income (loss) into *realized gains (losses) - investments/derivatives* in the consolidated condensed statements of income during the next twelve months.

The table below presents information about the nature and accounting treatment of the Company's primary derivative financial instruments and the location in and effect on the consolidated condensed financial statements for the periods presented below:

	As of			
	September 30, 2020		December 31, 2019	
	Notional Amount	Fair Value	Notional Amount	Fair Value
(Dollars In Thousands)				
Other long-term investments				
Derivatives not designated as hedging instruments:				
Interest rate swaps	\$ 1,628,000	\$ 210,420	\$ 2,228,000	\$ 98,655
Total return swaps	433,231	7,018	269,772	941
Embedded derivative - Modco reinsurance treaties	1,269,954	83,379	1,280,189	31,926
Embedded derivative - GLWB	1,652,482	119,616	2,845,768	144,269
Embedded derivative - FIA	77,832	4,769	—	—
Interest rate futures	700,637	4,818	896,073	7,557
Equity futures	156,317	2,063	159,901	2,109
Currency futures	161,793	1,750	72,593	131
Equity options	7,740,526	861,711	6,685,670	676,257
	<u>\$ 13,820,772</u>	<u>\$ 1,295,544</u>	<u>\$ 14,437,966</u>	<u>\$ 961,845</u>
Other liabilities				
Cash flow hedges:				
Interest rate swaps	\$ —	\$ —	\$ 350,000	\$ —
Foreign currency swaps	117,178	18,727	117,178	11,373
Derivatives not designated as hedging instruments:				
Interest rate swaps	1,194,000	—	50,000	—
Total return swaps	418,088	7,112	579,675	3,229
Embedded derivative - Modco reinsurance treaties	2,418,864	290,934	2,263,685	231,516
Embedded derivative - GLWB	7,996,876	1,218,546	7,004,877	562,327
Embedded derivative - FIA	3,656,227	580,268	2,892,803	332,869
Embedded derivative - IUL	339,564	194,228	301,598	151,765
Interest rate futures	421,631	1,825	669,223	10,375
Equity futures	162,260	3,571	174,743	2,376
Currency futures	128,613	1,016	192,306	1,836
Equity options	5,465,007	507,408	4,827,714	429,434
Other	268,436	46,236	199,387	53,245
	<u>\$ 22,586,744</u>	<u>\$ 2,869,871</u>	<u>\$ 19,623,189</u>	<u>\$ 1,790,345</u>

8. OFFSETTING OF ASSETS AND LIABILITIES

Certain of the Company's derivative instruments are subject to enforceable master netting arrangements that provide for the net settlement of all derivative contracts between the Company and a counterparty in the event of default or upon the occurrence of certain termination events. Collateral support agreements associated with each master netting arrangement provide that the Company will receive or pledge financial collateral in the event either minimum thresholds, or in certain cases ratings levels, have been reached. Additionally, certain of the Company's repurchase agreements provide for net settlement on termination of the agreement. Refer to Note 10, *Debt and Other Obligations* for details of the Company's repurchase agreement programs.

Collateral received includes both cash and non-cash collateral. Cash collateral received by the Company is recorded on the consolidated condensed balance sheet as "cash", with a corresponding amount recorded in "other liabilities" to represent the Company's obligation to return the collateral. Non-cash collateral received by the Company is not recognized on the consolidated condensed balance sheet unless the Company exercises its right to sell or re-pledge the underlying asset. As of September 30, 2020, the fair value of non-cash collateral received was \$29.5 million. As of December 31, 2019, the fair value of non-cash collateral received was \$21.3 million.

The tables below present the derivative instruments by assets and liabilities for the Company as of September 30, 2020:

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets		Net Amount
				Financial Instruments	Collateral Received	
(Dollars In Thousands)						
Offsetting of Assets						
Derivatives:						
Free-Standing derivatives	\$1,087,780	\$ —	\$1,087,780	\$ 537,340	\$ 391,941	\$ 158,499
Total derivatives, subject to a master netting arrangement or similar arrangement	1,087,780	—	1,087,780	537,340	391,941	158,499
Derivatives not subject to a master netting arrangement or similar arrangement						
Embedded derivative - Modco reinsurance treaties	83,379	—	83,379	—	—	83,379
Embedded derivative - GLWB	119,616	—	119,616	—	—	119,616
Embedded derivative - FIA	4,769	—	4,769	—	—	4,769
Total derivatives, not subject to a master netting arrangement or similar arrangement	207,764	—	207,764	—	—	207,764
Total derivatives	1,295,544	—	1,295,544	537,340	391,941	366,263
Total Assets	\$1,295,544	\$ —	\$1,295,544	\$ 537,340	\$ 391,941	\$ 366,263

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheets	Net Amounts of Liabilities Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets		Net Amount
				Financial Instruments	Collateral Posted	
(Dollars In Thousands)						
Offsetting of Liabilities						
Derivatives:						
Free-Standing derivatives	\$ 539,659	\$ —	\$ 539,659	\$ 537,340	\$ 2,319	\$ —
Total derivatives, subject to a master netting arrangement or similar arrangement	539,659	—	539,659	537,340	2,319	—
Derivatives not subject to a master netting arrangement or similar arrangement						
Embedded derivative - Modco reinsurance treaties	290,934	—	290,934	—	—	290,934
Embedded derivative - GLWB	1,218,546	—	1,218,546	—	—	1,218,546
Embedded derivative - FIA	580,268	—	580,268	—	—	580,268
Embedded derivative - IUL	194,228	—	194,228	—	—	194,228
Other	46,236	—	46,236	—	—	46,236
Total derivatives, not subject to a master netting arrangement or similar arrangement	2,330,212	—	2,330,212	—	—	2,330,212
Total derivatives	2,869,871	—	2,869,871	537,340	2,319	2,330,212
Repurchase agreements ⁽¹⁾	150,000	—	150,000	—	—	150,000
Total Liabilities	\$3,019,871	\$ —	\$3,019,871	\$ 537,340	\$ 2,319	\$2,480,212

(1) Borrowings under repurchase agreements are for a term less than 90 days.

The tables below present the derivative instruments by assets and liabilities for the Company as of December 31, 2019:

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheets	Net Amounts of Assets Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets		Net Amount
				Financial Instruments	Collateral Received	
(Dollars In Thousands)						
Offsetting of Assets						
Derivatives:						
Free-Standing derivatives	\$ 785,650	\$ —	\$ 785,650	\$ 452,562	\$ 215,587	\$ 117,501
Total derivatives, subject to a master netting arrangement or similar arrangement	785,650	—	785,650	452,562	215,587	117,501
Derivatives not subject to a master netting arrangement or similar arrangement						
Embedded derivative - Modco reinsurance treaties	31,926	—	31,926	—	—	31,926
Embedded derivative - GLWB	144,269	—	144,269	—	—	144,269
Other	—	—	—	—	—	—
Total derivatives, not subject to a master netting arrangement or similar arrangement	176,195	—	176,195	—	—	176,195
Total derivatives	961,845	—	961,845	452,562	215,587	293,696
Total Assets	\$ 961,845	\$ —	\$ 961,845	\$ 452,562	\$ 215,587	\$ 293,696

	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheets	Net Amounts of Liabilities Presented in the Balance Sheets	Gross Amounts Not Offset in the Balance Sheets		Net Amount
				Financial Instruments	Collateral Posted	
(Dollars In Thousands)						
Offsetting of Liabilities						
Derivatives:						
Free-Standing derivatives	\$ 458,623	\$ —	\$ 458,623	\$ 452,562	\$ 4,791	\$ 1,270
Total derivatives, subject to a master netting arrangement or similar arrangement	458,623	—	458,623	452,562	4,791	1,270
Derivatives not subject to a master netting arrangement or similar arrangement						
Embedded derivative - Modco reinsurance treaties	231,516	—	231,516	—	—	231,516
Embedded derivative - GLWB	562,327	—	562,327	—	—	562,327
Embedded derivative - FIA	332,869	—	332,869	—	—	332,869
Embedded derivative - IUL	151,765	—	151,765	—	—	151,765
Other	53,245	—	53,245	—	—	53,245
Total derivatives, not subject to a master netting arrangement or similar arrangement	1,331,722	—	1,331,722	—	—	1,331,722
Total derivatives	1,790,345	—	1,790,345	452,562	4,791	1,332,992
Repurchase agreements ⁽¹⁾	270,000	—	270,000	—	—	270,000
Total Liabilities	\$2,060,345	\$ —	\$2,060,345	\$ 452,562	\$ 4,791	\$1,602,992

(1) Borrowings under repurchase agreements are for a term less than 90 days.

9. COMMERCIAL MORTGAGE LOANS

Commercial Mortgage Loans

The Company invests a portion of its investment portfolio in commercial mortgage loans. As of September 30, 2020, the Company's commercial mortgage loan holdings were approximately \$9.9 billion, and \$9.8 billion net of allowance for credit losses. The Company has specialized in making loans on credit-oriented commercial properties, credit-anchored strip shopping centers, senior living facilities, and apartments. The Company's underwriting procedures relative to its commercial mortgage loan portfolio are based, in the Company's view, on a conservative and disciplined approach. The Company concentrates on a small number of commercial real estate asset classes (retail, industrial, senior living, office, and multi-family). With respect to retail, the Company's focus is on the necessities of life sector. The Company believes that this retail focus, along with the other preferred asset classes, tend to weather economic downturns better than other commercial real estate asset classes in which it has chosen not to participate. The Company believes this disciplined approach has helped to maintain a relatively low delinquency and foreclosure rate throughout its history. The majority of the Company's commercial mortgage loan portfolio was underwritten by the Company. From time to time, the Company may acquire loans in conjunction with an acquisition.

The Company's commercial mortgage loans are stated at unpaid principal balance, adjusted for any unamortized premium or discount, and net of the allowance for credit losses. See Note 2, *Summary of Significant Accounting Policies*, for a detailed discussion of the Company's policies with respect to the measurement of the allowance for credit losses. Interest income is accrued on the principal amount of the loan based on the loan's contractual interest rate. Amortization of premiums and discounts is recorded using the effective yield method. Interest income, amortization of premiums and discounts and prepayment fees are reported in net investment income.

Certain of the commercial mortgage loans have call options that occur within the next 10 years. However, if interest rates were to significantly increase, the Company may be unable to exercise the call options on its existing commercial mortgage loans commensurate with the significantly increased market rates. As of September 30, 2020, assuming the loans are called at their next call dates, approximately \$8.1 million of principal would become due for the remainder of 2020, \$763.7 million in 2021 through 2025 and \$56.7 million in 2026 through 2029.

The Company offers a type of commercial mortgage loan under which the Company will permit a loan-to-value ratio of up to 85% in exchange for a participating interest in the cash flows from the underlying real estate. As of September 30, 2020 and December 31, 2019, approximately \$805.2 million and \$717.0 million, respectively, of the Company's total commercial mortgage loans principal balance have this participation feature. Cash flows received as a result of this participation feature are recorded as interest income. During the three and nine months ended September 30, 2020 and 2019, the Company recognized \$0.9 million, \$17.3 million, \$3.8 million, and \$18.0 million respectively, of participation commercial mortgage loan income.

As of September 30, 2020, the Company had \$1.2 million of invested assets that consisted of nonperforming commercial mortgage loans, restructured commercial mortgage loans, or commercial mortgage loans that were foreclosed and were converted to real estate properties. The Company does not expect these investments to adversely affect its liquidity or ability to maintain proper matching of assets and liabilities. Non-performing commercial mortgage loans include loans that are greater than 90 days delinquent, or otherwise deemed uncollectible. During the nine months ended September 30, 2020, the Company recognized two troubled debt restructurings as a result of granting concessions to borrowers which included loan terms unavailable from other lenders. During the three and nine months ended September 30, 2020, the Company did not have any commercial mortgage loans that were foreclosed and were converted to real estate properties. It is the Company's policy to write off loan amounts that are deemed uncollectible. No amounts were written off during the three and nine months ended September 30, 2020.

As of September 30, 2019, \$3.2 million of the Company's invested assets consisted of nonperforming commercial mortgage loans, restructured commercial mortgage loans, or commercial mortgage loans that were foreclosed and were converted to real estate properties. The Company does not expect these investments to adversely affect its liquidity or ability to maintain proper matching of assets and liabilities. Non-performing commercial mortgage loans include loans that are greater than 90 days delinquent, or otherwise deemed uncollectible. During the nine months ended September 30, 2019, the Company recognized four troubled debt restructurings as a result of granting concessions to borrowers which included loan terms unavailable from other lenders. During the three and nine months ended September 30, 2019, the Company did not have any commercial mortgage loans that were foreclosed and were converted to real estate properties. The Company did not identify any loans whose principal was permanently impaired during the three and nine months ended September 30, 2019.

On March 27, 2020, H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act ("the CARES Act") was signed into legislation. Section 4013 of the CARES Act provides additional relief for certain loan modifications made as a result of the COVID-19 pandemic. Specifically, the CARES Act specifies that a financial institution may suspend the requirements under GAAP with respect to troubled debt restructuring classification and reporting for loan modifications made in response to the COVID-19 pandemic which meet the following criteria: 1) the borrower was not more than 30 days past due as of December 31, 2019 and 2) the modifications are related to arrangements that defer or delay the payment of principal or interest, or change the interest rate on the loan. The relief provided by the CARES Act terminates on the earlier of December 31, 2020 or 60 days after the end of the national emergency declared on March 13, 2020. Accordingly, the Company provided certain relief under the CARES Act under its COVID-19 Commercial Mortgage Loan Program (the "Loan Modification Program"). As of September 30, 2020, the Company had a total of 308 loans with \$2.2 billion in unpaid principal balance under the Loan Modification Program. The modifications under this program include agreements to defer principal payments only and/or to defer principal and interest payments for a specified period of time. None of these modifications were considered troubled debt restructurings.

As of September 30, 2020, the amortized cost basis of the Company's commercial mortgage loan receivables by origination year, net of the allowance, for credit losses is as follows:

Term Loans Amortized Cost Basis by Origination Year							
	2020	2019	2018	2017	2016	Prior	Total
(Dollars In Thousands)							
As of September 30, 2020							
Commercial mortgage loans:							
Performing	\$ 937,464	\$ 2,528,592	\$ 1,606,876	\$ 1,361,092	\$ 956,593	\$ 2,549,745	\$ 9,940,362
Non-performing	—	—	—	—	—	—	—
Amortized cost	\$ 937,464	\$ 2,528,592	\$ 1,606,876	\$ 1,361,092	\$ 956,593	\$ 2,549,745	\$ 9,940,362
Allowance for credit losses	(11,139)	(39,465)	(43,172)	(30,722)	(15,789)	(34,763)	(175,050)
Total commercial mortgage loans	\$ 926,325	\$ 2,489,127	\$ 1,563,704	\$ 1,330,370	\$ 940,804	\$ 2,514,982	\$ 9,765,312

The following table presents loan-to-value ratios for commercial mortgages by year of vintage:

Loan-to-Value Ratios for Commercial Mortgages by Year of Vintage							
	2020	2019	2018	2017	2016	Prior	Total
(Dollars In Thousands)							
As of September 30, 2020							
Commercial mortgage loans:							
Greater than 75%	\$ 37,291	\$ 105,608	\$ 104,885	\$ 51,973	\$ 6,605	\$ 6,122	\$ 312,484
50% - 75%	688,487	1,589,323	1,017,753	1,027,418	778,876	1,368,660	6,470,517
Less than 50%	211,686	833,661	484,238	281,701	171,112	1,174,963	3,157,361
Amortized Cost	937,464	2,528,592	\$ 1,606,876	\$ 1,361,092	\$ 956,593	\$ 2,549,745	\$ 9,940,362
Allowance for credit losses	(11,139)	(39,465)	(43,172)	(30,722)	(15,789)	(34,763)	(175,050)
Total commercial mortgage loans	\$ 926,325	\$ 2,489,127	\$ 1,563,704	\$ 1,330,370	\$ 940,804	\$ 2,514,982	\$ 9,765,312

(1) The loan-to-value ratio compares the current unpaid principal of the loan to the estimated fair value of the underlying property collateralizing the loan. Our weighted average loan-to-value ratio was 54% at both September 30, 2020 and December 31, 2019.

The following table presents debt service coverage ratios for commercial mortgages by year of vintage:

Debt Service Coverage Ratios for Commercial Mortgages by Year of Vintage							
	2020	2019	2018	2017	2016	Prior	Total
(Dollars In Thousands)							
As of September 30, 2020							
Commercial mortgage loans:							
>1.20x	\$ 900,073	\$ 2,073,671	\$ 1,202,174	\$ 1,059,070	\$ 725,071	\$ 1,943,864	\$ 7,903,923
1.00x - 1.20x	37,391	354,960	330,495	237,527	143,886	360,784	1,465,043
<1.00x	—	99,961	74,207	64,495	87,636	245,097	571,396
Amortized Cost	937,464	2,528,592	1,606,876	1,361,092	956,593	2,549,745	9,940,362
Allowance for credit losses	(11,139)	(39,465)	(43,172)	(30,722)	(15,789)	(34,763)	(175,050)
Total commercial mortgage loans	<u>\$ 926,325</u>	<u>\$ 2,489,127</u>	<u>\$ 1,563,704</u>	<u>\$ 1,330,370</u>	<u>\$ 940,804</u>	<u>\$ 2,514,982</u>	<u>\$ 9,765,312</u>

(1) The debt service coverage ratio compares a property's net operating income to its debt service payments, including principal and interest. Our weighted average debt service coverage ratio was 1.74x at September 30, 2020 and 1.73x at December 31, 2019.

The ACL increased by \$99.1 million during the nine months ended September 30, 2020, primarily as a result of deterioration in the macroeconomic forecasts, as a result of COVID-19, used in the measurement of the ACL since the initial allowance was established.

	For The Three Months Ended September 30, 2020	For The Nine Months Ended September 30, 2020
(Dollars In Thousands)		
Allowance for Funded Commercial Mortgage Loan Credit Losses		
Beginning balance	\$ 173,186	\$ 4,884
Cumulative effect adjustment	—	80,239
Charge offs	—	—
Recoveries	—	(1,839)
Provision	1,864	91,766
Ending balance	<u>\$ 175,050</u>	<u>\$ 175,050</u>
Allowance for Unfunded Commercial Mortgage Loan Commitments Credit Losses		
Beginning balance	\$ 19,550	\$ —
Cumulative effect adjustment	—	10,610
Charge offs	—	—
Recoveries	—	—
Provision	247	9,187
Ending balance	<u>\$ 19,797</u>	<u>\$ 19,797</u>

An analysis of delinquent loans is shown in the following chart.

As of September 30, 2020	30-59 Days Delinquent	60-89 Days Delinquent	Greater than 90 Days Delinquent	Total Delinquent
(Dollars In Thousands)				
Commercial mortgage loans	\$ —	\$ —	\$ —	\$ —
Number of delinquent commercial mortgage loans	—	—	—	—
As of December 31, 2019				
Commercial mortgage loans	\$ 6,455	\$ —	\$ 710	\$ 7,165
Number of delinquent commercial mortgage loans	2	—	3	5

The Company limits accrued interest income on loans to ninety days of interest. For loans in nonaccrual status, interest income is recognized on a cash basis. For the nine months ended September 30, 2020, an immaterial amount of accrued interest was excluded from the amortized cost basis pursuant to the Company's nonaccrual policy.

An analysis of loans in a nonaccrual status is shown in the following chart:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income
(Dollars In Thousands)						
As of September 30, 2020						
Commercial mortgage loans:						
With no related allowance recorded	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
With an allowance recorded	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
As of December 31, 2019						
Commercial mortgage loans:						
With no related allowance recorded	\$ 710	\$ 702	\$ —	\$ 237	\$ 20	\$ 28
With an allowance recorded	\$ 16,209	\$ 16,102	\$ 4,884	\$ 3,242	\$ 841	\$ 838

Commercial mortgage loans that were modified in a troubled debt restructuring as of September 30, 2020 and December 31, 2019 are shown below.

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
(Dollars In Thousands)			
As of September 30, 2020			
Troubled debt restructuring:			
Commercial mortgage loans	1	\$ 1,237	\$ 1,237
As of December 31, 2019			
Troubled debt restructuring:			
Commercial mortgage loans	2	\$ 3,771	\$ 3,771

10. DEBT AND OTHER OBLIGATIONS

Debt and Subordinated Debt

Debt and subordinated debt are summarized as follows:

	As of			
	September 30, 2020		December 31, 2019	
	Outstanding Principal	Carrying Amounts	Outstanding Principal	Carrying Amounts
(Dollars In Thousands)				
Debt (year of issue):				
Credit Facility	\$ 255,000	\$ 255,000	\$ —	\$ —
Term Loan Credit Agreement	600,000	599,727	600,000	599,672
Capital lease obligation	696	696	967	967
8.45% Senior Notes (2009), due 2039	180,719	269,490	180,719	271,638
4.30% Senior Notes (2018), due 2028	400,000	396,273	400,000	395,937
3.40% Senior Notes (2019), due 2030	400,000	397,691	400,000	397,520
	<u>\$ 1,836,415</u>	<u>\$ 1,918,877</u>	<u>\$ 1,581,686</u>	<u>\$ 1,665,734</u>
Subordinated debt (year of issue):				
5.35% Subordinated Debentures (2017), due 2052	\$ 500,000	\$ 495,664	\$ 500,000	\$ 495,562
3.55% Subordinated Funding Obligations (2018), due 2038	55,000	55,000	55,000	55,000
3.55% Subordinated Funding Obligations (2018), due 2038	55,000	55,000	55,000	55,000
	<u>\$ 610,000</u>	<u>\$ 605,664</u>	<u>\$ 610,000</u>	<u>\$ 605,562</u>

Under a revolving line of credit arrangement (the “Credit Facility”), the Company has the ability to borrow on an unsecured basis up to an aggregate principal amount of \$1.0 billion. The Company has the right in certain circumstances to request that the commitment under the Credit Facility be increased up to a maximum principal amount of \$1.5 billion. Balances outstanding under the Credit Facility accrue interest at a rate equal to, at the option of the Borrowers, (i) LIBOR plus a spread based on the ratings of the Company’s Senior Debt, or (ii) the sum of (A) a rate equal to the highest of (x) the Administrative Agent’s Prime rate, (y) 0.50% above the Funds rate, or (z) the one-month LIBOR plus 1.00% and (B) a spread based on the ratings of the Company’s Senior Debt. The Credit Facility also provided for a facility fee at a rate that varies with the ratings of the Company’s Senior Debt and that is calculated on the aggregate amount of commitments under the Credit Facility, whether used or unused. The annual facility fee rate is 0.125% of the aggregate principal amount. The Credit Facility provides that the Company is liable for the full amount of any obligations for borrowings or letters of credit, including those of PLICO, under the Credit Facility. The maturity date of the Credit Facility is May 3, 2023. The Company is not aware of any non-compliance with the financial debt covenants of the Credit Facility as of September 30, 2020. There was a combined outstanding balance of \$255.0 million, with \$215.0 million bearing an interest at a rate of LIBOR plus 1.00%, and \$40.0 million bearing an interest rate of Prime as of September 30, 2020. The Company did not have an outstanding balance as of December 31, 2019.

Non-Recourse Funding Obligations

Non-recourse funding obligations outstanding on a consolidated basis, are shown in the following table. See Note 14, *Subsequent Events* for additional information on the Company's non-recourse funding obligations.

Issuer	Outstanding Principal	Carrying Value ⁽¹⁾	Maturity Year	Year-to-Date Weighted-Avg Interest Rate
(Dollars In Thousands)				
As of September 30, 2020				
Golden Gate Captive Insurance Company ⁽²⁾⁽³⁾	\$ 1,858,000	\$ 1,858,000	2039	4.70 %
Golden Gate II Captive Insurance Company	20,600	17,796	2052	3.54 %
Golden Gate V Vermont Captive Insurance Company ⁽²⁾⁽³⁾	750,000	806,016	2037	5.12 %
MONY Life Insurance Company ⁽³⁾	1,885	2,216	2024	6.19 %
Total	\$ 2,630,485	\$ 2,684,028		
As of December 31, 2019				
Golden Gate Captive Insurance Company ⁽²⁾⁽³⁾	\$ 2,028,000	\$ 2,028,000	2039	4.70 %
Golden Gate II Captive Insurance Company	20,600	17,755	2052	5.32 %
Golden Gate V Vermont Captive Insurance Company ⁽²⁾⁽³⁾	720,000	777,527	2037	5.12 %
MONY Life Insurance Company ⁽³⁾	1,885	2,271	2024	6.19 %
Total	\$ 2,770,485	\$ 2,825,553		

(1) Carrying values include premiums and discounts and do not represent unpaid principal balance.

(2) Obligations are issued to non-consolidated subsidiaries of the Company. These obligations collateralize certain held-to-maturity securities issued by wholly owned subsidiaries of PLICO. Changes in Golden Gate and Golden Gate V are non-cash items.

(3) Fixed rate obligations.

Secured Financing Transactions

Repurchase Program Borrowings

While the Company anticipates that the cash flows of its operating subsidiaries will be sufficient to meet its investment commitments and operating cash needs in a normal credit market environment, the Company recognizes that investment commitments scheduled to be funded may, from time to time, exceed the funds then available. Therefore, the Company has established repurchase agreement programs for certain of its insurance subsidiaries to provide liquidity when needed. The Company expects that the rate received on its investments will equal or exceed its borrowing rate. Under this program, the Company may, from time to time, sell an investment security at a specific price and agree to repurchase that security at another specified price at a later date. These borrowings are typically for a term less than 90 days. The market value of securities to be repurchased is monitored and collateral levels are adjusted where appropriate to protect the counterparty against credit exposure. Cash received is invested in fixed maturity securities, and the agreements provide for net settlement in the event of default or on termination of the agreements. As of September 30, 2020, the fair value of securities pledged under the repurchase program was \$153.7 million, and the repurchase obligation of \$150.0 million was included in our consolidated condensed balance sheets (at average borrowing rate of 14 basis points). During the nine months ended September 30, 2020, the maximum balance outstanding at any one point in time related to these programs was \$565.0 million. The average daily balance was \$94.4 million (at an average borrowing rate of 50 basis points) during the nine months ended September 30, 2020. As of December 31, 2019, the fair value of securities pledged under the repurchase program was \$282.2 million, and the repurchase obligation of \$270.0 million was

included in the Company's consolidated condensed balance sheets (at an average borrowing rate of 163 basis points). During 2019, the maximum balance outstanding at any one point in time related to these programs was \$900.0 million. The average daily balance was \$212.2 million (at an average borrowing rate of 214 basis points) during the year ended December 31, 2019.

Securities Lending

The Company participates in securities lending, primarily as an investment yield enhancement, whereby securities that are held as investments are loaned out to third parties for short periods of time. The Company requires collateral at least equal to 102% of the fair value of the loaned securities to be separately maintained. The loaned securities' fair value is monitored on a daily basis and collateral is adjusted accordingly. The Company maintains ownership of the securities at all times and is entitled to receive from the borrower any payments for interest received on such securities during the loan term. Securities lending transactions are accounted for as secured borrowings. As of September 30, 2020, securities with a fair value of \$80.2 million were loaned under this program. As collateral for the loaned securities, the Company receives cash, which is primarily reinvested in short-term repurchase agreements, which are also collateralized by U.S. Government or U.S. Government Agency securities, and government money market funds. These investments are recorded in *short-term investments* with a corresponding liability recorded in *secured financing liabilities* to account for its obligation to return the collateral. As of September 30, 2020, the fair value of the collateral related to this program was \$82.8 million and the Company has an obligation to return \$82.8 million of collateral to the securities borrowers.

The following table provides the fair value of collateral pledged for repurchase agreements, grouped by asset class as of September 30, 2020 and December 31, 2019:

Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions Accounted for as Secured Borrowings

	Remaining Contractual Maturity of the Agreements				
	As of September 30, 2020				
	(Dollars In Thousands)				
	Overnight and Continuous	Up to 30 days	30-90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	\$ 153,681	\$ —	\$ —	\$ —	\$ 153,681
Total repurchase agreements and repurchase-to-maturity transactions	153,681	—	—	—	153,681
Securities lending transactions					
Corporate securities	60,358	—	—	—	60,358
Equity securities	17,282	—	—	—	17,282
Other government related securities	2,554	—	—	—	2,554
Total securities lending transactions	80,194	—	—	—	80,194
Total securities	\$ 233,875	\$ —	\$ —	\$ —	\$ 233,875

**Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions
Accounted for as Secured Borrowings**

	Remaining Contractual Maturity of the Agreements				
	As of December 31, 2019				
	(Dollars In Thousands)				
	Overnight and Continuous	Up to 30 days	30-90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	\$ 282,198	\$ —	\$ —	\$ —	\$ 282,198
Total repurchase agreements and repurchase-to-maturity transactions	282,198	—	—	—	282,198
Securities lending transactions					
Fixed maturity securities	\$ 55,720	\$ —	\$ —	\$ —	\$ 55,720
Equity securities	7,120	—	—	—	7,120
Total securities lending transactions	62,840	—	—	—	62,840
Total securities	\$ 345,038	\$ —	\$ —	\$ —	\$ 345,038

11. COMMITMENTS AND CONTINGENCIES

The Company has entered into indemnity agreements with each of its current directors other than those that are employees of Dai-ichi Life that provide, among other things and subject to certain limitations, a contractual right to indemnification to the fullest extent permissible under the law. The Company has agreements with certain of its officers providing up to \$10.0 million in indemnification. These obligations are in addition to the customary obligation to indemnify officers and directors contained in the Company's governance documents.

The Company leases administrative and marketing office space as well as various office equipment. Most leases have terms ranging from two years to twenty-five years. Leases with an initial term of 12 months or less are not recorded on the consolidated condensed balance sheet. The Company accounts for lease components separately from non-lease components (e.g., common area maintenance). Certain of the Company's lease agreements include options to renew at the Company's discretion. Management has concluded that the Company is not reasonably certain to elect any of these renewal options. The Company will use the interest rates received on its funding agreement backed notes as the collateralized discount rate when calculating the present value of remaining lease payments when the rate implicit in the lease is unavailable.

Under the insurance guaranty fund laws in most states, insurance companies doing business therein can be assessed up to prescribed limits for policyholder losses incurred by insolvent companies. From time to time, companies may be asked to contribute amounts beyond prescribed limits. It is possible that the Company could be assessed with respect to product lines not offered by the Company. In addition, legislation may be introduced in various states with respect to guaranty fund assessment laws related to insurance products, including long term care insurance and other specialty products, that increases the cost of future assessments or alters future premium tax offsets received in connection with guaranty fund assessments. The Company cannot predict the amount, nature, or timing of any future assessments or legislation, any of which could have a material and adverse impact on the Company's financial condition or results of operations.

A number of civil jury verdicts have been returned against insurers, broker-dealers, and other providers of financial services involving sales, refund, or claims practices, alleged agent misconduct, failure to properly supervise representatives, relationships with agents or persons with whom the insurer does business, and other matters. Often these lawsuits have resulted in the award of substantial judgments that are disproportionate to the actual damages, including material amounts of punitive and non-economic compensatory damages. In some states, juries, judges, and arbitrators have substantial discretion in awarding punitive and non-economic compensatory damages which creates the potential for unpredictable material adverse judgments or

awards in any given lawsuit or arbitration. Arbitration awards are subject to very limited appellate review. In addition, in some class action and other lawsuits, companies have made material settlement payments. The financial services and insurance industries in particular are also sometimes the target of law enforcement and regulatory investigations relating to the numerous laws and regulations that govern such companies. Some companies have been the subject of law enforcement or regulatory actions or other actions resulting from such investigations. The Company, in the ordinary course of business, is involved in such matters.

The Company establishes liabilities for litigation and regulatory actions when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. For matters where a loss is believed to be reasonably possible, but not probable, no liability is established. For such matters, the Company may provide an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. The Company reviews relevant information with respect to litigation and regulatory matters on a quarterly and annual basis and updates its established liabilities, disclosures, and estimates of reasonably possible losses or range of loss based on such reviews.

Certain of the Company's insurance subsidiaries, as well as certain other insurance companies for which the Company has coinsured blocks of life insurance and annuity policies, are under audit for compliance with the unclaimed property laws of a number of states. The audits are being conducted on behalf of the treasury departments or unclaimed property administrators in such states. The focus of the audits is on whether there have been unreported deaths, maturities, or policies that have exceeded limiting age with respect to which death benefits or other payments under life insurance or annuity policies should be treated as unclaimed property that should be escheated to the state. The Company is presently unable to estimate the reasonably possible loss or range of loss that may result from the audits due to a number of factors, including the early stages of the audits being conducted, and uncertainty as to whether the Company or other companies are responsible for the liabilities, if any, arising in connection with certain co-insured policies. The Company will continue to monitor the matter for any developments that would make the loss contingency associated with the audits reasonably estimable.

Advance Trust & Life Escrow Services, LTA, as Securities Intermediary of Life Partners Position Holder Trust v. Protective Life Insurance Company, Case No. 2:18-CV-01290, is a putative class action that was filed on August 13, 2018 in the United States District Court for the Northern District of Alabama. Plaintiff alleges that PLICO required policyholders to pay unlawful and excessive cost of insurance charges. Plaintiff seeks to represent all owners of universal life and variable universal life policies issued or administered by PLICO or its predecessors that provide that cost of insurance rates are to be determined based on expectations of future mortality experience. The plaintiff seeks class certification, compensatory damages, pre-judgment and post-judgment interest, costs, and other unspecified relief. The Company is vigorously defending this matter and cannot predict the outcome of or reasonably estimate the possible loss or range of loss that might result from this litigation.

Scottish Re (U.S.), Inc. ("SRUS") was placed in rehabilitation on March 6, 2019 by the State of Delaware. Under the related order, the Insurance Commissioner of the State of Delaware has been appointed the receiver of SRUS (the "Receiver") and provided with authority to conduct and continue the business of SRUS in the interest of its cedents, creditors, and stockholder. The order was accompanied by an injunction requiring the continued payment of reinsurance premiums to SRUS and temporarily prohibiting cedents, including the Company, from offsetting premiums payable against receivables from SRUS. On June 20, 2019, the Delaware Court of Chancery (the "Court") entered an order approving a Revised Offset Plan, which allows cedents, including the Company, to offset premiums under certain circumstances.

A proposed Rehabilitation Plan ("Rehabilitation Plan") was filed by the receiver of SRUS on June 30, 2020. The Rehabilitation Plan presents the following two options to each cedent: 1) remain in business with SRUS and be governed by the Rehabilitation Plan, or 2) recapture business ceded to SRUS. Due to SRUS's financial status, neither option pays 100% of outstanding claims. Certain financial terms and conditions will be imposed on the cedents based on the election made, the type of business ceded, the manner in which the business is collateralized, and the amount of losses sustained by a cedent. The Company is currently working to evaluate the impact of both options and to provide feedback/objections to the Receiver on the Rehabilitation Plan. On October 9, 2020, the Receiver filed a proposed order setting forth a schedule to present the Rehabilitation Plan for Court approval, which order contemplates possible modifications to the Rehabilitation Plan to be filed with the Court by March 16, 2021.

The Company continues to monitor SRUS and the actions of the Receiver through discussions with legal counsel and review of publicly available information. An allowance for credit losses related to SRUS is included in the overall reinsurance allowance for credit losses. See Note 2, *Summary of Significant Accounting Policies*. As of September 30, 2020, management does not believe that the ultimate outcome of the rehabilitation process will have a material impact on the Company's financial position or results of operations.

12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables summarize the changes in the accumulated balances for each component of accumulated other comprehensive income (loss) ("AOCI") as of September 30, 2020 and December 31, 2019.

Changes in Accumulated Other Comprehensive Income (Loss) by Component

	Unrealized Gains and Losses on Investments ⁽²⁾	Accumulated Gain and Loss Derivatives	Minimum Pension Liability Adjustment	Total Accumulated Other Comprehensive Income (Loss)
(Dollars In Thousands, Net of Tax)				
Balance, December 31, 2018	\$ (1,410,277)	\$ (7)	\$ (15,482)	\$ (1,425,766)
Other comprehensive income (loss) before reclassifications	2,848,198	(9,781)	(17,055)	2,821,362
Other comprehensive income (loss) relating to other-than-temporary impaired investments for which a portion has been recognized in operations	(3,574)	—	—	(3,574)
Amounts reclassified from accumulated other comprehensive income (loss) ⁽¹⁾	(10,489)	1,799	437	(8,253)
Balance, December 31, 2019	\$ 1,423,858	\$ (7,989)	\$ (32,100)	\$ 1,383,769
Other comprehensive income (loss) before reclassifications	1,267,512	(877)	—	1,266,635
Other comprehensive income (loss) on investments for which a credit loss has been recognized in operations	25,659	—	—	25,659
Amounts reclassified from accumulated other comprehensive income (loss) ⁽¹⁾	60,012	2,427	1,311	63,750
Balance, September 30, 2020	<u>\$ 2,777,041</u>	<u>\$ (6,439)</u>	<u>\$ (30,789)</u>	<u>\$ 2,739,813</u>

(1) See Reclassifications Out of Accumulated Other Comprehensive Income (Loss) table below for details.

(2) As of September 30, 2020 and December 31, 2019, net unrealized gains reported in AOCI were offset by \$(1.6) billion and \$(776.9) million, respectively, due to the impact those net unrealized losses would have had on certain of the Company's insurance assets and liabilities if the net unrealized losses had been recognized in net income (loss).

The following tables summarize the reclassifications amounts out of AOCI for the three and nine months ended September 30, 2020 and 2019.

Reclassifications Out of Accumulated Other Comprehensive Income (Loss)

Gains/(losses) in net income (loss):	Affected Line Item in the Condensed Consolidated Financial Statements	For The		For The	
		Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2020	2019	2020	2019
(Dollars In Thousands)					
Derivative instruments	Benefits and settlement expenses, net of reinsurance ceded ⁽¹⁾	\$ (401)	\$ (746)	\$ (3,072)	\$ (1,360)
	Tax (expense) benefit	84	157	645	285
		<u>\$ (317)</u>	<u>\$ (589)</u>	<u>\$ (2,427)</u>	<u>\$ (1,075)</u>
Unrealized gains and losses on available-for-sale securities	Realized gains (losses) - investments	\$ 2,682	\$ 15,686	\$ 44,576	\$ 21,901
	Net credit losses recognized in operations	(38,459)	—	(120,540)	—
	Net impairment losses recognized in operations	—	(10,818)	—	(14,658)
	Tax (expense) benefit	7,513	(1,022)	15,952	(1,521)
		<u>\$ (28,264)</u>	<u>\$ 3,846</u>	<u>\$ (60,012)</u>	<u>\$ 5,722</u>
Postretirement benefits liability adjustment	Other operating expenses	\$ (553)	\$ —	\$ (1,660)	\$ —
	Amortization of net actuarial gain (loss)	—	—	—	—
	Tax (expense) benefit	116	—	349	—
		<u>\$ (437)</u>	<u>\$ —</u>	<u>\$ (1,311)</u>	<u>\$ —</u>

(1) See Note 7, *Derivative Financial Instruments* for additional information.

13. INCOME TAXES

The Company used its respective estimates for its annual 2020 and 2019 income in computing its effective income tax rates for the three and nine months ended September 30, 2020 and 2019. The effective tax rates for the three and nine months ended September 30, 2020 and 2019, were 20.5%, 20.1%, 21.3%, and 19.8%, respectively.

The CARES Act, as described in Note 9, Commercial Mortgage Loans, includes tax provisions relevant to businesses. The Company was required to recognize the effect on the consolidated financial statements in the period the law was enacted, which was in the period ended March 31, 2020. For the period ended March 31, 2020, the CARES Act was not material to the Company's consolidated financial statements; however, if we were to have a taxable loss for the year ended December 31, 2020, we would be able to carryback those losses to prior periods. At this time, the Company does not expect the impact of the CARES Act to be material to the Company's consolidated financial statements for the year ended December 31, 2020.

In April 2019, the IRS proposed favorable and unfavorable adjustments to the Company's 2014 through 2016 reported taxable income. The Company agreed to these adjustments. The resulting taxes have been settled, other than interest; the settlement of interest will not materially impact the Company or its effective tax rate.

In general, the Company is no longer subject to income tax examinations by taxing authorities for tax years that began before 2017.

Due to the aforementioned IRS adjustments to the Company's pre-2017 taxable income, the Company has amended certain of its 2014 through 2016 state income tax returns. Such amendments will cause such years to remain open, pending the states' acceptances of the returns.

There have been no changes to the balance of unrecognized tax benefits during the three and nine months ended September 30, 2020. The Company believes that in the next twelve months, none of the unrecognized tax benefits will be reduced.

14. SUBSEQUENT EVENTS

The Company has evaluated the effects of events subsequent to September 30, 2020, and through November 13, 2020, the date the Company's financial statements were issued. All accounting and disclosure requirements related to subsequent events are included in the Company's consolidated condensed financial statements.

On October 1, 2020, as part of a corporate initiative to consolidate and simplify the Company's reserve financing structures and reduce related financial and operational costs, Golden Gate II Captive Insurance Company, Golden Gate III Vermont Captive Insurance Company, Golden Gate IV Vermont Captive Insurance Company, and Golden Gate V Vermont Captive Insurance Company, all of which are wholly owned captive insurance company subsidiaries of PLICO (collectively "the Captives") merged with and into (the "Captive Merger") Golden Gate Captive Insurance Company ("Golden Gate"), a Vermont special purpose financial insurance company and a wholly owned subsidiary of PLICO.

In conjunction with the Captive Merger, Golden Gate and Steel City, LLC ("Steel City"), wholly owned subsidiary of PLC, terminated the financing facility into which Golden Gate and Steel City had entered in 2016. This termination included redeeming the fixed maturity securities issued by Steel City to Golden Gate and the non-recourse funding obligation issued by Golden Gate to Steel City.

In conjunction with the Captive Merger, Golden Gate II redeemed the full outstanding principal amount of floating rate non-recourse funding obligations due July 15, 2052. These non-recourse funding obligations were previously marked to fair value in conjunction with the February 1, 2015 acquisition of the Company by The Dai-ichi Life Insurance Company (now known as Dai-ichi Life Holdings, Inc., "Dai-ichi Life"). The redemption required the acceleration of the accretion of the discount associated with the non-recourse funding obligation. The estimated impact of this non-cash acceleration is a \$3 million reduction to income before income taxes for the year ended December 31, 2020.

Also in conjunction with the Captive Merger, Golden Gate V and Red Mountain, LLC ("Red Mountain"), a wholly owned subsidiary of PLICO, terminated the financing facility into which Golden Gate V and Red Mountain had entered into in 2012. This termination included redeeming the fixed maturity securities issued by Red Mountain to Golden Gate V and the non-recourse funding obligation issued by Golden Gate V to Red Mountain. As a result of these redemptions, the amortization and accretion of premiums and discounts recorded against the fixed maturities and non-recourse funding obligations which were previously marked to fair value in conjunction with the February 1, 2015 acquisition of the Company by Dai-ichi Life was accelerated. The estimated net impact of this non-cash acceleration is a \$16 million reduction to income before income taxes for the year ended December 31, 2020.

On October 1, 2020, immediately following the Captive Merger, Golden Gate entered into a transaction with a term of 20 years, that may be extended to up to 25 years, to finance up to a maximum term of \$5 billion of “XXX” and “AXXX” reserves related to the term life insurance business and universal life insurance with secondary guarantee business that is reinsured to Golden Gate by PLICO and West Coast pursuant to an Excess of Loss Reinsurance Agreement (the “XOL Agreement”) with Hannover Life Reassurance Company of America (Bermuda) Ltd., The Canada Life Assurance Company (Barbados Branch) and RGA Reinsurance Company (Barbados) Ltd. (collectively, the “Retrocessionaires”). Pursuant to the XOL Agreement, in exchange for periodic fees, the Retrocessionaires assume, on an excess of loss basis, the obligation to pay (the “XOL Payments”) each quarter the lesser of a) the greater of (i) statutory reserves in excess of economic reserves and (ii) the financed amount and b) if total claims for such quarter exceed the available assets (as set forth in the XOL Agreement) of Golden Gate, the amount of such excess. The transaction is “non-recourse” to the Company, WCL, and PLICO, meaning that none of these companies are liable to reimburse the Retrocessionaires for any XOL payments required to be made.



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Independent Auditors' Review Report

The Board of Directors
Protective Life Corporation:

Report on the Financial Statements

We have reviewed the accompanying consolidated condensed balance sheet of Protective Life Corporation and its subsidiaries as of September 30, 2020, the related consolidated condensed statements of income (comprehensive income (loss), and shareowner's equity for the three-month and nine-month periods ended September 30, 2020 and 2019, and the related consolidated condensed statements of cash flows for the nine-month periods ended September 30, 2020 and 2019.

Management's Responsibility

The Company's management is responsible for the preparation and fair presentation of the interim financial information in accordance with U.S. generally accepted accounting principles; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with U.S. generally accepted accounting principles.

Auditors' Responsibility

Our responsibility is to conduct our reviews in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Birmingham, Alabama
November 13, 2020