CIGNA CORP
Form 10-Q
May 06, 2010

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from __________ to __________

Commission file number 1-08323

CIGNA Corporation

(Exact name of registrant as specified in its charter)

Delaware	**06-1059331**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Two Liberty Place, 1601 Chestnut Street
Philadelphia, Pennsylvania 19192
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code **(215) 761-1000**

Not Applicable

(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 þ No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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 definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

As of April 16, 2010, 276,674,906 shares of the issuer s common stock were outstanding.

CIGNA CORPORATION
INDEX

	Page
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements	1
Consolidated Statements of Income	1
Consolidated Balance Sheets	2
Consolidated Statements of Comprehensive Income and Changes in Total Equity	3
Consolidated Statements of Cash Flows	4
Notes to the Consolidated Financial Statements	5
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	43
Item 3. Quantitative and Qualitative Disclosures About Market Risk	73
Item 4. Controls and Procedures	74
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	75
Item 1A. Risk Factors	76
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	77
Item 6. Exhibits	78
SIGNATURE	79
INDEX TO EXHIBITS	E-1

Exhibit 10.1
Exhibit 10.2
Exhibit 10.3
Exhibit 12
Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

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

Table of Contents

Part I. ***FINANCIAL INFORMATION***
Item 1. ***FINANCIAL STATEMENTS***
CIGNA Corporation
Consolidated Statements of Income

	Unaudited Three Months Ended March 31,	
(In millions, except per share amounts)	**2010**	2009
Revenues		
Premiums and fees	**$ 4,543**	$ 4,051
Net investment income	**266**	229
Mail order pharmacy revenues	**348**	312
Other revenues	**54**	217
Realized investment losses:		
Other-than-temporary impairments on debt securities, net	**(1)**	(17)
Other realized investment losses	**(5)**	(19)
Total realized investment losses	**(6)**	(36)
Total revenues	**5,205**	4,773
Benefits and Expenses		
Health Care medical claims expense	**2,209**	1,780
Other benefit expenses	**879**	1,108
Mail order pharmacy cost of goods sold	**285**	252
GMIB fair value gain	**(4)**	(32)
Other operating expenses	**1,414**	1,392
Total benefits and expenses	**4,783**	4,500
Income from Continuing Operations before Income Taxes	**422**	273
Income taxes (benefits):		
Current	**87**	(85)
Deferred	**51**	150
Total taxes	**138**	65
Income from Continuing Operations	**284**	208
Income from Discontinued Operations, Net of Taxes		1
Net Income	**284**	209
Less: Net Income Attributable to Noncontrolling Interest	**1**	1
Shareholders Net Income	**$ 283**	$ 208

Basic Earnings Per Share:

Shareholders income from continuing operations	**$**	**1.03**	$	0.76
Shareholders income from discontinued operations				
Shareholders net income	**$**	**1.03**	$	0.76
Diluted Earnings Per Share:				
Shareholders income from continuing operations	**$**	**1.02**	$	0.76
Shareholders income from discontinued operations				
Shareholders net income	**$**	**1.02**	$	0.76
Dividends Declared Per Share	**$**	**0.040**	$	0.040
Amounts Attributable to CIGNA:				
Shareholders income from continuing operations	**$**	**283**	$	207
Shareholders income from discontinued operations				1
Shareholders Net Income	**$**	**283**	$	208

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

Table of Contents

CIGNA Corporation
Consolidated Balance Sheets

(In millions, except per share amounts)	**Unaudited As of March 31, 2010**	As of December 31, 2009
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost, $12,958; $12,580)	**$ 13,977**	$ 13,443
Equity securities, at fair value (cost, $141; $137)	**122**	113
Commercial mortgage loans	**3,493**	3,522
Policy loans	**1,529**	1,549
Real estate	**160**	124
Other long-term investments	**597**	595
Short-term investments	**188**	493
Total investments	**20,066**	19,839
Cash and cash equivalents	**1,299**	924
Accrued investment income	**278**	238
Premiums, accounts and notes receivable, net	**1,515**	1,361
Reinsurance recoverables	**6,520**	6,597
Deferred policy acquisition costs	**1,011**	943
Property and equipment	**860**	862
Deferred income taxes, net	**941**	1,029
Goodwill	**2,879**	2,876
Other assets, including other intangibles	**1,004**	1,056
Separate account assets	**7,491**	7,288
Total assets	**$ 43,864**	$ 43,013
Liabilities		
Contractholder deposit funds	**$ 8,506**	$ 8,484
Future policy benefits	**8,116**	8,136
Unpaid claims and claim expenses	**3,996**	3,968
Health Care medical claims payable	**1,341**	921
Unearned premiums and fees	**432**	427
Total insurance and contractholder liabilities	**22,391**	21,936
Accounts payable, accrued expenses and other liabilities	**5,606**	5,797
Short-term debt	**326**	104
Long-term debt	**2,212**	2,436
Nonrecourse obligations	**23**	23
Separate account liabilities	**7,491**	7,288
Total liabilities	**38,049**	37,584

Contingencies Note 17				
Shareholders Equity				
Common stock (par value per share, $0.25; shares issued, 351)		**88**		88
Additional paid-in capital		**2,522**		2,514
Net unrealized appreciation, fixed maturities	**$ 450**		$ 378	
Net unrealized appreciation, equity securities	**4**		4	
Net unrealized depreciation, derivatives	**(26)**		(30)	
Net translation of foreign currencies	**(8)**		(12)	
Postretirement benefits liability adjustment	**(950)**		(958)	
Accumulated other comprehensive loss		**(530)**		(618)
Retained earnings		**8,840**		8,625
Less treasury stock, at cost		**(5,119)**		(5,192)
Total shareholders equity		**5,801**		5,417
Noncontrolling interest		**14**		12
Total equity		**5,815**		5,429
Total liabilities and equity		**$ 43,864**		$ 43,013
Shareholders Equity Per Share		**$ 20.97**		$ 19.75

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

2

Table of Contents

CIGNA Corporation
Consolidated Statements of Comprehensive Income and Changes in Total Equity

	Unaudited			
	2010		2009	
(In millions, except per share amounts) **Three Months Ended March 31,**	**Compre-hensive Income**	**Total Equity**	Compre-hensive Income	Total Equity
Common Stock, January 1 and March 31,		**$ 88**		$ 88
Additional Paid-In Capital, January 1,		**2,514**		2,502
Effects of stock issuance for employee benefit plans		**8**		3
Additional Paid-In Capital, March 31,		**2,522**		2,505
Accumulated Other Comprehensive Loss, January 1,		**(618)**		(1,074)
Net unrealized appreciation, fixed maturities	**$ 72**	**72**	$ 53	53
Net unrealized depreciation, equity securities			(2)	(2)
Net unrealized appreciation on securities	**72**		51	
Net unrealized appreciation, derivatives	**4**	**4**	11	11
Net translation of foreign currencies	**4**	**4**	(28)	(28)
Postretirement benefits liability adjustment	**8**	**8**	4	4
Other comprehensive income	**88**		38	
Accumulated Other Comprehensive Loss, March 31,		**(530)**		(1,036)
Retained Earnings, January 1,		**8,625**		7,374
Shareholders net income	**283**	**283**	208	208
Effects of stock issuance for employee benefit plans		**(57)**		(35)
Common dividends declared (per share: $0.04; $0.04)		**(11)**		(11)
Retained Earnings, March 31,		**8,840**		7,536
Treasury Stock, January 1,		**(5,192)**		(5,298)
Other, primarily issuance of treasury stock for employee benefit plans		**73**		36
Treasury Stock, March 31,		**(5,119)**		(5,262)
Shareholders Comprehensive Income and Shareholders Equity	**371**	**5,801**	246	3,831

Noncontrolling interest, January 1,				**12**				6
Net income attributable to noncontrolling interest		**1**		**1**		1		1
Accumulated other comprehensive income attributable to noncontrolling interest		**1**		**1**				
Noncontrolling interest, March 31,		**2**		**14**		1		7
Total Comprehensive Income and Total Equity	**$**	**373**	**$**	**5,815**	$	247	$	3,838

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

Table of Contents

CIGNA Corporation
Consolidated Statements of Cash Flows

(In millions)	Unaudited Three Months Ended March 31, **2010**	2009
Cash Flows from Operating Activities		
Net income	**$ 284**	$ 209
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**61**	69
Realized investment losses	**6**	36
Deferred income taxes	**51**	150
Gains on sale of businesses (excluding discontinued operations)	**(6)**	(8)
Income from discontinued operations, net of taxes		(1)
Net changes in assets and liabilities, net of non-operating effects:		
Premiums, accounts and notes receivable	**(148)**	(124)
Reinsurance recoverables	**23**	(11)
Deferred policy acquisition costs	**(60)**	(28)
Other assets	**41**	78
Insurance liabilities	**406**	273
Accounts payable, accrued expenses and other liabilities	**(299)**	(464)
Current income taxes	**79**	(90)
Other, net	**(44)**	(17)
Net cash provided by operating activities	**394**	72
Cash Flows from Investing Activities		
Proceeds from investments sold:		
Fixed maturities	**240**	119
Commercial mortgage loans	**1**	
Other (primarily short-term and other long-term investments)	**443**	267
Investment maturities and repayments:		
Fixed maturities	**172**	199
Commercial mortgage loans	**11**	6
Investments purchased:		
Fixed maturities	**(752)**	(543)
Equity securities	**(4)**	
Commercial mortgage loans	**(32)**	(8)
Other (primarily short-term and other long-term investments)	**(145)**	(146)
Property and equipment purchases	**(52)**	(60)
Other (primarily other acquisitions/dispositions)	**(5)**	
Net cash used in investing activities	**(123)**	(166)
Cash Flows from Financing Activities		
Deposits and interest credited to contractholder deposit funds	**354**	373
Withdrawals and benefit payments from contractholder deposit funds	**(309)**	(322)
Change in cash overdraft position	**40**	14
Net change in short-term debt		74

Repayment of long-term debt		**(2)**		(2)
Issuance of common stock		**24**		
Net cash provided by financing activities		**107**		137
Effect of foreign currency rate changes on cash and cash equivalents		**(3)**		(10)
Net increase in cash and cash equivalents		**375**		33
Cash and cash equivalents, January 1,		**924**		1,342
Cash and cash equivalents, March 31,	**$**	**1,299**	$	1,375
Supplemental Disclosure of Cash Information:				
Income taxes paid, net of refunds	**$**	**6**	$	9
Interest paid	**$**	**32**	$	35

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

Table of Contents

CIGNA CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 Basis of Presentation

The Consolidated Financial Statements include the accounts of CIGNA Corporation and its significant subsidiaries (referred to collectively as the Company). Intercompany transactions and accounts have been eliminated in consolidation. These Consolidated Financial Statements were prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

The interim consolidated financial statements are unaudited but include all adjustments (including normal recurring adjustments) necessary, in the opinion of management, for a fair statement of financial position and results of operations for the periods reported. The interim consolidated financial statements and notes should be read in conjunction with the Consolidated Financial Statements and Notes in the Company s Form 10-K for the year ended December 31, 2009.

The preparation of interim consolidated financial statements necessarily relies heavily on estimates. This and certain other factors, such as the seasonal nature of portions of the health care and related benefits business as well as competitive and other market conditions, call for caution in estimating full year results based on interim results of operations.

Certain reclassifications have been made to prior period amounts to conform to the current presentation.

Discontinued operations for the three months ended March 31, 2009 represented a $1 million after-tax benefit from the settlement of certain issues related to a past divestiture.

Unless otherwise indicated, amounts in these Notes exclude the effects of discontinued operations.

Note 2 Recent Accounting Pronouncements

Variable interest entities. Effective January 1, 2010, the Company adopted the Financial Accounting Standards Board s (FASB) amended guidance that requires ongoing qualitative analysis to determine whether a variable interest entity must be consolidated based on the entity s purpose and design, the Company s ability to direct the entity s activities that most significantly impact its economic performance, and the Company s right or obligation to participate in that performance (ASC 810). A variable interest entity is insufficiently capitalized or is not controlled by its equity owners through voting or similar rights. These amendments must be applied to qualifying special-purpose entities and troubled debt restructures formerly excluded from such analysis. On adoption, the Company was not required to consolidate any variable interest entities and there were no effects to its results of operations or financial condition. Although consolidation was not required, disclosures about the Company s involvement with variable interest entities have been provided in Note 10.

Transfers of financial assets. Effective January 1, 2010, the Company adopted the FASB s guidance for accounting for transfers of financial assets (ASC 860) that changes the requirements for recognizing the transfer of financial assets and requires additional disclosures about a transferor s continuing involvement in transferred financial assets. The guidance also eliminates the concept of a qualifying special purpose entity when assessing transfers of financial instruments. On adoption, there were no effects to the Company s results of operations or financial condition.

Fair value measurements. The Company adopted the FASB s updated guidance on fair value measurements (ASU 2010-06) in the first quarter of 2010, which requires separate disclosures of significant transfers between levels in the fair value hierarchy. See Note 7 for additional information.

Other-than-temporary impairments. On April 1, 2009, the Company adopted the FASB s updated guidance for evaluating whether an impairment is other than temporary for fixed maturities with declines in fair value below amortized cost (ASC 320). A reclassification adjustment from retained earnings to accumulated other comprehensive income was required for previously impaired fixed maturities that had a non-credit loss as of the date of adoption, net of related tax effects.

The cumulative effect of adoption increased the Company s retained earnings in the second quarter of 2009 with an offsetting decrease to accumulated other comprehensive income of $18 million, with no overall change to shareholders equity. See Note 8 for information on the Company s other-than-temporary impairments including additional required disclosures.

Table of Contents

Note 3 Earnings Per Share (EPS)

Basic and diluted earnings per share were computed as follows:

(Dollars in millions, except per share amounts) Three Months Ended March 31,	Basic	Effect of Dilution	Diluted
2010			
Shareholders income from continuing operations	**$ 283**		**$ 283**
Shares (in thousands):			
Weighted average	**275,688**		**275,688**
Common stock equivalents		**2,412**	**2,412**
Total shares	**275,688**	**2,412**	**278,100**
EPS	**$ 1.03**	**$ (0.01)**	**$ 1.02**
2009			
Shareholders income from continuing operations	$ 207		$ 207
Shares (in thousands):			
Weighted average	272,591		272,591
Common stock equivalents		277	277
Total shares	272,591	277	272,868
EPS	$ 0.76	$	$ 0.76

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

	Three Months Ended March 31,	
(In millions)	**2010**	2009
Antidilutive options	**5.2**	11.3

The Company held 74,283,513 shares of common stock in Treasury as of March 31, 2010, and 78,169,190 shares as of March 31, 2009.

Table of Contents

Note 4 Health Care Medical Claims Payable

Medical claims payable for the Health Care segment reflects estimates of the ultimate cost of claims that have been incurred but not yet reported, those which have been reported but not yet paid (reported claims in process) and other medical expense payable, which primarily comprises accruals for provider incentives and other amounts payable to providers. Incurred but not yet reported comprises the majority of the reserve balance as follows:

(In millions)	**March 31, 2010**	December 31, 2009
Incurred but not yet reported	**$ 1,185**	$ 790
Reported claims in process	**137**	114
Other medical expense payable	**19**	17
Medical claims payable	**$ 1,341**	$ 921

Activity in medical claims payable was as follows:

	For the period ended	
(In millions)	**March 31, 2010**	December 31, 2009
Balance at January 1,	**$ 921**	$ 924
Less: Reinsurance and other amounts recoverable	**206**	211
Balance at January 1, net	**715**	713
Incurred claims related to:		
Current year	**2,259**	6,970
Prior years	**(50)**	(43)
Total incurred	**2,209**	6,927
Paid claims related to:		
Current year	**1,321**	6,278
Prior years	**507**	647
Total paid	**1,828**	6,925
Ending Balance, net	**1,096**	715
Add: Reinsurance and other amounts recoverable	**245**	206
Ending Balance	**$ 1,341**	$ 921

Reinsurance and other amounts recoverable reflect amounts due from reinsurers and policyholders to cover incurred but not reported and pending claims for minimum premium products and certain administrative services only business where the right of offset does not exist. See Note 11 for additional information on reinsurance. For the three months ended March 31, 2010, actual experience differed from the Company s key assumptions resulting in favorable incurred claims related to prior years medical claims payable of $50 million, or 0.7% of the current year incurred claims as reported for the year ended December 31, 2009. Actual completion factors resulted in a reduction in medical claims payable of $24 million, or 0.3% of the current year incurred claims as reported for the year ended December 31, 2009 for the insured book of business. Actual medical cost trend resulted in a reduction in medical claims payable of $26 million, or 0.4% of the current year incurred claims as reported for the year ended December 31, 2009 for the insured book of business.

For the year ended December 31, 2009, actual experience differed from the Company s key assumptions, resulting in favorable incurred claims related to prior years medical claims payable of $43 million, or 0.6% of the current year incurred claims as reported for the year ended December 31, 2008. Actual completion factors resulted in a reduction of the medical claims payable of $21 million, or 0.3% of the current year incurred claims as reported for the year ended December 31, 2008 for the insured book of business. Actual medical cost trend resulted in a reduction of the medical claims payable of $22 million, or 0.3% of the current year incurred claims as reported for the year ended December 31, 2008 for the insured book of business.

The favorable impacts in 2010 and 2009 relating to completion factors and medical cost trend variances are primarily due to the release of the provision for moderately adverse conditions, which is a component of the assumptions for both completion factors and medical cost trend, established for claims incurred related to prior years. This release was substantially offset by the provision for moderately adverse conditions established for claims incurred related to the current year.

The corresponding impact of prior year development on shareholders net income was not material for the three months ended March 31, 2010 and 2009. The change in the amount of the incurred claims related to prior years in the medical claims payable liability does not directly correspond to an increase or decrease in the Company s shareholders net income recognized for the following reasons:

First, due to the nature of the Company s retrospectively experience-rated business, only adjustments to medical claims payable on accounts in deficit affect shareholders net income. An increase or decrease to medical claims payable on accounts in deficit, in effect, accrues to the Company and directly impacts shareholders net income. An account is in deficit when the accumulated medical costs and administrative charges, including profit charges, exceed the accumulated premium received. Adjustments to medical claims payable on accounts in surplus accrue directly to the policyholder with no impact on the Company s shareholders net income. An account is in surplus when the accumulated premium received exceeds the accumulated medical costs and administrative charges, including profit charges.

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

The determination of liabilities for Health Care medical claims payable required the Company to make critical accounting estimates. See Note 2(N) to the Consolidated Financial Statements in the Company s 2009 Form 10-K.

Table of Contents

Note 5 Cost Reduction

As part of its strategy, the Company has undertaken several initiatives to realign its organization and consolidate support functions in an effort to increase efficiency and responsiveness to customers and to reduce costs.

During 2008 and 2009, the Company conducted a comprehensive review to reduce the operating expenses of its ongoing businesses (cost reduction program). As a result, the Company recognized severance-related and real estate charges in other operating expenses.

Substantially all of these charges were recorded in the Health Care segment, and are expected to be paid in cash by the end of 2010.

Cost reduction activity for 2010 was as follows:

(In millions)	Severance	Real estate	Total
Balance, January 1, 2010	$ 33	$ 8	$ 41
Less: Payments	10	1	11
Balance, March 31, 2010	$ 23	$ 7	$ 30

Note 6 Guaranteed Minimum Death Benefit Contracts

The Company s reinsurance operations, which were discontinued in 2000 and are now an inactive business in run-off mode, reinsured a guaranteed minimum death benefit (GMDB), also known as variable annuity death benefits (VADBe), under certain variable annuities issued by other insurance companies. These variable annuities are essentially investments in mutual funds combined with a death benefit. The Company has equity and other market exposures as a result of this product. In periods of declining equity markets and in periods of flat equity markets following a decline, the Company s liabilities for these guaranteed minimum death benefits increase. Conversely, in periods of rising equity markets, the Company s liabilities for these guaranteed minimum death benefits decrease.

In order to substantially reduce the equity market exposures relating to guaranteed minimum death benefit contracts, the Company operates a dynamic hedge program (GMDB equity hedge program), using exchange-traded futures contracts. The hedge program is designed to offset both positive and negative impacts of changes in equity markets on the GMDB liability. The hedge program involves detailed, daily monitoring of equity market movements and rebalancing the futures contracts within established parameters. While the hedge program is actively managed, it may not exactly offset changes in the GMDB liability due to, among other things, divergence between the performance of the underlying mutual funds and the hedge instruments, high levels of volatility in the equity markets, and differences between actual contractholder behavior and what is assumed. The performance of the underlying mutual funds compared to the hedge instruments is further impacted by a time lag, since the data is not reported and incorporated into the required hedge position on a real time basis. Although this hedge program does not qualify for GAAP hedge accounting, it is an economic hedge because it is designed to reduce and is effective in reducing equity market exposures resulting from this product. The results of the futures contracts are included in other revenue and amounts reflecting corresponding changes in liabilities for these GMDB contracts are included in benefits and expenses.

In 2000, the Company determined that the GMDB reinsurance business was premium deficient because the recorded future policy benefit reserve was less than the expected present value of future claims and expenses less the expected present value of future premiums and investment income using revised assumptions based on actual and expected experience. As a result, the Company increased its reserves. Since that time, the Company has tested for premium deficiency by performing a reserve review on a quarterly basis using current market conditions and assumptions. Under premium deficiency accounting, if the recorded reserve is determined insufficient, an increase to the reserve is reflected as a charge to current period income. Consistent with GAAP, the Company does not recognize gains on premium deficient long duration products.

The Company had future policy benefit reserves for GMDB contracts of $1.2 billion as of March 31, 2010, and $1.3 billion as of December 31, 2009. The determination of liabilities for GMDB requires the Company to make critical accounting estimates. The Company estimates its liabilities for GMDB exposures using a complex internal model run using many scenarios and based on assumptions regarding lapse, future partial surrenders, claim mortality (deaths that result in claims), interest rates (mean investment performance and discount rate) and volatility. Lapse refers to the full surrender of an annuity prior to a contractholder s death. Future partial surrender refers to the fact that most contractholders have the ability to withdraw substantially all of their mutual fund investments while retaining the death benefit coverage in effect at the time of the withdrawal. Mean investment performance for underlying equity mutual funds refers to market rates expected to be earned on the hedging instruments over the life of the GMDB equity hedge program, and for underlying fixed income mutual funds refers to the expected market return over the life of the contracts. Market volatility refers to market fluctuation. These assumptions are based on the Company s experience and future expectations over the long-term period, consistent with the long-term nature of this product. The Company regularly evaluates these assumptions and changes its estimates if actual experience or other evidence suggests that assumptions should be revised. If actual experience differs from the assumptions (including lapse, future partial surrenders, claim mortality, interest rates and volatility) used in estimating these liabilities, the result could have a material adverse effect on the Company s consolidated results of operations, and in certain situations, could have a material adverse effect on the Company s financial condition.

The following provides information about the Company s reserving methodology and assumptions for GMDB as of March 31, 2010:

- The reserves represent estimates of the present value of net amounts expected to be paid, less the present value of net future premiums. Included in net amounts expected to be paid is the excess of the guaranteed death benefits over the values of the contractholders accounts (based on underlying equity and bond mutual fund investments).
- The reserves include an estimate for partial surrenders that essentially lock in the death benefit for a particular policy based on annual election rates that vary from 0-21% depending on the net amount at risk for each policy and whether surrender charges apply.
- The assumed mean investment performance for the underlying equity mutual funds considers the Company s GMDB equity hedge program using futures contracts, and is based on the Company s view that short-term interest rates will average 5% over future periods, but considers that current short-term rates are less than 5%. The mean investment performance assumption for the underlying fixed income mutual funds (bonds and money market) is 5% based on a review of historical returns. The investment performance for underlying equity and fixed income mutual funds is reduced by fund fees ranging from 1-3% across all funds. The results of futures contracts are reflected in the liability calculation as a component of investment returns.
- The volatility assumption is based on a review of historical monthly returns for each key index (e.g. S&P 500) over a period of at least ten years. Volatility represents the dispersion of historical returns compared to the average historical return (standard deviation) for each index. The assumption is 16-27%, varying by equity fund type; 4-10%, varying by bond fund type; and 2% for money market funds. These volatility assumptions are used along with the mean investment performance assumption to project future return scenarios.
- The discount rate is 5.75%.
- The claim mortality assumption is 65-89% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000. For certain contracts, a spousal beneficiary is allowed to elect to continue a contract by becoming its new owner, thereby, postponing the death claim rather than receiving the death benefit currently. For certain issuers of these contracts, the claim mortality assumption depends on age, gender, and net amount at risk for the policy.
- The lapse rate assumption is 0-21%, depending on contract type, policy duration and the ratio of the net amount at risk to account value.

No reserve strengthening was required for GMDB in the first quarter of 2010, primarily due to the stabilization and recovery of equity markets.

In the first quarter of 2009, the Company reported a loss related to GMDB of $75 million pre-tax ($49 million after-tax), which included a charge of $73 million pre-tax ($47 million after-tax) to strengthen GMDB reserves. The

reserve strengthening primarily reflected an increase in the provision for future partial surrenders due to market declines, adverse volatility-related impacts due to turbulent equity market conditions, and interest rate impacts.

Table of Contents

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

	For the period ended	
(In millions)	**March 31, 2010**	December 31, 2009
Balance at January 1	**$ 1,285**	$ 1,609
Add: Unpaid Claims	**36**	34
Less: Reinsurance and other amounts recoverable	**53**	83
Balance at January 1, net	**1,268**	1,560
Add: Incurred benefits	**(23)**	(122)
Less: Paid benefits	**27**	170
Ending balance, net	**1,218**	1,268
Less: Unpaid Claims	**36**	36
Add: Reinsurance and other amounts recoverable	**49**	53
Ending balance	**$ 1,231**	$ 1,285

Benefits paid and incurred are net of ceded amounts. Incurred benefits reflect the favorable or unfavorable impact of a rising or falling equity market on the liability, and include the charges discussed above. As discussed below, losses or gains have been recorded in other revenues as a result of the GMDB equity hedge program to reduce equity market exposures.

The aggregate value of the underlying mutual fund investments was $17.2 billion as of March 31, 2010 and December 31, 2009. The death benefit coverage in force was $6.3 billion as of March 31, 2010 and $7.0 billion as of December 31, 2009. The death benefit coverage in force represents the excess of the guaranteed benefit amount over the value of the underlying mutual fund investments for all contractholders (approximately 570,000 as of March 31, 2010 and 590,000 as of December 31, 2009).

As discussed above, the Company operates a GMDB equity hedge program to substantially reduce the equity market exposures of this business by selling exchange-traded futures contracts, which are expected to rise in value as the equity market declines and decline in value as the equity market rises. In addition, the Company uses foreign currency futures contracts to reduce the international equity market and foreign currency risks associated with this business. The notional amount of futures contract positions held by the Company at March 31, 2010 was $1.0 billion. The Company recorded in other revenues pre-tax losses of $45 million for the three months ended March 31, 2010, and pre-tax gains of $117 million for the three months ended March 31, 2009.

The Company has also written reinsurance contracts with issuers of variable annuity contracts that provide annuitants with certain guarantees related to minimum income benefits (GMIB). All reinsured GMIB policies also have a GMDB benefit reinsured by the Company. See Note 7 for further information.

Note 7 Fair Value Measurements

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

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

Fair values are based on quoted market prices when available. When market prices are not available, fair value is generally estimated using discounted cash flow analyses, incorporating current market inputs for similar financial instruments with comparable terms and credit quality. In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that the Company believes a hypothetical market participant would use to determine a current transaction price. These valuation techniques involve some level of estimation and judgment by the Company which becomes significant with increasingly complex instruments or pricing models.

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

The Company performs ongoing analyses of prices used to value the Company s invested assets to determine that they represent appropriate estimates of fair value. This process involves quantitative and qualitative analysis including reviews of pricing methodologies, judgments of valuation inputs, the significance of any unobservable inputs, pricing statistics and trends. The Company also performs sample testing of sales values to confirm the accuracy of prior fair value estimates. These procedures are overseen by the Company s investment professionals.

Table of Contents

Financial Assets and Financial Liabilities Carried at Fair Value

The following tables provide information as of March 31, 2010 and December 31, 2009 about the Company s financial assets and liabilities carried at fair value. Similar disclosures for separate account assets, which are also recorded at fair value on the Company s Consolidated Balance Sheets, are provided separately as gains and losses related to these assets generally accrue directly to policyholders.

March 31, 2010 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Financial assets at fair value:				
Fixed maturities:				
Federal government and agency	**$ 36**	**$ 528**	**$ 1**	**$ 565**
State and local government		**2,523**		**2,523**
Foreign government		**1,154**	**15**	**1,169**
Corporate		**8,658**	**351**	**9,009**
Federal agency mortgage-backed		**30**		**30**
Other mortgage-backed		**114**	**8**	**122**
Other asset-backed		**84**	**475**	**559**
Total fixed maturities (1)	**36**	**13,091**	**850**	**13,977**
Equity securities	**2**	**86**	**34**	**122**
Subtotal	**38**	**13,177**	**884**	**14,099**
Short-term investments		**188**		**188**
GMIB assets (2)			**479**	**479**
Other derivative assets (3)		**18**		**18**
Total financial assets at fair value, excluding separate accounts	**$ 38**	**$ 13,383**	**$ 1,363**	**$ 14,784**
Financial liabilities at fair value:				
GMIB liabilities	**$**	**$**	**$ 886**	**$ 886**
Other derivative liabilities		**27**		**27**
Total financial liabilities at fair value	**$**	**$ 27**	**$ 886**	**$ 913**

(1) Fixed maturities includes $320 million of net appreciation required to adjust future policy benefits for the run-off

settlement annuity business including $56 million of appreciation for securities classified in Level 3.

(2) *The guaranteed minimum income benefit (GMIB) assets represent retrocessional contracts in place from two external reinsurers which cover 55% of the exposures on these contracts. The assets are net of a liability of $16 million for the future cost of reinsurance.*

(3) *Other derivative assets includes $14 million of interest rate and foreign currency swaps qualifying as cash flow hedges and $4 million of interest rate swaps not designated as accounting hedges.*

December 31, 2009 *(In millions)*	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets at fair value:				
Fixed maturities:				
Federal government and agency	$ 43	$ 527	$ 1	$ 571
State and local government		2,521		2,521
Foreign government		1,056	14	1,070
Corporate		8,241	344	8,585
Federal agency mortgage-backed		34		34
Other mortgage-backed		114	7	121
Other asset-backed		92	449	541
Total fixed maturities (1)	43	12,585	815	13,443
Equity securities	2	81	30	113
Subtotal	45	12,666	845	13,556
Short-term investments		493		493
GMIB assets (2)			482	482
Other derivative assets (3)		16		16
Total financial assets at fair value, excluding separate accounts	$ 45	$ 13,175	$ 1,327	$ 14,547
Financial liabilities at fair value:				
GMIB liabilities	$	$	$ 903	$ 903
Other derivative liabilities		30		30
Total financial liabilities at fair value	$	$ 30	$ 903	$ 933

(1) Fixed maturities includes $274 million of net appreciation required to adjust future policy benefits for the run-off settlement annuity business including $38 million of appreciation for

securities classified in Level 3.

(2) *The GMIB assets represent retrocessional contracts in place from two external reinsurers which cover 55% of the exposures on these contracts. The assets are net of a liability of $15 million for the future cost of reinsurance.*

(3) *Other derivative assets include $12 million of interest rate and foreign currency swaps qualifying as cash flow hedges and $4 million of interest rate swaps not designated as accounting hedges.*

Level 1 Financial Assets

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

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

Level 2 Financial Assets and Financial Liabilities

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

14

Fixed maturities and equity securities. Approximately 93% of the Company s investments in fixed maturities and equity securities are classified in Level 2 including most public and private corporate debt and equity securities, federal agency and municipal bonds, non-government mortgage-backed securities and preferred stocks. Because many fixed maturities and preferred stocks do not trade daily, fair values are often derived using recent trades of securities with similar features and characteristics. When recent trades are not available, pricing models are used to determine these prices. These models calculate fair values by discounting future cash flows at estimated market interest rates. Such market rates are derived by calculating the appropriate spreads over comparable U.S. Treasury securities, based on the credit quality, industry and structure of the asset. Typical inputs and assumptions to pricing models include, but are not limited to, a combination of benchmark yields, reported trades, issuer spreads, liquidity, benchmark securities, bids, offers, reference data, and industry and economic events. For mortgage-backed securities, inputs and assumptions may also include characteristics of the issuer, collateral attributes, prepayment speeds and credit rating. Nearly all of these instruments are valued using recent trades or pricing models. Less than 1% of the fair value of investments classified in Level 2 represents foreign bonds that are valued, consistent with local market practice, using a single unadjusted market-observable input derived by averaging multiple broker-dealer quotes.

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

Other derivatives classified in Level 2 represent over-the-counter instruments such as interest rate and foreign currency swap contracts. Fair values for these instruments are determined using market observable inputs including forward currency and interest rate curves and widely published market observable indices. Credit risk related to the counterparty and the Company is considered when estimating the fair values of these derivatives. However, the Company is largely protected by collateral arrangements with counterparties, and determined that no adjustment for credit risk was required as of March 31, 2010 or December 31, 2009. The nature and use of these other derivatives are described in Note 9.

Level 3 Financial Assets and Financial Liabilities

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

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

Fixed maturities and equity securities. Approximately 6% of fixed maturities and equity securities are priced using significant unobservable inputs and classified in this category, including:

(In millions)	**March 31, 2010**	December 31, 2009
Mortgage and asset-backed securities	**$ 483**	$ 456
Corporate bonds	**286**	288
Subordinated loans and private equity investments	**115**	101
Total	**$ 884**	$ 845

Fair values of mortgage and asset-backed securities and corporate bonds are determined using pricing models that incorporate the specific characteristics of each asset and related assumptions including the investment type and structure, credit quality, industry and maturity date in comparison to current market indices, spreads and liquidity of assets with similar characteristics. For mortgage and asset-backed securities, inputs and assumptions to pricing may also include collateral attributes and prepayment speeds. Recent trades in the subject security or similar securities are assessed when available, and the Company may also review published research as well as the issuer s financial

statements in its evaluation. Subordinated loans and private equity investments are valued at transaction price in the absence of market data indicating a change in the estimated fair values.

Guaranteed minimum income benefit contracts. Because cash flows of the GMIB liabilities and assets are affected by equity markets and interest rates but are without significant life insurance risk and are settled in lump sum payments, the Company reports these liabilities and assets as derivatives at fair value. The Company estimates the fair value of the assets and liabilities for GMIB contracts using assumptions regarding capital markets (including market returns, interest rates and market volatilities of the underlying equity and bond mutual fund investments), future annuitant behavior (including mortality, lapse, and annuity election rates), and non-performance risk, as well as risk and profit charges. As certain assumptions (primarily related to future annuitant behavior) used to estimate fair values for these contracts are largely unobservable, the Company classifies GMIB assets and liabilities in Level 3. The Company considered the following in determining the view of a hypothetical market participant:

- that the most likely transfer of these assets and liabilities would be through a reinsurance transaction with an independent insurer having a market capitalization and credit rating similar to that of the Company; and
- that because this block of contracts is in run-off mode, an insurer looking to acquire these contracts would have similar existing contracts with related administrative and risk management capabilities.

These GMIB assets and liabilities are estimated with a complex internal model using many scenarios to determine the present value of net amounts expected to be paid, less the present value of net future premiums expected to be received adjusted for risk and profit charges that the Company estimates a hypothetical market participant would require to assume this business. Net amounts expected to be paid include the excess of the expected value of the income benefits over the values of the annuitants accounts at the time of annuitization. Generally, market return, interest rate and volatility assumptions are based on market observable information. Assumptions related to annuitant behavior reflect the Company s belief that a hypothetical market participant would consider the actual and expected experience of the Company as well as other relevant and available industry resources in setting policyholder behavior assumptions. The significant assumptions used to value the GMIB assets and liabilities as of March 31, 2010 were as follows:

- The market return and discount rate assumptions are based on the market-observable LIBOR swap curve.

- The projected interest rate used to calculate the reinsured income benefits is indexed to the 7-year Treasury Rate at the time of annuitization (claim interest rate) based on contractual terms. That rate was 3.28% at March 31, 2010 and must be projected for future time periods. These projected rates vary by economic scenario and are determined by an interest rate model using current interest rate curves and the prices of instruments available in the market including various interest rate caps and zero-coupon bonds. For a subset of the business, there is a contractually guaranteed floor of 3% for the claim interest rate.

- The market volatility assumptions for annuitants underlying mutual fund investments that are modeled based on the S&P 500, Russell 2000 and NASDAQ Composite are based on the market-implied volatility for these indices for three to seven years grading to historical volatility levels thereafter. For the remaining 55% of underlying mutual fund investments modeled based on other indices (with insufficient market-observable data), volatility is based on the average historical level for each index over the past 10 years. Using this approach, volatility ranges from 17% to 31% for equity funds, 4% to 12% for bond funds and 1% to 2% for money market funds.

- The mortality assumption is 70% of the 1994 Group Annuity Mortality table, with 1% annual improvement beginning January 1, 2000.

- The annual lapse rate assumption reflects experience that differs by the company issuing the underlying variable annuity contracts, ranges from 2% to 17% and depends on the time since contract issue and the relative value of the guarantee.

- The annual annuity election rate assumption reflects experience that differs by the company issuing the underlying variable annuity contracts and depends on the annuitant s age, the relative value of the guarantee and whether a contractholder has had a previous opportunity to elect the benefit. Immediately after the expiration of

the waiting period, the assumed probability that an individual will annuitize their variable annuity contract is up to 80%. For the second and subsequent annual opportunities to elect the benefit, the assumed probability of election is up to 30%. Actual data is still emerging for the Company as well as the industry and the estimates are based on this limited data.
The nonperformance risk adjustment is incorporated by adding an additional spread to the discount rate in the calculation of both (1) the GMIB liability to reflect a hypothetical market participant s view of the risk of the Company not fulfilling its GMIB obligations, and (2) the GMIB asset to reflect a hypothetical market participant s view of the reinsurers credit risk, after considering collateral. The estimated market-implied spread is company-specific for each party involved to the extent that company-specific market data is available and is based on industry averages for similarly rated companies when company-specific data is not available. The spread is impacted by the credit default swap spreads of the specific parent companies, adjusted to reflect subsidiaries credit ratings relative to their parent company. The additional spread over LIBOR incorporated into the discount rate ranged from 20 to 115 basis points for the GMIB liability and from 0 to 60 basis points for the GMIB reinsurance asset for that portion of the interest rate curve most relevant to these policies.

The risk and profit charge assumption is based on the Company s estimate of the capital and return on capital that would be required by a hypothetical market participant.

Table of Contents

The Company regularly evaluates each of the assumptions used in establishing these assets and liabilities by considering how a hypothetical market participant would set assumptions at each valuation date. Capital markets assumptions are expected to change at each valuation date reflecting current observable market conditions. Other assumptions may also change based on a hypothetical market participant s view of actual experience as it emerges over time or other factors that impact the net liability. If the emergence of future experience or future assumptions differs from the assumptions used in estimating these assets and liabilities, the resulting impact could be material to the Company s consolidated results of operations, and in certain situations, could be material to the Company s financial condition.

GMIB liabilities are reported in the Company s Consolidated Balance Sheets in Accounts payable, accrued expenses and other liabilities. GMIB assets associated with these contracts represent net receivables in connection with reinsurance that the Company has purchased from two external reinsurers and are reported in the Company s Consolidated Balance Sheets in Other assets, including other intangibles. The current S&P financial strength rating of one reinsurer is AA-. The receivable from the second reinsurer is fully collateralized by assets held in a trust.

Table of Contents

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

The following tables summarize the changes in financial assets and financial liabilities classified in Level 3 for the three months ended March 31, 2010 and 2009. These tables exclude separate account assets as changes in fair values of these assets accrue directly to policyholders. Gains and losses reported in these tables may include changes in fair value that are attributable to both observable and unobservable inputs.

For the Three Months Ended March 31, 2010 *(In millions)*	**Fixed Maturities & Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at January 1, 2010	**$ 845**	**$ 482**	**$ (903)**	**$ (421)**
Gains (losses) included in shareholders net income:				
GMIB fair value gain/(loss)			**4**	**4**
Other	**4**			
Total gains (losses) included in shareholders net income	**4**		**4**	**4**
Gains included in other comprehensive income	**12**			
Gains required to adjust future policy benefits for settlement annuities [1]	**18**			
Purchases, issuances, settlements	**(11)**	**(3)**	**13**	**10**
Transfers into/(out of) Level 3:				
Transfers into Level 3	**54**			
Transfers out of Level 3	**(38)**			
Total transfers into/(out of) Level 3	**16**			
Balance at March 31, 2010	**$ 884**	**$ 479**	**$ (886)**	**$ (407)**
Total gains (losses) included in income attributable to instruments held at the reporting date	**$ 4**	**$**	**$ 4**	**$ 4**

(1) Amounts do not accrue to shareholders.

For the Three Months Ended March 31, 2009 *(In millions)*	**Fixed Maturities & Equity Securities**	**GMIB Assets**	**GMIB Liabilities**	**GMIB Net**
Balance at January 1, 2009	$ 889	$ 953	$ (1,757)	$ (804)
Gains (losses) included in shareholders net income:				

GMIB fair value gain/(loss)		(38)	70	32
Other	(4)			
Total gains (losses) included in shareholders net income	(4)	(38)	70	32
Losses included in other comprehensive income	(19)			
Losses required to adjust future policy benefits for settlement annuities [1]	(76)			
Purchases, sales, settlements	(3)	(7)	46	39
Transfers into/(out of) Level 3:				
Transfers into Level 3	155			
Transfers out of Level 3	(32)			
Total transfers into/(out of) Level 3	123			
Balance at March 31, 2009	$ 910	$ 908	$ (1,641)	$ (733)
Total gains (losses) included in income attributable to instruments held at the reporting date	$ (4)	$ (38)	$ 70	$ 32

(1) Amounts do not accrue to shareholders.

Table of Contents

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

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

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

Transfers into or out of the Level 3 category occur when unobservable inputs, such as the Company s best estimate of what a market participant would use to determine a current transaction price, become more or less significant to the fair value measurement. For the three months ended March 31, 2009, transfers into Level 3 from Level 2 primarily reflect an increase in the unobservable inputs used to value certain private corporate bonds, principally related to credit risk of the issuers.

The Company provided reinsurance for other insurance companies that offer a guaranteed minimum income benefit, and then retroceded a portion of the risk to other insurance companies. These arrangements with third-party insurers are the instruments still held at the reporting date for GMIB assets and liabilities in the table above. Because these reinsurance arrangements remain in effect at the reporting date, the Company has reflected the total gain or loss for the period as the total gain or loss included in income attributable to instruments still held at the reporting date. However, the Company reduces the GMIB assets and liabilities resulting from these reinsurance arrangements when annuitants lapse, die, elect their benefit, or reach the age after which the right to elect their benefit expires.

Under FASB s guidance for fair value measurements, the Company s GMIB assets and liabilities are expected to be volatile in future periods because the underlying capital markets assumptions will be based largely on market-observable inputs at the close of each reporting period including interest rates and market-implied volatilities.

The net GMIB fair value gain was $4 million for the three months ended March 31, 2010, and due primarily to favorable equity market returns, offset by declining interest rates.

The net GMIB fair value gain was $32 million for the three months ended March 31, 2009. The gain was due primarily to increases in interest rates since December 31, 2008 partially offset by declines in equity markets and bond fund returns and updates to the lapse assumption.

Table of Contents

Separate account assets

Fair values and changes in the fair values of separate account assets generally accrue directly to the policyholders and are excluded from the Company s revenues and expenses. As of March 31, 2010 and December 31, 2009 separate account assets were as follows:

March 31, 2010 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Guaranteed separate accounts (See Note 17)	**$ 276**	**$ 1,462**	**$**	**$ 1,738**
Non-guaranteed separate accounts [1]	**1,957**	**3,252**	**544**	**5,753**
Total separate account assets	**$ 2,233**	**$ 4,714**	**$ 544**	**$ 7,491**

(1) Non-guaranteed separate accounts include $2.6 billion in assets supporting the Company s pension plans, including $524 million classified in Level 3.

December 31, 2009 *(In millions)*	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Guaranteed separate accounts (See Note 17)	$ 275	$ 1,480	$	$ 1,755
Non-guaranteed separate accounts [1]	1,883	3,100	550	5,533
Total separate account assets	$ 2,158	$ 4,580	$ 550	$ 7,288

(1) Non-guaranteed separate accounts include $2.6 billion in assets

supporting the Company s pension plans, including $517 million classified in Level 3.

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

- equity securities and corporate and structured bonds valued using recent trades of similar securities or pricing models that discount future cash flows at estimated market interest rates as described above; and
- actively-traded institutional and retail mutual fund investments and separate accounts priced using the daily net asset value which is their exit price.

Separate account assets classified in Level 3 include investments primarily in securities partnerships and real estate generally valued based on the separate account s ownership share of the equity of the investee including changes in the fair values of its underlying investments. In addition, certain fixed income funds priced using the net asset values are classified in Level 3 due to restrictions on their withdrawal.

Table of Contents

The following table summarizes the changes in separate account assets reported in Level 3 for the three months ended March 31, 2010 and 2009.

	Three Months Ended March 31,	
(In millions)	**2010**	2009
Balance at January 1	**$ 550**	$ 475
Policyholder gains (losses) [1]	**16**	(46)
Purchases, issuances, settlements	**(3)**	8
Transfers into/(out of) Level 3:		
Transfers into Level 3		174
Transfers out of Level 3	**(19)**	(14)
Net transfers into/(out of) Level 3	**(19)**	160
Balance at March 31	**$ 544**	$ 597

(1) *Includes losses of $15 million and losses of $46 million attributable to instruments still held at March 31, 2010 and March 31, 2009 respectively.*

For the three months ended March 31, 2009, transfers into Level 3 primarily represented fixed income funds that are priced using the net asset value where restrictions were placed on withdrawal.

Assets and Liabilities Measured at Fair Value under Certain Conditions

Some financial assets and liabilities are not carried at fair value each reporting period, but may be measured using fair value only under certain conditions, such as investments in real estate entities and commercial mortgage loans when they become impaired. During the three months ended March 31, 2010, impaired real estate entities carried at cost of $35 million were written down to their fair values of $21 million, resulting in pre-tax realized investment losses of $14 million. Also during the three months ended March 31, 2010, impaired commercial mortgage loans with carrying values of $64 million were written down to their fair values of $53 million, resulting in pre-tax realized investment losses of $11 million. During 2009, impaired commercial mortgage loans with carrying values of $143 million were written down to their fair values of $126 million, resulting in pre-tax realized investment losses of $17 million. Also, during 2009, impaired real estate entities with carrying values of $48 million were written down to their fair values of $12 million, resulting in realized investment losses of $26 million. These fair values were calculated by discounting the expected future cash flows at estimated market interest rates. Such market rates were derived by calculating the appropriate spread over comparable U.S. Treasury rates, based on the characteristics of the underlying collateral including; the type, quality and location of the assets. The fair value measurements were classified in Level 3 because these cash flow models incorporate significant unobservable inputs.

Fair Value Disclosures for Financial Instruments Not Carried at Fair Value

Most financial instruments that are subject to fair value disclosure requirements are carried in the Company s consolidated financial statements at amounts that approximate fair value. The following table provides the fair values

and carrying values of the Company s financial instruments not recorded at fair value that are subject to fair value disclosure requirements at March 31, 2010 and December 31, 2009:

	March 31, 2010		December 31, 2009	
(In millions)	**Fair Value**	**Carrying Value**	Fair Value	Carrying Value
Commercial mortgage loans	**$ 3,407**	**$ 3,493**	$ 3,323	$ 3,522
Contractholder deposit funds, excluding universal life products	**$ 997**	**$ 992**	$ 940	$ 941
Long-term debt, including current maturities, excluding capital leases	**$ 2,578**	**$ 2,427**	$ 2,418	$ 2,427

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

Table of Contents

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

Contractholder deposit funds, excluding universal life products. Generally, these funds do not have stated maturities. Approximately 45% of these balances can be withdrawn by the customer at any time without prior notice or penalty. The fair value for these contracts is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. Most of the remaining contractholder deposit funds are reinsured by the buyers of the individual life and annuity and retirement benefits businesses. The fair value for these contracts is determined using the fair value of these buyers assets supporting these reinsured contracts. The Company had a reinsurance recoverable equal to the carrying value of these reinsured contracts.

Long-term debt, including current maturities, excluding capital leases. The fair value of long-term debt is based on quoted market prices for recent trades. When quoted market prices are not available, fair value is estimated using a discounted cash flow analysis and the Company s estimated current borrowing rate for debt of similar terms and remaining maturities.

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

Note 8 Investments

Total Realized Investment Gains and Losses

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

	Three Months Ended March 31,	
(In millions)	**2010**	2009
Fixed maturities	**$ 15**	$ (16)
Equity securities	**4**	(17)
Commercial mortgage loans	**(11)**	(1)
Other investments, including derivatives	**(14)**	(2)
Realized investment losses, before income taxes	**(6)**	(36)
Less income tax benefits	**(3)**	(12)
Net realized investment losses	**$ (3)**	$ (24)

Table of Contents

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

	Three Months Ended March 31,	
(In millions)	**2010**	2009
Credit-related [1]	**$ 25**	$ 11
Other [2]	**1**	10
Total [3]	**$ 26**	$ 21

(1) Credit-related losses include other-than-temporary declines in value of fixed maturities and equity securities, and impairments of commercial mortgage loans and real estate entities. The amount related to credit losses on fixed maturities for which a portion of the impairment was recognized in other comprehensive income was not significant.

(2) Prior to adoption of GAAP guidance for other-than-temporary impairments on April 1, 2009, other primarily represented the impact of rising market yields on investments where the Company could not demonstrate the intent and ability to hold until recovery.

(3) Includes other-than-temporary impairments on debt

securities of $1 million in the first quarter of 2010 and $17 million in the first quarter of 2009. These impairments are included in the other category in 2010 and in both the credit-related and other categories for 2009.

Fixed Maturities and Equity Securities

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

(In millions)	**As of March 31, 2010**	As of December 31, 2009
Included in fixed maturities:		
Trading securities (amortized cost: $8; $8)	**$ 8**	$ 8
Hybrid securities (amortized cost: $36; $37)	**42**	43
Total	**$ 50**	$ 51
Included in equity securities:		
Hybrid securities (amortized cost: $109; $109)	**$ 86**	$ 81

Fixed maturities and equity securities included $163 million at March 31, 2010, which were pledged as collateral to brokers as required under certain futures contracts. These fixed maturities and equity securities were primarily corporate securities.

The following information about fixed maturities excludes trading and hybrid securities. The amortized cost and fair value by contractual maturity periods for fixed maturities were as follows at March 31, 2010:

(In millions)	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 742	$ 761
Due after one year through five years	4,004	4,266
Due after five years through ten years	4,928	5,268
Due after ten years	2,601	2,922
Mortgage and other asset-backed securities	639	710
Total	$ 12,914	$ 13,927

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

Mortgage-backed assets consist principally of commercial mortgage-backed securities and collateralized mortgage obligations of which $33 million were residential mortgages and home equity lines of credit, all of which were originated using standard underwriting practices and are not considered sub-prime loans.

Gross unrealized appreciation (depreciation) on fixed maturities (excluding trading securities and hybrid securities) by type of issuer is shown below.

	March 31, 2010			
(In millions)	**Amortized Cost**	**Unrealized Appre-ciation**	**Unrealized Depre-ciation**	**Fair Value**
Federal government and agency	**$ 392**	**$ 174**	**$ (1)**	**$ 565**
State and local government	**2,350**	**182**	**(9)**	**2,523**
Foreign government	**1,122**	**52**	**(5)**	**1,169**
Corporate	**8,411**	**606**	**(57)**	**8,960**
Federal agency mortgage-backed	**29**	**1**		**30**
Other mortgage-backed	**120**	**8**	**(7)**	**121**
Other asset-backed	**490**	**74**	**(5)**	**559**
Total	**$ 12,914**	**$ 1,097**	**$ (84)**	**$ 13,927**

(In millions)	December 31, 2009			
Federal government and agency	$ 398	$ 174	$ (1)	$ 571
State and local government	2,341	188	(8)	2,521
Foreign government	1,040	38	(8)	1,070
Corporate	8,104	529	(98)	8,535
Federal agency mortgage-backed	33	1		34
Other mortgage-backed	125	5	(10)	120
Other asset-backed	494	55	(8)	541
Total	$ 12,535	$ 990	$ (133)	$ 13,392

The above table includes investments with a fair value of $2.3 billion supporting the Company s run-off settlement annuity business, with gross unrealized appreciation of $354 million and gross unrealized depreciation of $34 million at March 31, 2010. Such unrealized amounts are required to support future policy benefit liabilities of this business and, as such, are not included in accumulated other comprehensive income. At December 31, 2009, investments supporting this business had a fair value of $2.3 billion, gross unrealized appreciation of $326 million and gross unrealized depreciation of $52 million.

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

	Three Months Ended March 31,	
(In millions)	**2010**	2009
Proceeds from sales	**$ 240**	$ 119
Gross gains on sales	**$ 15**	$ 3
Gross losses on sales	**$ (1)**	$ (3)

Table of Contents

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

- length of time and severity of decline;
- financial health and specific near term prospects of the issuer;
- changes in the regulatory, economic or general market environment of the issuer s industry or geographic region; and
- the Company s intent to sell or the likelihood of a required sale prior to recovery.

Excluding trading and hybrid securities, as of March 31, 2010, fixed maturities with a decline in fair value from amortized cost (which were primarily investment grade corporate bonds) were as follows, including the length of time of such decline:

(In millions)	**Fair Value**	**Amortized Cost**	**Unrealized Depreciation**	**Number of Issues**
Fixed maturities:				
One year or less:				
Investment grade	$ 838	$ 856	$ (18)	222
Below investment grade	$ 89	$ 92	$ (3)	49
More than one year:				
Investment grade	$ 605	$ 661	$ (56)	109
Below investment grade	$ 43	$ 50	$ (7)	16

The unrealized depreciation of investment grade fixed maturities is primarily due to increases in market yields since purchase. Approximately $22 million of the unrealized depreciation is due to securities with a decline in value of greater than 20%. The remaining $62 million of the unrealized depreciation is due to securities with declines in value of less than 20%. There were no equity securities with a fair value significantly lower than cost as of March 31, 2010.

Short-term investments and cash equivalents. Short-term investments and cash equivalents includes corporate securities of $921 million, federal government securities of $171 million and money market funds of $75 million at March 31, 2010. The Company s short-term investments and cash equivalents at December 31, 2009 included corporate securities of $624 million, federal government securities of $402 million and money market funds of $104 million.

Note 9 Derivative Financial Instruments

The Company s investment strategy is to manage the characteristics of investment assets (such as duration, yield, currency and liquidity) to meet the varying demands of the related insurance and contractholder liabilities (such as paying claims, investment returns and withdrawals). As part of this investment strategy, the Company typically uses derivatives to minimize interest rate, foreign currency and equity price risks. The Company routinely monitors exposure to credit risk associated with derivatives and diversifies the portfolio among approved dealers of high credit quality to minimize credit risk. From time to time, the Company has used derivatives to enhance investment returns. In addition, the Company has written or sold contracts to guarantee minimum income benefits.

The Company uses hedge accounting when derivatives are designated, qualified and highly effective as hedges. Effectiveness is formally assessed and documented at inception and each period throughout the life of a hedge using various quantitative methods appropriate for each hedge, including regression analysis and dollar offset. Under hedge accounting, the changes in fair value of the derivative and the hedged risk are generally recognized together and offset each other when reported in shareholders net income.

Table of Contents

The Company accounts for derivative instruments as follows:

- Derivatives are reported on the balance sheet at fair value with changes in fair values reported in net income or accumulated other comprehensive income.
- Changes in the fair value of derivatives that hedge market risk related to future cash flows and that qualify for hedge accounting are reported in a separate caption in accumulated other comprehensive income. These hedges are referred to as cash flow hedges.
- A change in the fair value of a derivative instrument may not always equal the change in the fair value of the hedged item; this difference is referred to as hedge ineffectiveness. Where hedge accounting is used, the Company reflects hedge ineffectiveness in net income (generally as part of realized investment gains and losses).

Certain subsidiaries of the Company are parties to over-the-counter derivative instruments that contain provisions requiring both parties to such instruments to post collateral depending on net liability thresholds and the party s financial strength or credit rating. The collateral posting requirements vary by counterparty. The aggregate fair value of derivative instruments with such credit-risk-related contingent features where a subsidiary of the Company was in a net liability position as of March 31, 2010 was $25 million for which the Company was not required to post collateral with its counterparties. If the various contingent features underlying the agreements were triggered as of March 31, 2010, the Company would be required to post collateral equal to the total net liability. Such subsidiaries are parties to certain other derivative instruments that contain termination provisions for which the counterparties could demand immediate payment of the total net liability position if the financial strength rating of the subsidiary were to decline below specified levels. As of March 31, 2010, there was no net liability position under such derivative instruments.

The tables below present information about the nature and accounting treatment of the Company s primary derivative financial instruments including the Company s purpose for entering into specific derivative transactions, and their locations in and effect on the financial statements as of and for the three months ended March 31, 2010. Derivatives in the Company s separate accounts are excluded from the tables because associated gains and losses generally accrue directly to policyholders.

Table of Contents

Instrument / Volume of Activity	Primary Risk	Purpose	Cash Flows	Accounting Policy
Derivatives Designated as Accounting Hedges	**Cash Flow Hedges**			
Interest rate swaps $159 million of par value of related investments **Foreign currency swaps $179 million of U.S. dollar equivalent par value of related investments** **Combination swaps (interest rate and foreign currency) $54 million of U.S. dollar equivalent par value of related investments**	Interest rate and foreign currency	To hedge the interest and/or foreign currency cash flows of fixed maturities and commercial mortgage loans to match associated liabilities. Currency swaps are primarily euros, Australian dollars, Canadian dollars and British pounds for periods of up to 11 years.	The Company periodically exchanges cash flows between variable and fixed interest rates and/or between two currencies for both principal and interest. Net interest cash flows are reported in net investment income and included in operating activities.	Using cash flow hedge accounting, fair values are reported in other long-term investments or other liabilities and accumulated other comprehensive income and amortized into net investment income or reported in other realized investment gains and losses as interest or principal payments are received.

Fair Value Effect on the Financial Statements (In millions)

	Other Long-Term Investments		**Accounts Payable, Accrued Expenses and Other Liabilities**		**Gain (Loss) Recognized in Other Comprehensive Income**	
					Three Months Ended March 31,	
Instrument	**As of March 31, 2010**	As of December 31, 2009	**As of March 31, 2010**	As of December 31, 2009	**2010**	2009
Interest rate swaps	**$ 9**	$ 8	**$**	$		