Fidelity & Guaranty Life
Form 10-Q
May 08, 2014

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

For the transition period from to

Commission file number: 001-36227

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

Delaware (State or other jurisdiction of incorporation or organization)	46-3489149 (I.R.S. Employer Identification No.)
1001 Fleet Street, 6th Floor Baltimore, MD (Address of principal executive offices)	21202 (Zip Code)

(410) 895-0100
(Registrant's telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large Accelerated Filer ¨	Accelerated Filer ¨
Non-accelerated Filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

There were 58,437,412 shares of the registrant's common stock outstanding as of May 5, 2014.

FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
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PART I: FINANCIAL INFORMATION
Item 1. Financial Statements
FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	March 31, 2014 (Unaudited)	September 30, 2013
ASSETS		
Investments:		
Fixed maturities securities, available-for-sale, at fair value	$16,865.1	$15,541.4
Equity securities, available-for-sale, at fair value	353.1	271.1
Derivative investments	273.0	221.8
Other invested assets	323.4	188.2
Total investments	17,814.6	16,222.5
Related party loans and investments	145.7	119.0
Cash and cash equivalents	701.5	1,204.3
Accrued investment income	178.7	159.3
Reinsurance recoverable	3,694.0	3,728.6
Intangibles, net	540.3	563.8
Deferred tax assets	173.2	226.4
Other assets	134.4	205.2
Total assets	$23,382.4	$22,429.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
Contractholder funds	$15,998.3	$15,248.2
Future policy benefits	3,533.7	3,556.8
Funds withheld for reinsurance liabilities	1,362.3	1,407.7
Liability for policy and contract claims	60.5	51.5
Long-term debt	300.0	300.0
Other liabilities	604.9	700.0
Total liabilities	21,859.7	21,264.2
Shareholders' equity:		
Common stock ($.01 par value, 500,000,000 shares authorized, 58,439,476 issued and outstanding at March 31, 2014; 47,000,000 shares issued and outstanding at September 30, 2013)	0.6	—
Additional paid-in capital	701.1	527.1
Retained earnings	545.5	524.9
Accumulated other comprehensive income	275.5	112.9
Total shareholders' equity	1,522.7	1,164.9
Total liabilities and shareholders' equity	$23,382.4	$22,429.1

See accompanying notes to condensed consolidated financial statements.

FIDELITY & GUARANTY LIFE AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In millions, except share data)

	Three months ended		Six months ended	
	March 31, 2014 (Unaudited)	March 31, 2013	March 31, 2014 (Unaudited)	March 31, 2013
Revenues:				
Premiums	$14.6	$14.1	$28.3	$27.9
Net investment income	184.3	167.9	367.7	338.2
Net investment (losses) gains	(1.7)	206.7	121.7	353.2
Insurance and investment product fees and other	17.1	14.6	32.7	28.5
Total revenues	214.3	403.3	550.4	747.8
Benefits and expenses:				
Benefits and other changes in policy reserves	178.9	240.9	395.8	324.5
Acquisition and operating expenses, net of deferrals	32.0	23.4	58.0	50.4
Amortization of intangibles	11.3	28.9	34.2	98.4
Total benefits and expenses	222.2	293.2	488.0	473.3
Operating (loss) income	(7.9)	110.1	62.4	274.5
Interest expense	(5.6)	—	(11.2)	—
(Loss) income before income taxes	(13.5)	110.1	51.2	274.5
Income tax (benefit) expense	(38.3)	36.9	(16.3)	90.7
Net income	$24.8	$73.2	$67.5	$183.8
Net income per common share:				
Basic	$0.43	$1.56	$1.26	$3.91
Diluted	$0.42	$1.56	$1.26	$3.91
Weighted average common shares used in computing net income per common share:				
Basic	58,270,822	47,000,000	53,656,357	47,000,000
Diluted	58,447,122	47,000,000	53,756,814	47,000,000
Cash dividend per common share	$0.065	$—	$0.065	$—
Supplemental disclosures:				
Total other-than-temporary impairments	$—	$(0.4)	$—	$(0.9)
Portion of other-than-temporary impairments included in other comprehensive income	—	—	—	—
Net other-than-temporary impairments	—	(0.4)	—	(0.9)
(Losses) gains on derivative instruments	(8.2)	132.2	103.4	106.7
Other investment gains	6.5	74.9	18.3	247.4
Total net investment (losses) gains	$(1.7)	$206.7	$121.7	$353.2

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
	(Unaudited)		(Unaudited)	
Net income	$24.8	$73.2	$67.5	$183.8
Other comprehensive income				
Unrealized investment gains (losses):				
Changes in unrealized investment gains before reclassification adjustment	383.9	54.0	373.6	180.3
Net reclassification adjustment for (gains) included in net investment gains	(10.2)	(74.5)	(18.3)	(246.5)
Changes in unrealized investment gains (losses) after reclassification adjustment	373.7	(20.5)	355.3	(66.2)
Adjustments to intangible assets	(113.1)	22.2	(105.1)	50.2
Changes in deferred income tax asset/liability	(91.2)	(0.6)	(87.6)	5.4
Net change to derive comprehensive income (loss) for the period	169.4	1.1	162.6	(10.6)
Comprehensive income, net of tax	$194.2	$74.3	$230.1	$173.2

See accompanying notes to condensed consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital/Contributed Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, September 30, 2012	$—	$ 415.6	$440.7	$ 434.5	$1,290.8
Capital contributions from Harbinger Group Inc.	—	93.2	—	—	93.2
Dividends	—	—	(93.7)	—	(93.7)
Net income	—	—	183.8	—	183.8
Unrealized investment losses, net	—	—	—	(10.6)	(10.6)
Stock compensation	—	(0.2)	—	—	(0.2)
Balance, March 31, 2013	$—	$ 508.6	$530.8	$ 423.9	$1,463.3
Balance, September 30, 2013	$—	$ 527.1	$524.9	$ 112.9	$1,164.9
Dividends	—	—	(46.9)	—	(46.9)
Stock split	0.5	(0.5)	—	—	—
Proceeds from issuance of common stock, net of transaction fees	0.1	172.5	—	—	172.6
Net income	—	—	67.5	—	67.5
Unrealized investment gains, net	—	—	—	162.6	162.6
Stock compensation	—	2.0	—	—	2.0
Balance, March 31, 2014	$0.6	$ 701.1	$545.5	$ 275.5	$1,522.7

See accompanying notes to condensed consolidated financial statements.

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

	Six months ended March 31, 2014 (Unaudited)	March 31, 2013
Cash flows from operating activities:		
Net income	$67.5	$183.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of properties	2.4	1.9
Amortization of intangibles	34.2	98.4
Stock-based compensation	12.3	1.6
Amortization of debt issuance costs	1.7	—
Deferred income taxes	(34.4)	146.6
Interest credited/index credits and other changes to contractholder account balances	324.5	313.4
Amortization of fixed maturity discounts and premiums	(19.8)	22.6
Net recognized (gains) on investments and derivatives	(121.7)	(353.2)
Charges assessed to contractholders for mortality and administration	(21.1)	(15.9)
Deferred policy acquisition costs	(115.8)	(71.5)
Changes in operating assets and liabilities:		
Accrued investment income	(19.4)	21.3
Reinsurance recoverable	(14.1)	32.1
Future policy benefits	(23.1)	(45.7)
Funds withheld from reinsurers	(56.8)	(14.3)
Collateral (returned) posted	36.9	—
Liability for policy and contract claims	9.0	(22.7)
Other assets and other liabilities	(1.2)	(109.9)
Net cash provided by operating activities	61.1	188.5
Cash flows from investing activities:		
Proceeds from investments sold, matured or repaid:		
Fixed maturities	2,627.9	5,738.3
Equity securities	47.5	31.5
Derivatives instruments and other invested assets	221.8	119.7
Cost of investments acquired:		
Fixed maturities	(3,695.0)	(5,800.0)
Equity securities	(120.7)	(39.1)
Derivatives instruments and other invested assets	(246.7)	(76.3)
Related party loans and investments	(26.7)	(132.2)
Capital expenditures	(4.3)	(2.4)
Net cash (used in) investing activities	(1,196.2)	(160.5)
Cash flows from financing activities:		
Capital funding	—	93.2
Proceeds from issuance of common stock, net of transaction fees	175.5	—
Dividends paid	(46.9)	(93.7)
Proceeds from issuance of new debt	—	300.0
Debt issuance costs	—	(10.2)
Contractholder account deposits	1,340.8	772.9
Contractholder account withdrawals	(837.1)	(950.3)

Net cash provided by financing activities	632.3	111.9
Change in cash & cash equivalents	(502.8)	139.9
Cash and cash equivalents at beginning of period	1,204.3	1,054.6
Cash and cash equivalents at end of period	$701.5	$1,194.5
Supplemental disclosures of cash flow information:		
Interest paid	$11.5	$—
Income taxes paid	$24.4	$1.7

See accompanying notes to condensed consolidated financial statements.

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

(1) Basis of Presentation and Nature of Business

Fidelity & Guaranty Life (formerly, Harbinger F&G, LLC ("HFG")) ("FGL" and, collectively with its subsidiaries, the "Company") is a subsidiary of Harbinger Group Inc. ("HGI"). HGI is a diversified holding company focused on obtaining controlling equity stakes in companies that operate across a diversified set of industries. FGL and HGI's shares of common stock trade on the New York Stock Exchange ("NYSE") under the symbols "FGL" and "HRG," respectively. In January of 2014, HGI transferred HGI's ownership interest in FGL common shares to FS Holdco, Ltd, which is a direct wholly-owned subsidiary of HGI. HGI indirectly held 47,000,000 shares of FGL's outstanding common stock, representing an 80.4% interest at March 31, 2014.

FGL's primary business is the sale of individual life insurance products and annuities through independent agents, managing general agents, and specialty brokerage firms and in selected institutional markets. FGL's principal products are deferred annuities (including fixed indexed annuity ("FIA") contracts), immediate annuities and life insurance products. FGL markets products through its wholly-owned insurance subsidiaries, Fidelity & Guaranty Life Insurance Company ("FGL Insurance") and Fidelity & Guaranty Life Insurance Company of New York ("FGL NY Insurance"), which together are licensed in all fifty states and the District of Columbia.

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

On August 9, 2013, the Company distributed its ownership interests in its wholly-owned subsidiaries, HGI Real Estate, LLC, and FS Holdco Ltd, to HGI and HGI's subsidiaries. Beginning on August 9, 2013 with the distribution of FS Holdco Ltd, the Company's financials reflected the 10% reinsurance agreement, whereby FGL cedes 10% of its in-force annuity block not already reinsured on a funds withheld basis to Front Street RE (Cayman) Ltd. ("FSRCI"), a subsidiary of FS Holdco Ltd. Accordingly, the three and six months ended March 31, 2013 include net earnings of $12.7 and $17.4, respectively from HGI Real Estate, LLC and FS Holdco operations.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of the Company included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. All such adjustments are of a normal recurring nature. Although the Company believes that the disclosures are adequate to make the information presented not misleading, certain information and footnote disclosures, including a description of significant accounting policies normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), have been condensed or omitted pursuant to such rules and regulations. These interim financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Registration Statement on Form S-1/A filed with the SEC on December 3, 2013 (the "Form S-1"). The results of operations for the three and six months ended March 31, 2014 are not necessarily indicative of the results for any subsequent periods or the entire fiscal year ending September 30, 2014.

The Company's fiscal quarters end on the last calendar day of the months of December, March, June and September.

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(2) Significant Accounting Policies and Practices
Principles of Consolidation
The accompanying unaudited condensed consolidated financial statements include the accounts of FGL and all other entities in which FGL has a controlling financial interest (none of which are variable interest entities). All intercompany accounts and transactions have been eliminated in consolidation.
Recent Accounting Pronouncements
Offsetting Assets and Liabilities
In December 2011, the Financial Accounting Standards Board ("FASB") issued amended disclosure requirements for offsetting financial assets and financial liabilities to allow investors to better compare financial statements prepared under GAAP with financial statements prepared under International Financial Reporting Standards. The new standards are effective for the Company beginning in the first quarter of its fiscal year ending September 30, 2014. ASU 2011-11 Disclosures about Offsetting Assets and Liabilities - was adopted by the Company effective October 1, 2013. FGL does not offset any of its derivative transactions, including bifurcated embedded derivatives, in its statement of financial position. The Company only enters into purchased equity options and long futures contracts. The Company has not entered into any repurchase and reverse repurchase agreements or securities borrowing and lending transactions. Accordingly, no additional disclosures are required.

Investments in Qualified Affordable Housing Projects
In January 2014, the FASB issued amended guidance which allows investors in Low Income Housing Tax Credit ("LIHTC") programs that meet specified conditions to present the net tax benefits (net of the amortization of the cost of the investment) within income tax expense. The cost of the investments that meet the specified conditions will be amortized in proportion to (and over the same period as) the total expected tax benefits, including the tax credits and other tax benefits, as they are realized on the tax return. The guidance is required to be applied retrospectively, if investors elect the proportional amortization method. However, if investors have existing LIHTC investments accounted for under the effective-yield method at adoption, they may continue to apply that method for those existing investments. The new standards will become effective for the Company beginning in the first quarter of its fiscal year ending September 30, 2016. The Company is currently evaluating the impact of this new accounting guidance on its consolidated financial position and results of operations.
Income Taxes
FGL and certain of its non-life insurance subsidiaries are included in the consolidated U.S. Federal income tax return of HGI. The Company's life insurance subsidiaries file a consolidated life insurance income tax return. Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company assesses the recoverability of its deferred tax assets in each reporting period under the guidance outlined within ASC 740 ("Income Taxes"). The guidance requires an assessment of both positive and negative evidence in determining the realizability of deferred tax assets. A valuation allowance is required to reduce the Company's deferred tax asset to an amount that is more likely than not to be realized. In determining the net deferred tax asset and valuation allowance, management is required to make judgments and estimates related to projections of future profitability. These judgments include the following: the timing and extent of the utilization of net operating loss carry-forwards, the reversals of temporary differences, and tax planning strategies. Because of the change in facts and circumstances described in Note 11 of the Financial Statements, the Company determined that it was now more likely than not that a portion of its existing deferred tax assets that had previously had a valuation allowance placed against them, were now more likely than not recoverable. Therefore, the Company released a portion of its valuation allowance and recognized a $35.0 million gain in the current period income statement. After the valuation allowance release, the Company still has a partial valuation allowance of $123.4 million against its gross deferred tax assets of $296.6 million as of March 31, 2014 for other deferred tax assets that are not likely to be realized. The effect on deferred tax assets and liabilities of a change in tax

rates is recognized in income in the period that includes the enactment date. The Company has the ability and intent to recover in a tax-free manner assets (or liabilities) with book/tax

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basis differences for which no deferred taxes have been provided, in accordance with ASC Topic 740, “Income Taxes”. The Company applies the accounting guidance for uncertain tax positions which prescribes a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The guidance also provides information on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Accrued interest expense and penalties related to uncertain tax positions are recorded in “Income tax benefit” in the Company’s Consolidated Statements of Operations. The Company had no unrecognized tax benefits related to uncertain tax positions as of March 31, 2014 and September 30, 2013.

(3) Significant Risks and Uncertainties

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Due to the inherent uncertainty involved in making estimates, actual results in future periods could differ from those estimates.

The Company’s significant estimates which are susceptible to change in the near term relate to (1) recognition of deferred tax assets and related valuation allowances, (2) fair value of certain invested assets and derivatives including embedded derivatives (see Notes 4 and 5), (3) Other than temporary impairment “OTTI” of available-for-sale investments (see Note 4), (4) amortization of intangibles (see Note 7), (5) estimates of reserves for loss contingencies, including litigation and regulatory reserves (see Note 12) and (6) reserves for future policy benefits and product guarantees.

Concentrations of Financial Instruments

As of March 31, 2014 and September 30, 2013, the Company’s most significant investment in one industry, excluding U.S. Government securities, was its investment securities in the banking industry with a fair value of $2,019.4, or 11.3% and $1,892.1 or 11.7%, respectively, of the invested assets portfolio. The Company’s holdings in this industry include investments in 78 different issuers with the top ten investments accounting for 37.7% of the total holdings in this industry. As of March 31, 2014, the company had no investments that exceeded 10% of stockholders equity. As of September 30, 2013, the Company had investments in 6 issuers that exceeded 10% of stockholders equity with a fair value of $788.7, or 4.9% of the invested assets portfolio. Additionally, the Company’s largest concentration in any single issuer as of March 31, 2014 and September 30, 2013, had a fair value of $136.8 and $150.7 or 0.8% and 0.9% of the invested assets portfolio, respectively.

Concentrations of Financial and Capital Markets Risk

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

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

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Concentration of Reinsurance Risk

The Company has a significant concentration of reinsurance with Wilton Reassurance Company ("Wilton Re") and FSRCI (an affiliate) that could have a material impact on the Company's financial position in the event that Wilton Re or FSRCI fail to perform their obligations under the various reinsurance treaties. As of March 31, 2014, the net amount recoverable from Wilton Re was $1,354.5 and the net amount recoverable from FSRCI is $1,306.5. The Company monitors both the financial condition of individual reinsurers and risk concentration arising from similar geographic regions, activities and economic characteristics of reinsurers to reduce the risk of default by such reinsurers.

(4) Investments

The Company's debt and equity securities investments have been designated as available-for-sale and are carried at fair value with unrealized gains and losses included in accumulated other comprehensive income ("AOCI") net of associated adjustments for value of business acquired ("VOBA"), deferred acquisition costs ("DAC") and deferred income taxes. The Company's consolidated investments at March 31, 2014 and September 30, 2013 are summarized as follows:

	March 31, 2014				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Carrying Value
Available-for sale securities					
Asset-backed securities	$1,816.2	$19.6	$(10.1)	$1,825.7	$1,825.7
Commercial mortgage-backed securities	463.3	25.2	(1.9)	486.6	486.6
Corporates	10,177.3	431.4	(86.6)	10,522.1	10,522.1
Equities	346.6	14.6	(8.1)	353.1	353.1
Hybrids	423.6	28.6	(0.6)	451.6	451.6
Municipals	1,182.8	77.0	(19.8)	1,240.0	1,240.0
Agency residential mortgage-backed securities	96.9	2.5	—	99.4	99.4
Non-agency residential mortgage-backed securities	1,730.9	126.3	(10.1)	1,847.1	1,847.1
U.S. Government	389.1	6.3	(2.8)	392.6	392.6
Total available-for-sale securities	16,626.7	731.5	(140.0)	17,218.2	17,218.2
Derivative investments	154.6	120.7	(2.3)	273.0	273.0
Other invested assets	323.4	—	—	323.4	323.4
Total investments	$17,104.7	$852.2	$(142.3)	$17,814.6	$17,814.6

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	September 30, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Carrying Value
Available-for-sale securities					
Asset-backed securities	$1,745.2	$24.5	$(5.2)	$1,764.5	$1,764.5
Commercial mortgage-backed securities	431.3	24.6	(1.6)	454.3	454.3
Corporates	9,314.7	288.7	(185.1)	9,418.3	9,418.3
Equities	274.6	6.8	(10.3)	271.1	271.1
Hybrids	412.6	19.5	(3.3)	428.8	428.8
Municipals	998.8	48.9	(40.7)	1,007.0	1,007.0
Agency residential mortgage-backed securities	96.5	2.4	(0.3)	98.6	98.6
Non-agency residential mortgage-backed securities	1,304.0	77.5	(13.4)	1,368.1	1,368.1
U.S. Government	998.5	7.2	(3.9)	1,001.8	1,001.8
Total available-for-sale securities	15,576.2	500.1	(263.8)	15,812.5	15,812.5
Derivatives Instruments	141.7	88.5	(8.4)	221.8	221.8
Other invested assets	188.2	—	—	188.2	188.2
Total investments	$15,906.1	$588.6	$(272.2)	$16,222.5	$16,222.5

Included in AOCI were cumulative unrealized gains of $0.9 and unrealized losses of $1.9 related to the non-credit portion of OTTI on non-agency residential mortgage-backed securities ("RMBS") at March 31, 2014 and September 30, 2013. The non-agency RMBS unrealized gains and losses represent the difference between amortized cost and fair value on securities that were previously impaired. There have been no impairments or write downs on any of the 2014 purchased non-agency RMBS.

Securities held on deposit with various state regulatory authorities had a fair value of $14,334.4 and $19.4 at March 31, 2014 and September 30, 2013, respectively. The increase in securities held on deposits is due to the FGL Insurance's re-domestication from Maryland to Iowa. Under Iowa regulations, insurance companies are required to hold securities on deposit in an amount no less than the company's legal reserve as prescribed by Iowa regulations. In accordance with the Company's Federal Home Loan Bank of Atlanta (“FHLB”) agreements, the investments supporting the funding agreement liabilities are pledged as collateral to secure the FHLB funding agreement liabilities. The collateral investments had a fair value of $592.3 and $604.9 at March 31, 2014 and September 30, 2013, respectively.

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The amortized cost and fair value of fixed maturity available-for-sale securities by contractual maturities, as applicable, are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or pre-pay obligations.

	March 31, 2014	
	Amortized Cost	Fair Value
Corporates, Non-structured Hybrids, Municipal and U.S. Government securities:		
Due in one year or less	$353.8	$356.8
Due after one year through five years	2,770.7	2,856.0
Due after five years through ten years	3,528.3	3,612.6
Due after ten years	5,446.5	5,703.8
Subtotal	12,099.3	12,529.2
Other securities which provide for periodic payments:		
Asset-backed securities	1,816.2	1,825.7
Commercial-mortgage-backed securities	463.3	486.6
Structured hybrids	73.5	77.1
Agency residential mortgage-backed securities	96.9	99.4
Non-agency residential mortgage-backed securities	1,730.9	1,847.1
Total fixed maturity available-for-sale securities	$16,280.1	$16,865.1

The Company's available-for-sale securities with unrealized losses are reviewed for potential OTTI. In evaluating whether a decline in value is other-than-temporary, the Company considers several factors including, but not limited to the following: (1) the extent and the duration of the decline; (2) the reasons for the decline in value (credit event, currency or interest-rate related, including general credit spread widening); and (3) the financial condition of and near-term prospects of the issuer. The Company also considers the ability and intent to hold the investment for a period of time to allow for a recovery of value.

The Company analyzes its ability to recover the amortized cost by comparing the net present value of cash flows expected to be collected with the amortized cost of the security. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including interest rate and prepayment assumptions, based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also include other assumptions regarding the underlying collateral including default rates and recoveries, which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. If the net present value is less than the amortized cost of the investment, an OTTI is recognized. FGL has concluded that the fair values of the securities presented in the table below were not OTTI as of March 31, 2014.

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The fair value and gross unrealized losses of available-for-sale securities, aggregated by investment category, were as follows:

	March 31, 2014					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available-for-sale securities						
Asset-backed securities	$684.9	$(7.7)	$120.3	$(2.4)	$805.2	$(10.1)
Commercial-mortgage-backed securities	46.8	(0.6)	0.2	(1.3)	47.0	(1.9)
Corporates	1,902.2	(54.9)	769.9	(31.7)	2,672.1	(86.6)
Equities	70.0	(6.4)	26.0	(1.7)	96.0	(8.1)
Hybrids	19.1	(0.4)	10.5	(0.2)	29.6	(0.6)
Municipals	359.8	(13.5)	107.5	(6.3)	467.3	(19.8)
Agency residential mortgage-backed securities	9.9	—	0.6	—	10.5	—
Non-agency residential mortgage-backed securities	335.9	(7.6)	96.7	(2.5)	432.6	(10.1)
U.S. Government	127.9	(2.5)	39.7	(0.3)	167.6	(2.8)
Total available-for-sale securities	$3,556.5	$(93.6)	$1,171.4	$(46.4)	$4,727.9	$(140.0)
Total number of available-for-sale securities in an unrealized loss position less than twelve months						448
Total number of available-for-sale securities in an unrealized loss position twelve months or longer						156
Total number of available-for-sale securities in an unrealized loss position						604

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	September 30, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available-for-sale securities						
Asset-backed securities	$329.3	$(4.5)	$81.5	$(0.7)	$410.8	$(5.2)
Commercial-mortgage-backed securities	26.6	(0.5)	4.8	(1.1)	31.4	(1.6)
Corporates	3,457.2	(175.0)	186.0	(10.1)	3,643.2	(185.1)
Equities	118.6	(9.2)	32.2	(1.1)	150.8	(10.3)
Hybrids	52.0	(3.3)	—	—	52.0	(3.3)
Municipals	333.3	(27.3)	144.4	(13.4)	477.7	(40.7)
Agency residential mortgage-backed securities	9.8	(0.2)	1.1	(0.1)	10.9	(0.3)
Non-agency residential mortgage-backed securities	325.2	(12.2)	69.9	(1.2)	395.1	(13.4)
U.S government	753.9	(3.9)	—	—	753.9	(3.9)
Total available-for-sale securities	$5,405.9	$(236.1)	$519.9	$(27.7)	$5,925.8	$(263.8)
Total number of available-for-sale securities in an unrealized loss position less than twelve months						588
Total number of available-for-sale securities in an unrealized loss position twelve months or longer						78
Total number of available-for-sale securities in an unrealized loss position						666

At March 31, 2014 and September 30, 2013, securities in an unrealized loss position were primarily concentrated in investment grade corporate debt instruments. Agency residential mortgage-backed securities had positions with an unrealized loss less than $0.1 as of March 31, 2014.

At March 31, 2014 and September 30, 2013, securities with a fair value of $1.0 and $60.9, respectively, were depressed greater than 20% of amortized cost (excluding U.S. Government and U.S. Government sponsored agency securities), which represented less than 1% of the carrying values of all investments.

The following table provides a reconciliation of the beginning and ending balances of the credit loss portion of OTTI on fixed maturity securities held by the Company for the three months and six ended March 31, 2014, and March 31, 2013, for which a portion of the OTTI was recognized in AOCI:

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Beginning balance	$2.7	$2.7	$2.7	$2.7
Increases attributable to credit losses on securities:				
Other-than-temporary impairment was previously recognized	—	—	—	—
Other-than-temporary impairment was not previously recognized	—	—	—	—
Ending balance	$2.7	$2.7	$2.7	$2.7

The company recognized $0.0 of impairment losses in operations during three and six months ended March 31, 2014. For the three and six months ended March 31, 2013, the Company recognized impairment losses in operations totaling $0.4 and $0.9, including credit impairments of $0.1 and $0.3, and change-of-intent impairments of $0.3 and $0.6 and had an amortized cost of $2.7 and a fair value of $1.8 at March 31, 2013.

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Details underlying write-downs taken as a result of OTTI that were recognized in net income and included in net realized gains on securities were as follows:

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
OTTI recognized in net income:				
Non-agency residential mortgage-backed securities	$—	$0.4	$—	$0.9
Total OTTI	$—	$0.4	$—	$0.9

The portion of OTTI recognized in AOCI is disclosed in the Statement of Comprehensive Income.

Net Investment Income

The major sources of “Net investment income” on the accompanying Condensed Consolidated Statements of Operations were as follows:

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Fixed maturity available-for-sale securities	$175.4	$165.0	$350.7	$328.3
Equity available-for-sale securities	4.9	2.9	9.3	8.2
Related party loans	1.7	1.4	3.5	5.9
Policy loans	0.1	0.2	0.3	0.4
Invested cash and short-term investments	0.1	0.4	0.2	1.2
Other investments	6.0	0.8	11.2	1.1
Gross investment income	188.2	170.7	375.2	345.1
Investment expense	(3.9)	(2.8)	(7.5)	(6.9)
Net investment income	$184.3	$167.9	$367.7	$338.2

Net investment (losses) gains

Details underlying “Net investment (losses) gains” reported on the accompanying Condensed Consolidated Statements of Operations were as follows:

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Net realized gains on fixed maturity available-for-sale securities	$6.1	$72.6	19.7	244.6
Realized gains (losses) on equity securities	0.3	1.9	(1.4)	1.9
Net realized gains on securities	6.4	74.5	18.3	246.5
Realized gains on certain derivative instruments	44.9	29.6	99.8	45.3
Unrealized (losses) gains on certain derivative instruments	(24.3)	102.6	36.7	61.4
Change in fair value of reinsurance related embedded derivative	(28.8)	—	(33.1)	—
Realized (losses) gains on derivatives and reinsurance related embedded derivative	(8.2)	132.2	103.4	106.7
Realized (losses) on other invested assets	0.1	—	—	—
Net investment (losses) gains	$(1.7)	$206.7	$121.7	$353.2

For the three and six months ended March 31, 2014, principal repayments, calls, tenders, and proceeds from the sale of fixed maturity available-for-sale securities totaled $964.2 and $2,627.9, gross gains on such sales totaled $7.8 and $22.2 and gross losses totaled $1.7 and $2.5, respectively.

For the three and six months ended March 31, 2013, principal repayments, calls, tenders, and proceeds from the sale of fixed maturity available-for-sale securities, totaled $3,323.2 and $5,738.3, gross gains on such sales totaled $71.0 and $249.0 and gross losses totaled $0.1 and $0.6, respectively.

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(5) Derivative Financial Instruments

The carrying amounts of derivative instruments, including derivative instruments embedded in FIA contracts, is as follows:

	March 31, 2014	September 30, 2013
Assets:		
Derivative investments:		
Call options	$271.5	$ 221.8
Futures contracts	1.5	—
Other Assets:		
Reinsurance related embedded derivative	84.9	118.0
	$357.9	$ 339.8
Liabilities:		
Contractholder funds:		
FIA embedded derivative	$1,718.7	$1,544.4
Funds withheld for reinsurance liabilities		
Call options payable to FSRCI	25.0	22.8
Other liabilities:		
Futures contracts	—	1.0
	$1,743.7	$1,568.2

The change in fair value of derivative instruments included in the accompanying Condensed Consolidated Statements of Operations is as follows:

	Three months ended		Six months ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Revenues:				
Net investment gains (losses):				
Call options	$19.3	$ 118.5	$122.1	$97.6
Futures contracts	1.3	13.7	14.4	9.1
Reinsurance related embedded derivative	(28.8)	—	(33.1)	—
	$(8.2)	$ 132.2	$103.4	$106.7
Benefits and other changes in policy reserves:				
FIA embedded derivatives	$74.0	$ 122.5	$174.3	$88.8

Additional Disclosures

Reinsurance Related Embedded Derivatives

Effective December 31, 2012, FGL Insurance entered into a modified coinsurance arrangement with FSRCI, meaning that funds were withheld by FGL Insurance. This arrangement creates an obligation for FGL Insurance to pay FSRCI at a later date, which resulted in an embedded derivative. This embedded derivative is considered a total return swap with contractual returns that are attributable to the assets and liabilities associated with this reinsurance arrangement. The fair value of the total return swap is based on the change in fair value of the underlying assets held in the funds withheld portfolio. Investment results for the assets that support the coinsurance with funds withheld reinsurance arrangement, including gains and losses from sales, are passed directly to the reinsurer pursuant to contractual terms of the reinsurance

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arrangement. The reinsurance related embedded derivative is reported in “Other assets” on the Condensed Consolidated Balance Sheets and the related gains or losses are reported in “Net investment gains” on the Condensed Consolidated Statements of Operations.

Credit Risk

The Company is exposed to credit loss in the event of nonperformance by its counterparties on the call options and reflects assumptions regarding this nonperformance risk in the fair value of the call options. The nonperformance risk is the net counterparty exposure based on the fair value of the open contracts less collateral held. The Company maintains a policy of requiring all derivative contracts to be governed by an International Swaps and Derivatives Association (“ISDA”) Master Agreement.

Information regarding the Company’s exposure to credit loss on the call options it holds is presented in the following table:

		March 31, 2014				September 30, 2013			
Counterparty	Credit Rating (Moody's/S&P) (a)	Notional Amount	Fair Value	Collateral	Net Credit Risk	Notional Amount	Fair Value	Collateral	Net Credit Risk
Merrill Lynch	A/A	$2,018.2	$83.0	$41.1	$41.9	$2,037.8	$70.7	$—	$70.7
Deutsche Bank	A2/A	2,265.3	81.9	45.7	36.2	1,620.4	51.7	23.0	28.7
Morgan Stanley	A3/A	2,143.3	89.9	63.2	26.7	2,264.1	75.7	49.0	26.7
Royal Bank of Scotland	BBB+/Baa2	114.7	8.1	—	8.1	364.3	20.3	—	20.3
Barclay's Bank	A2/A	260.4	8.6	—	8.6	120.8	3.4	—	3.4
		$6,801.9	$271.5	$150.0	$121.5	$6,407.4	$221.8	$72.0	$149.8

(a) Credit rating as of March 31, 2014.

Collateral Agreements

The Company is required to maintain minimum ratings as a matter of routine practice as part of its over-the-counter derivative agreements on ISDA forms. Under some ISDA agreements, the Company has agreed to maintain certain financial strength ratings. A downgrade below these levels provides the counterparty under the agreement the right to terminate the open derivative contracts between the parties, at which time any amounts payable by the Company or the counterparty would be dependent on the market value of the underlying derivative contracts. The Company’s current rating allows multiple counterparties the right to terminate ISDA agreements. No ISDA agreements have been terminated, although the counterparties have reserved the right to terminate the ISDA agreements at any time. In certain transactions, the Company and the counterparty have entered into a collateral support agreement requiring either party to post collateral when the net exposures exceed pre-determined thresholds. These thresholds vary by counterparty and credit rating. As of March 31, 2014 and September 30, 2013, counterparties posted $150.0 and $72.0 of collateral of which $108.9 and $72.0 is included in "Cash and cash equivalents" with an associated payable for this collateral included in "Other liabilities" on the Condensed Consolidated Balance Sheets. The remaining, $41.1 of non-cash collateral was held by a third-party custodian at March 31, 2014. Accordingly, the maximum amount of loss due to credit risk that the Company would incur if parties to the call options failed completely to perform according to the terms of the contracts was $121.5 and $149.8 at March 31, 2014 and September 30, 2013, respectively.

The Company held 1,990 and 1,693 futures contracts at March 31, 2014 and September 30, 2013, respectively. The fair value of the futures contracts represents the cumulative unsettled variation margin (open trade equity, net of cash settlements). The Company provides cash collateral to the counterparties for the initial and variation margin on the futures contracts which is included in "Cash and cash equivalents" in the accompanying Condensed Consolidated Balance Sheets. The amount of collateral held by the counterparties for such contracts was $8.6 and $5.9 at March 31, 2014 and September 30, 2013, respectively.

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(6) Fair Value of Financial Instruments

The Company’s measurement of fair value is based on assumptions used by market participants in pricing the asset or liability, which may include inherent risk, restrictions on the sale or use of an asset or non-performance risk, which may include the Company’s own credit risk. The Company’s estimate of an exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability (“exit price”) in the principal market, or the most advantageous market in the absence of a principal market, for that asset or liability, as opposed to the price that would be paid to acquire the asset or receive a liability (“entry price”). The Company categorizes financial instruments carried at fair value into a three-level fair value hierarchy, based on the priority of inputs to the respective valuation technique. The three-level hierarchy for fair value measurement is defined as follows:

Level 1 -Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.

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

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

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment’s level within the fair value hierarchy is based on the lower level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the investment.

When a determination is made to classify an asset or liability within Level 3 of the fair value hierarchy, the determination is based upon the significance of the unobservable inputs to the overall fair value measurement. Because certain securities trade in less liquid or illiquid markets with limited or no pricing information, the determination of fair value for these securities is inherently more difficult. However, Level 3 fair value investments may include, in addition to the unobservable or Level 3 inputs, observable components, which are components that are actively quoted or can be validated to market-based sources.

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The carrying amounts and estimated fair values of the Company’s financial instruments for which the disclosure of fair values is required, including financial assets and liabilities measured and carried at fair value on a recurring basis, with the exception of investment contracts, a portion of related party loans, portions of other invested assets and debt, are summarized according to the hierarchy previously described, as follows:

	March 31, 2014				
	Level 1	Level 2	Level 3	Fair Value	Carrying Amount
Assets					
Cash and cash equivalents	$701.5	$—	$—	$701.5	$701.5
Fixed maturity securities, available-for-sale:					
Asset-backed securities	—	1,778.3	47.4	1,825.7	1,825.7
Commercial mortgage-backed securities	—	486.6	—	486.6	486.6
Corporates	—	9,865.1	657.0	10,522.1	10,522.1
Hybrids	—	451.6	—	451.6	451.6
Municipals	—	1,204.4	35.6	1,240.0	1,240.0
Agency residential mortgage-backed securities	—	99.4	—	99.4	99.4
Non-agency residential mortgage-backed securities	—	1,847.1	—	1,847.1	1,847.1
U.S. Government	181.5	211.1	—	392.6	392.6
Equity securities available-for-sale	—	353.1	—	353.1	353.1
Derivative financial instruments	—	273.0	—	273.0	273.0
Reinsurance related embedded derivative, included in other assets	—	84.9	—	84.9	84.9
Related party loans and investments	—	—	145.7	145.7	145.7
Other invested assets	—	—	323.4	323.4	323.4
Total financial assets at fair value	$883.0	$16,654.6	$1,209.1	$18,746.7	$18,746.7
Liabilities					
Derivatives:					
FIA embedded derivatives, included in contractorholder funds	$—	$—	$1,718.7	$1,718.7	$1,718.7
Investment contracts, included in contractholder funds	—	—	12,872.3	12,872.3	14,279.6
Call options payable for FSRCI, included in funds withheld for reinsurance liabilities	—	25.0		25.0	25.0
Debt	—	300.0	—	300.0	300.0
Total financial liabilities at fair value	$—	$325.0	$14,591.0	$14,916.0	$16,323.3

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	September 30, 2013				
	Level 1	Level 2	Level 3	Fair Value	Carrying Amount
Assets					
Cash and cash equivalents	$1,204.3	$—	$—	$1,204.3	$1,204.3
Fixed maturity securities, available-for-sale:			—		
Asset-backed securities	—	1,518.1	246.4	1,764.5	1,764.5
Commercial mortgage-backed securities	—	448.7	5.6	454.3	454.3
Corporates	—	8,957.2	461.1	9,418.3	9,418.3
Hybrids	—	428.8	—	428.8	428.8
Municipals	—	1,007.0	—	1,007.0	1,007.0
Agency residential mortgage-backed securities	—	98.6	—	98.6	98.6
Non-agency residential mortgage-backed securities	—	1,368.1	—	1,368.1	1,368.1
U.S. Government	790.9	210.9	—	1,001.8	1,001.8
Equity securities available-for-sale	—	271.1	—	271.1	271.1
Derivative financial instruments	—	221.8	—	221.8	221.8
Reinsurance related embedded derivative, included in other assets	—	118.0	—	118.0	118.0
Related party loans and investments	—	—	119.0	119.0	119.0
Other invested assets	—	—	188.2	188.2	188.2
Total financial assets at fair value	$1,995.2	$14,648.3	$1,020.3	$17,663.8	$17,663.8
Liabilities					
Derivatives:					
FIA embedded derivatives, included in contractholder funds	$—	$—	$1,544.4	$1,544.4	$1,544.4
Derivative instruments: futures contracts	—	1.0	—	1.0	1.0
Investment contracts, included in contractholder funds	—	—	12,378.6	12,378.6	13,703.8
Call options payable for FSRCI, included in funds withheld for reinsurance liabilities	—	22.8	—	22.8	22.8
Debt	—	300.0	—	300.0	300.0
Total financial liabilities at fair value	$—	$323.8	$13,923.0	$14,246.8	$15,572.0

The carrying amounts of accrued investment income, and portions of other insurance liabilities, approximate fair value due to their short duration and, accordingly, they are not presented in the tables above.

Valuation Methodologies

Fixed Maturity Securities & Equity Securities

The Company measures the fair value of its securities based on assumptions used by market participants in pricing the security. The most appropriate valuation methodology is selected based on the specific characteristics of the fixed maturity or equity security, and the Company will then consistently apply the valuation methodology to measure the security’s fair value. The Company's fair value measurement is based on a market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable securities. Sources of inputs to the market approach include a third-party pricing service, independent broker quotations or pricing matrices. The Company uses observable and unobservable inputs in its valuation methodologies. Observable inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. In addition, market indicators and industry and economic events are monitored and further market data will be acquired when certain thresholds are met. For certain security types, additional inputs may be used, or some of the inputs described above may not be applicable. For broker-quoted only securities, quotes from market makers or broker-dealers are obtained from sources recognized to be market participants. Management believes the broker quotes are prices at which trades could be executed based on historical trades executed at broker-quoted or slightly higher prices.

The Company did not adjust prices received from third parties as of March 31, 2014 and September 30, 2013. However, the Company does analyze the third-party valuation methodologies and its related inputs to perform assessments to determine the appropriate level within the fair value hierarchy.

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Derivative Financial Instruments

The fair value of derivative assets and liabilities is based upon valuation pricing models, which represents what the Company would expect to receive or pay at the balance sheet date if it canceled the options, entered into offsetting positions, or exercised the options. The fair value of futures contracts represents the cumulative unsettled variation margin (open trade equity, net of cash settlements). Fair values for these instruments are determined externally by an independent actuarial firm using market-observable inputs, including interest rates, yield curve volatilities, and other factors. Credit risk related to the counterparty is considered when estimating the fair values of these derivatives. The fair values of the embedded derivatives in the Company’s FIA products are derived using market indices, pricing assumptions and historical data. The fair value of the reinsurance related embedded derivative in the funds withheld reinsurance agreement with FSRCI is estimated based upon the change in the fair value of the assets supporting the funds withheld from reinsurance liabilities. As the fair value of the assets is based on a quoted market price (Level 2), the fair value of the embedded derivative is based on market-observable inputs and is classified as Level 2.

Investment contracts include deferred annuities, FIAs, indexed universal life policies (“IULs”) and immediate annuities. The fair value of deferred annuity, FIA, and IUL contracts is based on their cash surrender value (i.e. the cost the Company would incur to extinguish the liability) as these contracts are generally issued without an annuitization date. The fair value of immediate annuities contracts is derived by calculating a new fair value interest rate using the updated yield curve and treasury spreads as of the respective reporting date. At March 31, 2014 and September 30, 2013, this resulted in lower fair value reserves relative to the carrying value. The Company is not required to, and has not, estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value.

Other Invested Assets

Fair value of our loan participation interest securities has been assessed to be equal to the unpaid principal balance of the participation interest as of March 31, 2014. In making this assessment the Company considered the sufficiency of the underlying loan collateral, movements in the benchmark interest rate between origination date and March 31, 2014, the primary market participant for these securities and the short-term maturity of these loans (less than 1 year). All of the other financial instruments included in other investments, primarily commercial mortgage loans ("CMLs") and policy loans, are carried at amortized cost which approximates fair value. Information on determining the carry value of these investments is described below:

In September 2013, the Company initiated a commercial loan program with Principal Real Estate Investors ("Principal"). The Company has funded eight CMLs originated and serviced by Principal with a fair value of $116.5 at March 31, 2014 which is equal to amortized cost as these loans were recently originated and are performing in good standing with no material credit concerns with the borrower or the property. Principal monitors the status of the payment obligations, the credit quality of the borrower and the property as well as for other events that may impact the performance and principal repayment of the CMLs. Additionally, the Company reviews Principal's valuation methodologies and processes to perform assessments. A CMLs' good standing and payment obligations are material factors in evaluating CMLs carrying value. At March 31, 2014, all eight CMLs are performing in good standing and there are no credit or other events which would require impairment evaluation.

Also included in other invested assets are policy loans. We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived.

Related Party Loans & Related Party Investments

The related party loans (discussed in Note 14) carrying value at par approximates fair value, as this is the exit price for the obligation of these loans.

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Quantitative information regarding significant unobservable inputs used for recurring Level 3 fair value measurements of financial instruments carried at fair value as of March 31, 2014 and September 30, 2013 are as follows:

	Fair Value at			Range (Weighted average)
	March 31, 2014	Valuation Technique	Unobservable Input(s)	March 31, 2014
Assets				
Asset-backed securities	$47.4	Broker-quoted	Offered quotes	95.50% -101.36% (98.56%)
Corporates	591.2	Broker-quoted	Offered quotes	0.00% - 120.00% (93.74%)
Corporates	65.8	Market Pricing	Quoted prices	93.84% - 137.97% (99.11%)
Municipal	35.6	Broker-quoted	Offered quotes	101.80%
Salus preferred equity, included in related party loans and investments	33.4	Market- approach	Yield	8%-9.5%
Salus 2013 Participations, included in other invested assets	193.4	Market Pricing	Offered quotes	100.00%
Total	$966.8			
Liabilities				
Derivatives:				
FIA embedded derivatives, included in contractholder funds	$1,718.7	Discounted cash flow	Market value of option	0% - 43.57% (3.58%)
			SWAP rates	1.80% - 2.84% (2.34%)
			Mortality multiplier	80%
			Surrender rates	0.50% - 75% (7%)
			Non-performance spread	0.25%
Total liabilities at fair value	$1,718.7			

	Fair Value at			Range (Weighted average)
	September 30, 2013	Valuation Technique	Unobservable Input(s)	September 30, 2013
Assets				
Asset-backed securities	$246.5	Broker-quoted	Offered quotes	100.00% - 107.25% (100.91%)
Corporates	404.5	Broker-quoted	Offered quotes	0.00% - 113.00% (90.45%)
Corporates	56.6	Market Pricing	Quoted prices	90.06% - 130.92% (97.19%)
Commercial mortgage-backed securities	5.6	Broker-quoted	Offered quotes	95.50%
Salus 2013 Participations, included in other invested assets	157.0	Market Pricing	Offered quotes	100.00%

Total Liabilities	$870.2			
Derivatives:				
FIA embedded derivatives, included in contractholder funds	$1,544.4	Discounted cash flow	Market value of option	0% - 38.24% (3.82%)
			SWAP rates	1.54% - 2.77% (2.16%)
			Mortality multiplier	80%
			Surrender rates	0.50% - 75% (7%)
			Non-performance spread	0.25%
Total liabilities at fair value	$1,544.4			

The significant unobservable inputs used in the fair value measurement of FIA embedded derivatives included in contractholder funds are market value of option, interest swap rates, mortality multiplier, surrender rates, and non-performance spread. The mortality multiplier at March 31, 2014 and September 30, 2013, is based on the 2000 annuity tables and assumes the contractholder population is 50% female and 50% male. Significant increases

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(decreases) in the market value of option in isolation would result in a higher or lower, respectively, fair value measurement. Significant increases or decreases in interest swap rates, mortality multiplier, surrender rates, or non-performance spread in isolation would result in a lower or higher, respectively, fair value measurement. Generally, a change in any one unobservable input would not result in a change in any other unobservable input. Changes in unrealized losses (gains), net in the Company's FIA embedded derivatives are included in "Benefits and other changes in policy reserves" in the Condensed Consolidated Statements of Operations.
The following tables summarize changes to the Company's financial instruments carried at fair value and classified within Level 3 of the fair value hierarchy for the three and six months ended March 31, 2014 and March 31, 2013 respectively. This summary excludes any impact of amortization of VOBA and DAC. The gains and losses below may include changes in fair value due in part to observable inputs that are a component of the valuation methodology.

	Three months ended March 31, 2014					
	Balance at Beginning of Period	Total Gains (Losses) Included in Earnings	Included in AOCI	Net Purchases, Sales, & Settlements	Net transfer In (Out) of Level 3 (a)	Balance at End of Period
Assets						
Fixed maturity securities available-for-sale:						
Asset-backed securities	$250.8	$—	$(0.7)	$—	$(202.7)	$47.4
Commercial mortgage-backed securities	6.0	—	—	—	(6.0)	—
Corporates	607.1	—	10.2	39.7	—	657.0
Municipals	34.4	—	1.2	—	—	35.6
Salus preferred equity, included in related party loans and investments	—	—	—	33.4	—	33.4
Salus 2013 Participations, included in other invested assets	199.6	—	—	(6.2)	—	193.4
Total assets at Level 3 fair value	$1,097.9	$—	$10.7	$66.9	$(208.7)	$966.8
Liabilities						
FIA embedded derivatives, included in contractholder funds	$1,644.7	$74.0	$—	$—	$—	$1,718.7
Total liabilities at Level 3 fair value	$1,644.7	$74.0	$—	$—	$—	$1,718.7

(a) This includes a $6.0 transfer to asset-backed securities from commercial mortgage-backed securities, the remaining transfers were from level 3 to level 2.

	Six months ended March 31, 2014					
	Balance at Beginning of Period	Total Gains (Losses) Included in Earnings	Included in AOCI	Net Purchases, Sales, & Settlements	Net transfer In (Out) of Level 3 (a)	Balance at End of Period
Assets						
Fixed maturity securities available-for-sale:						
Asset-backed securities	$246.5	$—	$(1.4)	$5.0	$(202.7)	$47.4
Commercial mortgage-backed securities	5.6	—	0.4	—	(6.0)	—
Corporates	461.1	—	4.0	191.9	—	657.0
Municipals	—	—	0.6	35.0	—	35.6
	—	—	—	33.4	—	33.4

Salus preferred equity, included in related party loans and investments						
Salus 2013 Participations, included in other invested assets	157.0	—	—	36.4	—	193.4
Total assets at Level 3 fair value	$870.2	$—	$3.6	$301.7	$(208.7)	$966.8
Liabilities						
FIA embedded derivatives, included in contractholder funds	$1,544.4	$174.3	$—	$—	$—	$1,718.7
Total liabilities at Level 3 fair value	$1,544.4	$174.3	$—	$—	$—	$1,718.7

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(a) This includes a $6.0 transfer to asset-backed securities from commercial mortgage-backed securities, the remaining transfers were from level 3 to level 2.

	Three months ended March 31, 2013					
	Balance at Beginning of Period	Total Gains (Losses) Included in Earnings	Included in AOCI	Net Purchases, Sales, & Settlements	Net transfer In (Out) of Level 3 (a)	Balance at End of Period
Assets						
Fixed maturity securities available-for-sale:						
Asset-backed securities	$5.3	$—	$—	$—	$—	$5.3
Commercial mortgage-backed securities	6.1	—	0.1	—	—	6.2
Corporates	256.1	(0.1)	3.1	131.3	(33.9)	356.5
Hybrids	5.0	—	—	—	(5.0)	—
Equity securities available-for-sale	—	—	—	10.0	—	10.0
Salus preferred equity, included in related party loans and investments	32.0	—	—	—	—	32.0
Total assets at Level 3 fair value	$304.5	$(0.1)	$3.2	$141.3	$(38.9)	$410.0
Liabilities						
FIA embedded derivatives, included in contractholder funds	$1,517.1	$122.5	$—	$—	$—	$1,639.6
Total liabilities at Level 3 fair value	$1,517.1	$122.5	$—	$—	$—	$1,639.6

(a) The net transfers in and out of Level 3 during the three months ended March 31, 2013 were exclusively to or from Level 2.

	Six months ended March 31, 2013					
	Balance at Beginning of Period	Total Gains (Losses) Included in Earnings	Included in AOCI	Net Purchases, Sales, & Settlements	Net transfer In (Out) of Level 3 (a)	Balance at End of Period
Assets						
Fixed maturity securities available-for-sale:						
Asset-backed securities	$15.9	$—	$—	$—	$(10.6)	$5.3
Commercial mortgage-backed securities	5.0	—	0.1	1.0	0.1	6.2
Corporates	135.3	(0.3)	1.1	254.1	(33.7)	356.5
Hybrids	8.9	—	(0.2)	—	(8.7)	—
Equity securities available-for-sale	—	—	—	10.0	—	10.0
Salus preferred equity, included in related party loans and investments	32.0	—	—	—	—	32.0
Total assets at Level 3 fair value	$197.1	$(0.3)	$1.0	$265.1	$(52.9)	$410.0
Liabilities						
FIA embedded derivatives, included in contractholder funds	$1,550.8	$88.8	$—	$—	$—	$1,639.6
Total liabilities at Level 3 fair value	$1,550.8	$88.8	$—	$—	$—	$1,639.6

(a) The net transfers in and out of Level 3 during the six months ended March 31, 2013 were exclusively to or from Level 2.

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The Company reviews the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in and out of Level 3, or between other levels, at the beginning fair value for the reporting period in which the changes occur. There were no transfers between Level 1 and Level 2 for the three or six months ended March 31, 2014. We transferred $79.3 U.S. Government securities from Level 1 into Level 2 for the three and six months ended March 31, 2013 reflecting the level of market activity in these instruments.

Primary market issuance and secondary market activity for certain asset-backed, hybrid and corporate securities during the three months and six months ended March 31, 2014 and March 31, 2013 increased the market observable inputs used to establish fair values for similar securities. These factors, along with more consistent pricing from third-party sources, resulted in the Company concluding that there is sufficient trading activity in similar instruments to support classifying these securities as Level 2 as of March 31. 2014 and March 31, 2013. Accordingly, the Company's assessment resulted in net transfers out of Level 3 of $208.7 related to asset backed securities during the three and six months ended March 31, 2014 and of $38.9 and $52.9 related to corporate and hybrid securities during the three and six months ended March 31, 2013, respectively.

The following tables present the gross components of purchases, sales, and settlements, net, of Level 3 financial instruments for the three and six months ended March 31, 2014 and March 31, 2013, respectively. There were no issuances during these periods.

	Three months ended March 31, 2014			
	Purchases	Sales	Settlements	Net Purchases, Sales, & Settlements
Assets				
Fixed maturity securities available-for-sale:				
Corporates	$41.6	$—	$(1.9)	$39.7
Related party loans and investments	33.4	—	—	33.4
Other invested assets	27.3	—	(33.5)	(6.2)
Total assets at fair value	$102.3	$—	$(35.4)	$66.9

	Six months ended March 31, 2014			
	Purchases	Sales	Settlements	Net Purchases, Sales, & Settlements
Assets				
Fixed maturity securities available-for-sale:				
Asset-backed securities	$5.0			