MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES

(a wholly owned subsidiary of Sammons Financial Group, Inc.)

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES
(a wholly owned subsidiary of Sammons Financial Group, Inc.)

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Independent Auditor's Report

To the Board of Directors and Shareholder of
Midland National Life Insurance Company and Subsidiaries

We have audited the accompanying consolidated financial statements of Midland National Life Insurance Company and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, of comprehensive income, of stockholder's equity and of cash flows for each of the three years in the period ended December 31, 2012.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Midland National Life Insurance Company and its subsidiaries at December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 2 of the consolidated financial statements, on January 1, 2012, the Company adopted, retrospectively, a change in the method of accounting for the deferral of acquisition costs for new or renewed insurance contracts. Our opinion is not modified with respect to this matter.

PricewaterhouseCoopers LLP

April 9, 2013

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES

(a wholly owned subsidiary of Sammons Financial Group, Inc.)

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2012 and 2011

(Amounts in Thousands)

	2012	2011
ASSETS		
Investments		
Fixed maturities, available-for-sale, at fair value	$ 30,223,820	$27,210,029
Equity securities, available-for-sale, at fair value	375,311	406,809
Mortgage loans	1,107,024	490,031
Policy loans	349,403	340,731
Short-term investments	605,505	290,070
Derivative instruments	306,972	235,342
Other invested assets	838,113	889,972
Total investments	33,806,148	29,862,984
Cash	171,003	165,611
Accrued investment income	273,189	258,004
Deferred policy acquisition costs	1,205,520	1,247,354
Deferred sales inducements	324,262	374,891
Present value of future profits of acquired businesses	16,084	17,176
Other receivables, other assets and property, plant and equipment	128,803	114,550
Reinsurance receivables	2,124,940	2,075,717
Separate account assets	909,762	884,513
Total assets	$ 38,959,711	$ 35,000,800
LIABILITIES		
Policyholder account balances	$ 28,318,326	$26,320,092
Policy benefit reserves	1,174,409	1,129,354
Policy claims and benefits payable	144,479	132,627
Repurchase agreements, other borrowings and collateral on derivative instruments	2,953,579	2,599,406
Derivative instruments	1,660	13,134
Federal income tax liability, net	752,954	266,822
Other liabilities	704,112	646,714
Separate account liabilities	909,762	884,513
Total liabilities	34,959,281	31,992,662
STOCKHOLDER'S EQUITY		
Common stock, $1 par value, 1,000 shares authorized, issued and outstanding	2,549	2,549
Additional paid-in capital	375,003	354,208
Retained earnings	2,156,427	1,885,618
Accumulated other comprehensive income	1,466,451	765,763
Total stockholder’s equity	4,000,430	3,008,138
Total liabilities and stockholder’s equity	$ 38,959,711	$ 35,000,800

The accompanying notes are an integral part of the consolidated financial statements.

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES

(a wholly owned subsidiary of Sammons Financial Group, Inc.)

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010

(Amounts in Thousands)

	2012	2011	2010
REVENUES			
Premiums	$ 201,993	$ 164,718	$ 146,850
Charges on interest sensitive and investment-type products	379,115	338,336	303,885
Net investment income	1,360,396	1,402,512	1,407,708
Net gains on derivatives and derivative instruments	35,472	5,767	191,371
Net realized investment gains (losses)	51,437	(8,206)	94,571
Other-than-temporary impairment losses	(19,319)	(9,853)	(75,139)
Non-credit portion in other comprehensive income	3,860	2,326	3,557
Net impairment loss recognized in earnings	(15,459)	(7,527)	(71,582)
Other income	26,905	14,208	17,738
Total revenue	2,039,859	1,909,808	2,090,541
BENEFITS AND EXPENSES			
Interest credited to policyholder account balances	745,291	816,565	881,856
Benefits incurred	349,217	261,976	302,497
Amortization of deferred sales inducements	78,923	78,655	80,863
Total benefits	1,173,431	1,157,196	1,265,216
Operating and other expenses (net of commissions and other expenses deferred)	175,625	160,005	144,018
Amortization of deferred policy acquisition costs and present value of future profits of acquired businesses	202,443	197,955	206,850
Total benefits and expenses	1,551,499	1,515,156	1,616,084
Income before income taxes	488,360	394,652	474,457
Income tax provision	142,028	108,412	128,435
Net income	$ 346,332	$ 286,240	$ 346,022

The accompanying notes are an integral part of the consolidated financial statements.

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES
(a wholly owned subsidiary of Sammons Financial Group, Inc.)
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010
(Amounts in Thousands)

	2012	2011	2010
Net income	$ 346,332	$ 286,240	$ 346,022
Other comprehensive income:			
Net unrealized gain on available-for-sale investments, non-credit portion of OTTI, and certain interest rate swaps (net of tax $376,166 in 2012, $367,424 in 2011 and $320,272 in 2010)	698,594	682,360	594,792
Pension liability (net of tax $272 in 2012, ($1,755) in 2011 and ($1,760) in 2010)	505	(3,259)	(3,269)
Post-retirement liability (net of tax $856 in 2012, ($2,071) in 2011 and ($654) in 2010)	1,589	(3,845)	(1,214)
Total other comprehensive income	700,688	675,256	590,309
Comprehensive income	$ 1,047,020	$ 961,496	$ 936,331

The accompanying notes are an integral part of the consolidated financial statements.

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES
(a wholly owned subsidiary of Sammons Financial Group, Inc.)
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011 and 2010
(Amounts in Thousands)

	Midland National Life Insurance Co. Stockholder's Equity					
	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Stockholder's Equity
Balance, December 31, 2009	$ 2,549	$ 301,827	$ 1,599,861	$ (483,751)	$ 504,190	$ 1,924,676
Deconsolidation of variable interest entity		16,880			(504,190)	(487,310)
Cumulative effect adjustment on adoption of ASU 2010-26 (net of tax $83,787)			(139,553)	(16,051)		(155,604)
Total Comprehensive income (loss)			346,022	590,309		936,331
Capital contribution		5,000				5,000
Employee stock ownership plan		12,200				12,200
Dividends paid on common stock			(92,260)			(92,260)
Balance, December 31, 2010	2,549	335,907	1,714,070	90,507	-	2,143,033
Total comprehensive income			286,240	675,256		961,496
Capital contribution		5,000				5,000
Employee stock ownership plan		13,301				13,301
Dividends paid on common stock			(114,692)			(114,692)
Balance, December 31, 2011	$ 2,549	$ 354,208	$ 1,885,618	$ 765,763	$ -	$ 3,008,138
Total comprehensive income			346,332	700,688		1,047,020
Capital contribution		2,115				2,115
Employee stock ownership plan		18,680				18,680
Dividends paid on common stock			(75,523)			(75,523)
Balance, December 31, 2012	$ 2,549	$ 375,003	$ 2,156,427	$ 1,466,451	$ -	$ 4,000,430

The accompanying notes are an integral part of the consolidated financial statements.

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES

(a wholly owned subsidiary of Sammons Financial Group, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, and 2010

(Amounts in Thousands)

	2012	2011	2010
OPERATING ACTIVITIES			
Net income	$ 346,332	$ 286,240	$ 346,022
Adjustments to reconcile net income to net cash provided by operating activities			
Amortization of deferred policy acquisition costs, deferred sales inducements and present value of future profits of acquired businesses	281,366	276,610	287,713
Net amortization of premiums and discounts on investments	(129,810)	(154,194)	(131,051)
Amortization of index options	246,893	289,043	179,637
Employee stock ownership plan	18,680	13,301	12,200
Policy acquisition costs deferred	(268,516)	(232,011)	(236,136)
Sales inducements deferred	(88,791)	(81,990)	(92,589)
Net realized investment (gains) losses and net impairment losses recognized in earnings	(35,978)	15,733	(22,989)
Net (gains) on derivatives and derivative instruments	(35,472)	(5,767)	(191,371)
Provision for deferred income taxes	86,702	90,205	16,678
Net interest credited and product charges on universal life and investment policies	610,673	747,044	895,323
Changes in other assets and liabilities			
Net receivables	(34,884)	(79,743)	(23,954)
Net payables	8,793	19,484	69,216
Policy benefits	84,030	52,526	102,645
Other, net	(70,485)	(44,448)	(49,118)
Net cash provided by operating activities	1,019,533	1,192,033	1,162,226

(continued)

MIDLAND NATIONAL LIFE INSURANCE COMPANY AND SUBSIDIARIES

(a wholly owned subsidiary of Sammons Financial Group, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
FOR THE YEARS ENDED DECEMBER 31, 2012, 2011, and 2010

(Amounts in Thousands)

	2012	2011	2010
INVESTING ACTIVITIES			
Proceeds from investments sold, matured or repaid			
Fixed maturities	$ 4,592,800	$ 4,255,557	$ 5,026,800
Equity securities	121,001	131,333	224,575
Mortgage loans	78,968	53,944	52,252
Other invested assets	210,817	206,589	52,778
Cost of investments acquired			
Fixed maturities	(6,166,191)	(5,571,152)	(6,821,533)
Equity securities	(86,211)	(61,026)	(160,158)
Mortgage loans	(698,344)	(307,412)	(61,773)
Derivative instruments	(156,031)	(242,316)	(125,959)
Other invested assets	(26,807)	(21,548)	(31,865)
Change in cash due to deconsolidation of VIE	-	-	(159,827)
Net change in policy loans	(8,673)	(7,545)	(17,207)
Net change in short-term investments	(315,435)	(41,433)	104,634
Net change in collateral on derivatives	55,105	(49,878)	(86,174)
Net change in amounts due to/from brokers	29,793	(160,148)	30,861
Net cash used in investing activities	(2,369,208)	(1,815,035)	(1,972,596)
FINANCING ACTIVITIES			
Receipts from universal life and investment products	$ 3,315,548	$ 2,966,600	$ 2,906,068
Benefits paid on universal life and investment products	(2,186,141)	(2,240,684)	(2,189,030)
Net change in repurchase agreements and other borrowings	299,068	121,872	(38,643)
Capital contributions received	2,115	5,000	5,000
Dividends paid on common stock	(75,523)	(114,692)	(92,257)
Net cash provided by financing activities	1,355,067	738,096	591,138
Net increase (decrease) in cash	5,392	115,094	(219,232)
Cash at beginning of year	165,611	50,517	269,749
Cash at end of year	$ 171,003	$ 165,611	$ 50,517
SUPPLEMENTAL INFORMATION			
Cash paid during the year for			
Income taxes, paid to parent	$ 29,987	$ 62,700	$ 51,374
Interest on other borrowings	2,002	1,940	2,381

The accompanying notes are an integral part of the consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Midland National Life Insurance Company and Subsidiaries ("Midland National" or the "Company") is a wholly owned subsidiary of Sammons Financial Group, Inc. ("SFG"). Midland National is comprised of four subsidiaries. MNL Reinsurance Company ("MNL Re") and Solberg Reinsurance Company ("Solberg Re"), subsidiaries of Midland National, are captive reinsurance companies domiciled in Iowa. SFG Reinsurance Company ("SFG Re"), a subsidiary of Midland National, is a captive reinsurance company domiciled in South Carolina. In October 2012, SFG Re was dissolved and all remaining assets and liabilities were transferred back to its parent company, Midland National. Midland National Services Corporation, LLC ("MNSC") is a Delaware Limited Liability Company created as a wholly owned subsidiary of Midland National to hold agreed amounts for payment of facility fees and other amounts due under a credit facility agreement that governs a letter of credit arrangement between several SFG entities and a large commercial bank. Midland National offers individual life and annuity products in 49 states and the District of Columbia. The Company is affiliated through common ownership with North American Company for Life and Health Insurance ("North American").

Midland National is a limited partner in Guggenheim Partners Opportunistic Investment Grade Securities Fund, LLC ("the Fund"), a private investment company and variable interest entity. In 2009, Midland National was considered the primary beneficiary under accounting guidance previously in effect and owned 50.9% of the Fund. As the primary beneficiary, the Company consolidated the Fund in its consolidated financial statements. In accordance with new guidance issued by the Financial Accounting Standards Board ("FASB"), the Company deconsolidated the Fund as of January 1, 2010. See Note 6 for further discussion of the deconsolidation of the Fund.

Basis of presentation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") and reflect the consolidation of the Company with its wholly owned subsidiaries and all entities for which it holds a controlling financial interest. Intercompany transactions have been eliminated in consolidation.

The Company has a financial interest in several entities where it is required to determine whether the entity should be consolidated in the Company's financial statements. For each financial interest, the Company performs an analysis to determine whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity ("VIE"). The analysis requires the evaluation of several characteristics, including the determination of whether an entity has sufficient equity at risk to allow it to adequately finance its activities, the determination of whether the party with the power to direct the activities of the entity has equity investment at risk in the entity, and whether the equity investment at risk lacks the obligation to absorb expected losses or the right to receive expected residual returns.

Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance its activities independently and the equity holders have the obligation to absorb losses, the right to receive residual returns, and the right to make decisions about the entity's activities. The usual condition for a controlling financial interest in an entity is ownership of a majority voting interest. Accordingly, the Company consolidates voting interest entities in which it has a majority voting interest.

If an entity is determined to be a VIE, the next step is the identification of the primary beneficiary of the VIE. An enterprise is deemed to be the primary beneficiary of a VIE if it has both (i) the power to direct the activities of the entity that most significantly impact the VIE's economic success and (ii) has the obligation to absorb losses or receive benefits that could potentially be significant to the VIE, or both. The Company determines whether it is the primary beneficiary of a VIE by performing an analysis that principally considers: (i) the VIE's purpose and design, including the risks the VIE was designed to create and pass through to its variable interest holders, (ii) the VIE's capital structure, (iii) the terms between the VIE and its variable interest holders and other parties involved with the VIE, (iv) which variable interest holders have the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, (v) which variable interest holders have the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE and (vi) related party relationships. The party that is the primary beneficiary consolidates the financial results of the VIE. The Company will continue to assess its investments on an ongoing basis as circumstances may change whereby an entity could be determined to be a VIE. The Company could become a primary beneficiary in such a VIE, or an entity's characteristics could change whereby it is no longer a VIE. All of these situations could potentially have a corresponding impact on the Company's consolidated financial statements.

When the Company does not have a controlling financial interest in an entity but exerts significant influence over the entity's operating and financial policies (generally defined as owning a voting interest of 20% to 50%) and has an investment in common stock or in-substance common stock, the Company accounts for its investment using the equity method of accounting. For certain limited partnerships, the threshold for the equity method of accounting is 5%.

See Note 6 for further discussion related to the Company's involvement with VIEs.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount 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. Actual results could differ significantly from those estimates.

The most significant areas which require the use of management's estimates relate to the determination of the fair values of financial assets and liabilities, derivatives and derivative instruments, impairment of securities, income taxes, deferred policy acquisition costs ("DAC"), deferred sales inducements ("DSI"), present value of future profits of acquired businesses ("PVFP"), reinsurance receivables and policy benefit reserves for traditional life insurance policies.

Interest rate risk

The Company is subject to the risk that interest rates will change and cause changes in investment prepayments and changes in the value of its investments. Policyholder persistency is also affected by changes in interest rates. The Company manages its interest rate risk by monitoring its asset and liability durations within a pre-determined range. It will mitigate this risk by rebalancing assets when it approaches the boundaries of the pre-determined range. To the extent that fluctuations in interest rates cause the cash flows and duration of assets and liabilities to differ from product pricing assumptions, the Company may have to sell assets prior to their maturity and realize a loss.

Liquidity risk

Market conditions for fixed income securities could be such that illiquidity in the markets could make it difficult for the Company to sell certain securities and generate cash to meet policyholder obligations. Management believes it has adequate liquidity in its investment portfolio and other sources of funds to meet any future policyholder obligations.

Counterparty risk

The Company enters into derivative and repurchase agreements with various financial institution counterparties. The Company is at risk that any particular counterparty will fail to fulfill its obligations under outstanding agreements. The Company limits this risk by selecting counterparties with long-standing performance records and with credit ratings of “A” or above. The amount of exposure to each counterparty is essentially the net replacement cost or fair value for such agreements with each counterparty, as well as any interest due the Company from the last interest payment period less any collateral posted by the counterparty.

Fair value of financial assets, financial liabilities, and financial instruments

The Company can elect an option to record at fair value certain financial assets and financial liabilities. The election is irrevocable and is made contract by contract. The Company has elected to utilize the fair value option for certain fixed income securities designated as hybrid instruments.

Fair value estimates are significantly affected by the assumptions used, including discount rates and estimates of future cash flows. Although fair value estimates are calculated using assumptions that management believes are appropriate, changes in assumptions could cause these estimates to vary materially. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in some cases, could not be realized in the immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented in Note 3 may not represent the underlying value to the Company.

The Company uses the following methods and assumptions in estimating the fair value of its financial instruments:

Available-for-sale securities

Fair value for fixed maturity and equity securities is obtained primarily from independent pricing sources, broker quotes and fair value/cash flow models. Fair value is based on quoted market prices, where available. For securities not actively traded, fair value is estimated using values obtained from independent pricing services or broker quotes. When values are not available from pricing services or broker quotes, such as private placements including corporate securities, asset-backed securities, commercial mortgage-backed and residential mortgage-backed securities, fair value may be estimated by discounting expected future cash flows using a current market rate applicable to the yield, credit quality and maturity of the investments.

Mortgage loans

Fair value for mortgage loans is estimated using a duration-adjusted pricing methodology that reflects changes in market interest rates and the specific interest-rate sensitivity of each mortgage. Price changes derived from the monthly duration-adjustments are applied to the mortgage portfolio. Each mortgage modeled is assigned a spread corresponding to its risk profile for valuation purposes. For fair value reporting purposes, these spreads are adjusted for current market conditions. Fair value is also adjusted by internally generated illiquidity and default factors.

Short-term investments

The carrying amounts for short-term investments, which primarily consist of money market funds, direct reverse repurchase agreements and fixed income securities acquired with less than one year to maturity, approximate fair value due to their short-term nature.

Derivative instruments

Fair value for options is based on internal financial models or counterparty quoted prices. Variation margin accounts, consisting of cash balances applicable to open futures contracts, held by counterparties are reported at the cash balances, which is equal to fair value. Fair value for interest rate swaps, credit default swaps, interest rate floors and other derivatives is based on exchange prices, broker quoted prices or fair values provided by the counterparties.

Other invested assets

Other invested assets consist primarily of limited partnerships. The Company measures the fair value of these investments on the basis of the net asset value per share of the investment (or its equivalent) if the net asset value of the investment (or its equivalent) is calculated in a manner consistent with the measurement guidance issued by the Financial Accounting Standards Board ("FASB") for investment companies as of the reporting entity's measurement date.

Reinsurance receivables – embedded derivatives from reinsurance ceded

Fair value for embedded derivatives related to coinsurance with funds withheld treaties for indexed annuities is determined based on fair values of the financial instruments in the funds withheld portfolios and on models the Company has developed to estimate the fair values of the liabilities ceded.

Separate account assets

Separate account assets are reported at fair value in the consolidated balance sheets based on quoted net asset values of the underlying mutual funds.

Policyholder account balances

Fair value for the Company's liabilities under investment-type insurance contracts is estimated using two methods. For those contracts without a defined maturity, the fair value is estimated as the amount payable on demand (cash surrender value). For those contracts with known maturities, fair value is estimated using discounted cash flow calculations using interest rates currently being offered for similar contracts with maturities consistent with the contracts being valued. The reported value of the Company's investment-type insurance contracts includes the fair value of indexed life and annuity embedded derivatives which are calculated using discounted cash flow valuation techniques based on current interest rates adjusted to reflect credit risk and an additional provision for adverse deviation.

Repurchase agreements, other borrowings and collateral on derivative instruments

The fair value of the Company's repurchase agreements is tied to the fair value of the underlying collateral securities. The fair value of other borrowings which primarily consists of borrowings from the Federal Home Loan Bank of Des Moines ("FHLB"), approximates its reported value due to its short maturity. The fair value of the note payable to Guggenheim Life and Annuity Company is based on discounted future cash flows using a current market rate applicable to the yield, credit quality and maturity of the note. The fair value of collateral on derivative instruments approximates the carrying value due to the short-term nature of the investment. These investments primarily consist of money market funds.

Investments and investment income

Available-for-sale securities

The Company is required to classify its fixed maturity investments (bonds and redeemable preferred stocks) and equity securities (common and non-redeemable preferred stocks) into three categories: securities that the Company has the positive intent and the ability to hold to maturity are classified as "held-to-maturity;" securities that are held for current resale are classified as "trading securities;" and securities not classified as held-to-maturity or as trading securities are classified as "available-for-sale." Investments classified as trading or available-for-sale are required to be reported at fair value in the consolidated balance sheets. The Company currently has no securities classified as held-to-maturity or trading.

Available-for-sale securities are classified as such if not considered trading securities or if there is not the positive intent and ability to hold the securities to maturity. Such securities are carried at fair value with the unrealized holding gains (losses) and non-credit related impairment losses included as a component of other comprehensive income (loss) ("OCI") in the consolidated statements of comprehensive income. OCI is reported net of related adjustments to DAC, DSI, deferred income taxes, and the accumulated unrealized holding gains (losses) on securities sold which are released into income as realized investment gains (losses).

For collateralized mortgage obligations ("CMOs") and mortgage-backed securities, the Company recognizes income using a constant effective yield based on anticipated prepayments and the estimated economic life of the securities. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date and anticipated future payments. The net investment in the security is adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the security. This adjustment is included in net investment income. Included in this category is approximately $169,228 and $109,464 of mortgaged-backed securities that are all or partially collateralized by sub-prime mortgages at December 31, 2012 and 2011, respectively. A sub-prime mortgage is defined as a mortgage with one or more of the following attributes: weak credit score, high debt-to-income ratio, high loan-to-value ratio or undocumented income. At December 31, 2012 and 2011, 58% and 62%, respectively of the Company's securities with sub-prime exposure are rated as investment grade.

Mortgage loans

Mortgage loans consist principally of commercial mortgage loans and are carried at the adjusted unpaid balances. The Company's lending policies allow for primarily first-lien mortgages that do not exceed 75% of the fair market value of the property allowing for sufficient excess collateral to absorb losses should we be required to foreclose and take possession of the collateral. The mortgage portfolio invests primarily in larger metropolitan areas across the U.S. and is diversified by type of property. Property and casualty insurance is required on all properties covered by mortgage loans at least equal to the excess of the loan over the maximum loan which would be permitted by law on the land without the buildings. Interest income on non-performing loans is generally recognized on a cash basis.

The Company's mortgage loan portfolio includes reverse mortgages, which are first liens on the related residential properties located primarily in California and Florida. At December 31, 2012 and 2011, the reported value of these reverse mortgages were $26,593 and $29,301, respectively. Income on reverse mortgages is recognized using an effective yield based on the contractual interest rate and anticipated repayment of the mortgage. The reverse mortgages have a Principal Limit Factor ("PLF") that defines the maximum amount that can be advanced to a borrower. The PLF is a function of the age of the borrower and co-borrower, if any, and the appraised value of the residential property. The maximum PLF in the Company's reverse mortgage portfolio is 62.5% of the underlying property value at the time of mortgage origination.

Policy loans

Policy loans are carried at unpaid principal balances.

Short-term investments

Short-term investments primarily include fixed income securities, stated at amortized cost, acquired with less than one year to maturity, direct reverse repurchase agreements and money market funds.

Derivative instruments

Derivative instruments consist of options, futures, interest rate floors, interest rate and credit default swaps. Options, interest rate floors, interest rate swaps and credit default swaps are reported at fair value. Futures are reported at the cash balances held in counterparty variation margin accounts, which amount equals fair value.

Other invested assets

Other invested assets are primarily comprised of limited partnerships. Limited partnerships are recorded on the cost or equity method of accounting depending on the respective ownership percentage, ability to control or election to apply fair value accounting. In most cases, the carrying amounts represent the Company's share of the entity's underlying equity reported in its balance sheet. In situations where the Company has an ownership of less than 5%, the limited partnership is carried at cost. These investments are reviewed for impairment on a periodic basis. The aggregate carrying value of investments recorded on the cost method was $22,589 and $36,363 as of December 31, 2012 and 2011, respectively.

Other-than-temporary impairment losses

The Company reviews its investments to determine if declines in value are other-than-temporary. If the fair value of a fixed maturity security is less than its amortized cost basis at the balance sheet date, the Company must assess whether the impairment is other-than-temporary. For fixed income securities, the primary factor the Company considers in its assessment of whether a decline in value is other-than-temporary is the issuer's ability to pay the amounts due according to the contractual terms of the investment. Additional factors considered in evaluating whether a decline in value is other-than-temporary are the length of time and magnitude by which the fair value is less than amortized cost, adverse conditions specifically related to the security, changes to the rating of the security by a rating agency, changes in the quality of underlying credit enhancements and changes in the fair value of the security subsequent to the balance sheet date.

When an other-than-temporary impairment ("OTTI") has occurred, the amount of the impairment charged against earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis, the entire impairment is recognized as a charge against earnings. If the Company does not intend to sell the security and it is not more likely than not it will be required to sell the security before recovery of its amortized cost basis, the impairment is bifurcated into a credit related loss and a non-credit related loss. The credit related loss is measured as the difference between the present value of cash flows expected to be collected from the debt security and the debt security's amortized cost. The amount of the credit related loss is recognized as a charge against earnings. The difference between the unrealized loss on the impaired debt security and the credit related loss charged against earnings is the non-credit related loss that is recognized in accumulated other comprehensive income.

The Company uses a single best estimate of cash flows approach and uses the effective yield prior to the date of impairment to calculate the present value of cash flows. The Company's assumptions for residential mortgage-backed securities, commercial mortgage-backed securities, other asset-backed securities and collateralized debt obligations include collateral pledged, scheduled interest payments, default levels, delinquency rates and the level of nonperforming assets for the remainder of the investments' expected term. The Company's assumptions for corporate and other fixed maturity securities include scheduled interest payments and an estimated recovery value, generally based on a percentage return of the current market value.

After an other-than-temporary write-down, the new cost basis is the prior amortized cost less the credit loss. The adjusted cost basis is generally not adjusted for subsequent recoveries in fair value. However, if the Company can reasonably estimate future cash flows after a write-down and the expected cash flows indicate some or all of the credit related loss will be recovered, the discount or reduced premium recorded is amortized over the remaining life of the security. Amortization in this instance is computed using the prospective method and is determined based on the current estimate of the amount and timing of future cash flows.

During 2012, 2011 and 2010, the Company recorded $15,459, $7,527 and $71,582, respectively, of realized losses as a result of OTTI. These losses are included in net impairment loss recognized in earnings in the consolidated statements of income.

Investment income

Investment income is recorded when earned and includes interest received and accrued, amortization of purchased premium and discounts on securities, proceeds from derivatives and equity earnings from limited partnerships. Net realized investment gains (losses) are determined on the basis of specific identification of the investments. Dividends are recorded on the ex-dividend date.

See Note 4 for further discussion of the Company's investments and investment income.

Cash

Cash consists of demand deposits and non-interest bearing deposits held by various commercial and custodial banks. The Company has deposits with certain financial institutions which exceed federally insured limits. The Company has reviewed the creditworthiness of these financial institutions and believes there is minimal risk of material loss.

Derivatives and derivative instruments

The Company uses derivative instruments to manage its fixed indexed and policy obligation interest guarantees and interest rate and credit risks applicable to its investments. To mitigate these risks, the Company enters into interest rate and credit default swap agreements, futures contracts and equity indexed call options. To qualify for hedge accounting, the Company is required to formally document the hedging relationship at the inception of each derivative transaction. This documentation includes the specific derivative instrument, risk management objective, hedging strategy, identification of the hedged item, specific risk being hedged and how effectiveness will be assessed. To be considered an effective hedge, the derivative must be highly effective in offsetting the variability of the cash flows or the changes in fair value of the hedged item. Effectiveness is evaluated on a retrospective and prospective basis.

Derivative instruments are carried at fair value, with certain changes in fair value reflected in OCI in the consolidated statements of comprehensive income (for those derivatives designated as effective “cash flow hedges”) while other changes in derivative fair value related to non-hedge derivatives are reflected as net gains (losses) on derivatives and derivative instruments in the consolidated statements of income.

The Company has certain reinsurance arrangements and debt instruments containing embedded derivatives due to the incorporation of credit risk exposures that are not clearly and closely related to the creditworthiness of the obligor.

The agreements between the Company and its derivatives counterparties require the posting of collateral when the market value of the derivative instruments exceeds the cost of the instruments. Collateral posted by counterparties is reported in the consolidated balance sheets in short-term investments with a corresponding liability reported in repurchase agreements, other borrowings and collateral on derivative instruments. Collateral posted by the Company is reported in the consolidated balance sheets as a component of other receivables, other assets and property, plant and equipment.

See Note 5 for further discussion of the Company’s derivatives and derivative instruments.

Accrued investment income

Accrued investment income consists of amounts due on invested assets. It excludes amounts the Company does not expect to receive.

Deferred policy acquisition costs

Policy acquisition costs that vary with, and are primarily related to the successful acquisition of new and renewal insurance contracts are deferred to the extent that such costs are deemed recoverable from future profits. The costs result directly from and are essential to the contract transaction and would not have been incurred by the Company had the contract transaction not occurred. Such costs include commissions, policy issuance, underwriting and medical inspection fees. For traditional insurance policies, such costs are amortized over the estimated premium paying period of the related policies in proportion to the ratio of the annual premium revenues to the total anticipated premium revenues. For interest sensitive policies, these costs are amortized over the lives of the policies in relation to the present value of actual and estimated gross profits. Recoverability of DAC is evaluated on an annual basis by comparing the current estimate of future profits to the unamortized asset balance.

See Note 8 for further discussion of the Company's DAC.

Deferred sales inducements

The Company defers certain sales inducement costs. Sales inducements consist of premium bonuses and bonus interest on the Company's life and annuity products. The Company accounts and reports for certain sales inducements whereby capitalized costs are reported separately in the consolidated balance sheets and the amortization of the capitalized sales inducements is reported as a separate component of insurance benefits in the consolidated statements of income in accordance with authoritative guidance.

See Note 8 for further discussion of the Company's DSI.

To the extent that unrealized investment gains or losses on available-for-sale securities would result in an adjustment to the amortization pattern of DAC and DSI had those gains or losses actually been realized, the adjustments are recorded directly to stockholder's equity through OCI as an offset to the unrealized investment gains or losses on available-for-sale securities.

Present value of future profits of acquired businesses

The PVFP represents the portion of the purchase price of blocks of businesses that was allocated to the future profits attributable to the insurance in force at the dates of acquisition. The PVFP is amortized in relationship to the actual and expected emergence of such future profits. Based on current conditions and assumptions as to future events, the Company expects to amortize $1,020, $1,129, $963, $996 and $798 of the existing PVFP over the next five years. Recoverability of the PVFP is evaluated periodically by comparing the current estimate of future profits to the unamortized asset balance.

See Note 8 for further discussion of the Company's PVFP.

Retrospective adjustments of DAC, DSI, and PVFP are made periodically upon revision of current or estimates of future gross profits on interest sensitive and investment-type products to be realized from a group of policies.

Reinsurance receivables

Liabilities ceded to reinsurance companies and receivables related to obligations due from those reinsurers to the Company are reported as reinsurance receivables. Funds withheld liabilities and embedded derivatives associated with certain annuity coinsurance with funds withheld agreements are also reported as reinsurance receivables in the consolidated balance sheets. The Company uses reinsurance for risk mitigation on life and annuity products and, in certain cases, capital relief. The Company generally reinsures the excess of each individual risk over $1,000 on ordinary life policies in order to spread its risk of loss. The Company remains contingently liable for the liabilities ceded in the event the reinsurers are unable to meet their obligations under the reinsurance agreements. To limit the possibility of such losses, the Company evaluates the financial condition of its reinsurers and monitors its concentration of credit risk. The Company generally reinsures with companies rated "A" or better by A.M. Best. The Company monitors these ratings on an on-going basis as it is at risk that a reinsurer may be downgraded after an agreement has been entered.

Separate account assets and liabilities

The separate accounts held by the Company are funds on which investment income and gains or losses accrue directly to certain policyholders. The assets of these accounts are legally separated and are not subject to the claims that may arise out of any other business of the Company. The Company reports its separate account assets at fair value. The underlying investment risks are assumed by the policyholders. The Company records the related liabilities at amounts equal to the fair value of the underlying assets. The Company reflects these assets and liabilities in separate account assets and liabilities in the consolidated balance sheets. The Company reports the fees earned for administrative and policyholder services performed for the separate accounts as a component of other income in the consolidated statements of income.

Policy claims and benefits payable

The liability for policy claims and benefits payable includes provisions for reported claims and estimates for claims incurred but not reported, based on the terms of the related policies and contracts and on prior experience. Claim liabilities are based on estimates and are subject to future changes in claim severity and frequency. Estimates are periodically reviewed and adjustments are reflected in benefits incurred in the consolidated statements of income.

Recognition of traditional life insurance revenue and policy benefits

Traditional life insurance products include those products with fixed and guaranteed premiums and benefits. Life insurance premiums are recognized as premium income when due. Benefits and expenses are associated with earned premiums so as to result in recognition of profits over the life of the contracts. This association is accomplished by means of the provision for policy benefit reserves and the amortization of DAC.

Policy benefit reserves for traditional life insurance policies reported in the consolidated balance sheets of $1,174,409 and $1,129,354 at December 31, 2012 and 2011, respectively, generally are computed by the net level premium method based on estimated future investment yield, mortality, morbidity and withdrawals that were appropriate at the time the policies were issued or acquired. Interest rate assumptions ranged from and 6.00% to 9.00% in 2012 and 2011.

Recognition of revenue and policy benefits for interest sensitive life insurance products and investment contracts ("interest sensitive policies")

Interest sensitive policies are issued on a periodic and single premium basis. Amounts collected are credited to policyholder account balances. Revenues from interest sensitive policies consist of charges assessed against policyholder account balances for the cost of insurance, policy administration, and surrender charges. Revenues also include investment income related to the investments that support the policyholder account balances. Policy benefits and claims that are charged to expense include benefits incurred in the period in excess of related policyholder account balances. Benefits also include interest and fixed index amounts credited to the account balances.

Policyholder reserves for universal life and other interest sensitive life insurance and investment contracts, reported in the consolidated balance sheets as policyholder account balances of $28,318,326 and $26,320,092 at December 31, 2012 and 2011, respectively, are determined using the retrospective deposit method. Policy reserves consist of the policyholder deposits and credited interest and fixed index credits less withdrawal charges for mortality and policy administrative expenses. Interest crediting rates ranged primarily from 1.00% to 6.60% in 2012 and 2011. For certain contracts, these crediting rates extend for periods in excess of one year.

Repurchase agreements

As part of its investment strategy, the Company enters into repurchase agreements to increase the Company's investment return. The Company accounts for these transactions as secured borrowings, where the amount borrowed is tied to the fair value of the underlying collateral securities. Repurchase agreements involve a sale of securities and an agreement to repurchase the same securities at a later date at an agreed-upon price. As of December 31, 2012 and 2011, there were $2,184,795 and $2,185,727, respectively, of such agreements outstanding. The collateral for these agreements is held in fixed maturities in the consolidated balance sheets.

Dividends and distributions

Payment of dividends or other distributions of the insurance subsidiaries are limited by statute, which is generally limited to the greater of the insurance companies' prior year statutory net gain from operations or 10% of the insurance companies' statutory surplus as regards policyholders at the previous year end date.

See Note 13 for further discussion on the Company's statutory financial data and dividend restrictions.

Income taxes

The Company and its eligible subsidiaries file a consolidated Federal income tax return with Sammons Enterprises, Inc. ("SEI") and its other eligible subsidiaries. The policy for intercompany allocation of Federal income taxes is that the Company computes the provision for income taxes on a separate return basis as if the Company and its eligible subsidiaries were filing their own consolidated return. The Company makes payment to, or receives payment from, SFG in the amount it would have paid to, or received from, the Internal Revenue Service ("IRS") had it filed a consolidated tax return with only its own subsidiaries. The separate Company provisions and payments are computed using the tax elections made by SEI.

The Company recognizes deferred income tax assets and liabilities for the expected future tax effects attributable to temporary differences between the financial statement and tax return bases of assets and liabilities, based on enacted tax rates expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be realized or settled. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that all or some portion of the deferred tax assets will not be realized.

If applicable, the Company's liability for income taxes would include a liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the IRS or other taxing jurisdictions. The Company recognizes tax benefits only on tax positions where it is more likely than not to prevail if reviewed by the IRS or another taxing authority.

Comprehensive income

Comprehensive income for the Company includes net income and OCI, which includes changes in pension liability and post-retirement liability, net unrealized investment gains (losses) on available-for-sale securities, non-credit portion of OTTI losses, and interest rate swaps accounted for as cash flow hedges (net of related adjustments to intangibles and deferred income taxes).

2. EFFECTS OF NEW AUTHORITATIVE GUIDANCE

Recently adopted authoritative guidance

Fair value measurements

Effective January 1, 2011, the Company adopted additional guidance on improving disclosures for fair value measurements. The new disclosures include gross presentation of activities within the Level 3 roll forward. The adoption of the new guidance had no impact on the consolidated financial statements, but did increase the disclosures related to fair value.

See Note 3 for further discussion of the Company's Fair Value of Financial Instruments.

In May 2011, the FASB issued guidance related to fair value measurement and disclosure, which substantially converged GAAP with International Financial Reporting Standards ("IFRS"). This guidance is largely consistent with existing fair value measurement principles in GAAP; however, disclosure requirements have been expanded. The expanded disclosures include all Level 3 fair value measurements, quantitative information about significant unobservable inputs used and a description of the valuation processes in place. The Company adopted this guidance effective January 1, 2012. The adoption of the new guidance had no impact on the consolidated financial statements, but did increase the disclosures related to quantitative information about significant unobservable inputs used and a description of the valuation process for Level 3 fair value measurements.

Investments held through separate accounts

Effective January 1, 2011, the Company adopted guidance that clarifies an insurance entity should not consider any separate account interests held for the benefit of policyholders in an investment to be the insurer's interests. Additionally, the guidance does not require an insurer to consolidate an investment in which a separate account holds a controlling financial interest if the investment is not or would not be consolidated in the standalone financial statements of the separate account. The guidance also directs how an insurer should consolidate an investment fund in situations in which the insurer concludes that consolidation is required. The adoption of this guidance had no effect on the consolidated financial statements.

Allowance for credit losses

In July 2010, the FASB issued guidance related to disclosures about the credit quality of financing receivables and the allowance for credit losses. The guidance requires disclosures that facilitate financial statement users in evaluating the nature of credit risk inherent in the portfolio of financing receivables; how that risk is analyzed and assessed in arriving at the allowance for credit losses; and any changes and the reasons for those changes to the allowance for credit losses. The guidance requires several new disclosures regarding the reserve for credit losses and other disclosures related to the credit quality of the Company's mortgage loan portfolio. The Company adopted the guidance on January 1, 2011. The adoption of the new guidance had no impact on the consolidated financial statements, but did increase the disclosures about the allowance for credit losses.

See Note 4 for further discussion of the Company's Investments and Net Investment Income.

Deferred policy acquisition costs

In October 2010, the FASB issued guidance on accounting for costs associated with acquiring or renewing insurance contracts. The guidance addresses diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The guidance prescribes that certain incremental direct costs of successful initial or renewal contract acquisitions may be deferred. The guidance defines incremental direct costs as those costs that result directly from and are essential to the contract transaction and would not have been incurred by the insurance entity had the contract transaction not occurred. The guidance also clarifies the definition of the types of incurred costs that may be capitalized and the accounting and recognition treatment of advertising, research, and other administrative costs related to the acquisition of insurance contracts. The Company retrospectively adopted this guidance on January 1, 2012. The adoption reduced January 1, 2010 stockholder's equity by $155,604, net of tax of $83,787. Net income was reduced by $1,366 and $6,450 for the years ended December 31, 2011 and 2010, respectively. The following tables present the effect of the change on financial statement line items for prior periods that were retrospectively adjusted:

(Dollars in Thousands)

	December 31, 2011			
	As originally reported	As of Jan 1, 2010	2010 and 2011 Transactions	As Adjusted
Assets:				
Deferred policy acquisition costs	$ 1,397,148	$ (170,580)	$ 20,786	$ 1,247,354
Deferred sales inducements	374,354	852	(315)	374,891
Total Assets	**35,150,057**	**(169,728)**	**20,471**	**35,000,800**
Liabilities:				
Federal income tax liability, net	340,860	(83,787)	9,749	266,822
Other liabilities	584,434	69,663	(7,383)	646,714
Total Liabilities	**32,004,420**	**(14,124)**	**2,366**	**31,992,662**
Stockholder's Equity				
Retained earnings	2,032,987	(139,553)	(7,816)	1,885,618
Accumulated other comprehensive income	755,893	(16,051)	25,921	765,763
Total Stockholder's Equity	**3,145,637**	**(155,604)**	**18,105**	**3,008,138**
Total Liabilities and Stockholder's Equity	**$ 35,150,057**	**$ (169,728)**	**$ 20,471**	**$ 35,000,800**

	December 31, 2011			
	As originally reported	As of Jan 1, 2011	2011 Transactions	As Adjusted
Revenues:				
Interest sensitive life and investment product charges	$ 338,445	$ -	$ (109)	$ 338,336
Other income	9,304	-	4,904	14,208
Total revenues	**1,905,013**	**-**	**4,795**	**1,909,808**
Benefits and Expenses:				
Amortization of deferred sales inducements	78,438	-	217	78,655
Operating and other expenses (net of commissions and other expenses deferred)	139,279	-	20,726	160,005
Amortization of deferred policy acquisition costs and present value of future profits of acquired businesses	212,002	-	(14,047)	197,955
Total benefits and expenses	**1,508,260**	**-**	**6,896**	**1,515,156**
Income before income tax	396,753	-	(2,101)	394,652
Income tax provision	109,147	-	(735)	108,412
Net income	**$ 287,606**	**$ -**	**$ (1,366)**	**$ 286,240**

(Dollars in Thousands)

	December 31, 2010			
	As originally reported	As of Jan 1, 2010	2010 Transactions	As Adjusted
Revenues:				
Interest sensitive life and investment product charges	$ 303,991	$ -	$ (106)	$ 303,885
Other income	15,045	-	2,693	17,738
Total revenues	**2,087,954**	**-**	**2,587**	**2,090,541**
Benefits and Expenses:				
Amortization of deferred sales inducements	80,765	-	98	80,863
Operating and other expenses (net of commissions and other expenses deferred)	116,552	-	27,466	144,018
Amortization of deferred policy acquisition costs and present value of future profits of acquired businesses	221,904	-	(15,054)	206,850
Total benefits and expenses	**1,603,574**	**-**	**12,510**	**1,616,084**
Income before income tax	484,380	-	(9,923)	474,457
Income tax provision	131,908	-	(3,473)	128,435
Net income	**$ 352,472**	**$ -**	**$ (6,450)**	**$ 346,022**

Comprehensive income

Effective January 1, 2012, the Company adopted guidance issued by the FASB related to the presentation of comprehensive income. The guidance requires companies to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements. The guidance removes the presentation option allowing comprehensive income disclosures in the statement of changes in stockholder’s equity, but does not change the items that must be reported in other comprehensive income. The Company has elected to present a separate statement of comprehensive income immediately following the consolidated statements of income. Other than the presentation change, the adoption of the guidance did not have any impact on the consolidated financial statements.

Troubled debt restructurings

In April 2011, the FASB issued guidance on the determination of whether a mortgage loan modification is a troubled debt restructuring. Under the guidance, if a restructuring constitutes a concession and the debtor is experiencing financial difficulties, a troubled debt restructuring has occurred. The guidance requires retrospective application to any restructuring activities occurring since January 1, 2011. The Company adopted the new guidance effective January 1, 2012 and it had no impact on the consolidated financial statements.

Recently issued authoritative guidance

Offsetting assets and liabilities

In December 2011, the FASB issued updated guidance regarding the disclosure of offsetting assets and liabilities. This new guidance requires an entity to disclose information on both a gross basis and net basis about both instruments and transactions eligible for offset in the consolidated balance sheets and instruments and transactions subject to an agreement similar to a master netting arrangement. The scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. This guidance will be effective January 1, 2013 and shall be applied retrospectively for all comparative periods presented. The Company has assessed the impact of the guidance on the Company's consolidated financial statements and expects no material impact to the 2013 consolidated financial statements.

(Dollars in Thousands)

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value and estimated fair value of the Company's financial instruments are as follows:

	December 31, 2012		December 31, 2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Available-for-sale:				
Fixed maturities	$30,223,820	$30,223,820	$27,210,029	$27,210,029
Equity securities	375,311	375,311	406,809	406,809
Mortgage loans	1,107,024	1,083,114	490,031	473,562
Short-term investments	605,505	605,505	290,070	290,070
Derivative instruments	306,972	306,972	235,342	235,342
Other invested assets	838,113	841,440	889,972	901,156
Reinsurance receivables - embedded derivatives from reinsurance ceded	218,905	218,905	128,480	128,480
Separate account assets	909,762	909,762	884,513	884,513
Financial liabilities:				
Policyholder account balances:				
Investment-type insurance contracts	15,999,482	14,577,504	14,898,807	13,450,772
Indexed life and annuity embedded derivatives	181,550	181,550	(35,142)	(35,142)
Repurchase agreements, other borrowings and collateral on derivative instruments	2,953,579	2,953,579	2,599,406	2,599,406
Derivative instruments	1,660	1,660	13,134	13,134

Fair value measurements

Fair value is based on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value guidance also establishes a hierarchical disclosure framework which prioritizes and ranks the level of market price observability used in measuring financial instruments at fair value. Market price observability is affected by a number of factors, including the type of instrument and the characteristics specific to the instrument. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

The Company determines the fair value of its investments, in the absence of observable market prices, using the valuation methodologies described below applied on a consistent basis. For some investments, market activity may be minimal or nonexistent and management's determination of fair value is then based on the best information available in the circumstances and may incorporate management's own assumptions, which involves a significant degree of judgment.

Investments for which market prices are not observable are generally private investments, securities valued using non-binding broker quotes or securities with very little trading activity. Fair values of private investments are determined by reference to public market or private transactions or valuations for comparable companies or assets in the relevant asset class when such amounts are available. If these are not available, a discounted cash flow analysis using interest spreads adjusted for the maturity/average life differences may be used. Spread adjustments are intended to reflect an illiquidity premium and take into account a variety of factors including but not limited to senior unsecured versus secured, par amount outstanding, number of holders, maturity, average life, composition of lending group, debt rating, credit default spreads, default rates and credit spreads applicable to the security sector. These valuation methodologies involve a significant degree of judgment.

Financial instruments measured and reported at fair value are classified and disclosed in one of the following categories.

Level 1 – Quoted prices are available in active markets that the Company has the ability to access for identical financial instruments as of the reporting date. The types of financial instruments included in Level 1 are listed equities, mutual funds, money market funds, non-interest bearing cash, exchange traded futures and options, and separate account assets. As required by the fair value measurements guidance, the Company does not adjust the quoted price for these financial instruments, even in situations where it holds a large position and a sale could reasonably impact the quoted price.

Level 2 – Fair values are based on quoted prices for similar assets or liabilities in active and inactive markets. Inactive markets involve few transactions for similar assets or liabilities and the prices are not current or price quotations vary substantially over time or among market makers, which would include some broker quotes. Level 2 inputs also include corroborated market data such as interest rate spreads, yield curves, volatilities, prepayment speeds, credit risks and default rates. Financial instruments that are generally included in this category include corporate bonds, asset-backed securities, CMOs, short-term securities, less liquid and restricted equity securities and over-the-counter derivatives.

Level 3 – Pricing inputs are unobservable for the financial instrument and include situations where there is little, if any, market activity for the financial instrument. These inputs may reflect the Company's estimates of the assumptions that market participants would use in valuing the financial instruments. Financial instruments that are included in this category generally include private corporate securities, collateralized debt obligations and indexed life and annuity embedded derivatives.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. From time to time there may be movements between levels as inputs become more or less observable, which may depend on several factors including the activity of the market for the specific security, the activity of the market for similar securities, the level of risk spreads and the source of the information from which we obtain the information. Transfers in or out of any level are measured as of the beginning of the period.

The Company relies on third party pricing services and independent broker quotes to value fixed maturity and equity securities. The third party pricing services use discounted cash flow models or the market approach to value the securities when the securities are not traded on an exchange. The following characteristics are considered in the valuation process: benchmark yields, reported trades, issuer spreads, bids, offers, benchmark and comparable securities, estimated cash flows and prepayment speeds.

The Company performs both quantitative and qualitative analysis of the prices. The review includes initial and ongoing review of the third party pricing methodologies, back testing of recent trades, and review of pricing trends and statistics.

The following tables summarize the valuation of the Company’s financial instruments carried at fair value in the consolidated balance sheets as of December 31, 2012 and 2011 by the fair value hierarchy levels defined in the fair value measurements guidance. Methods and assumptions used to determine the fair values are described in Note 1:

(Dollars in Thousands)

	December 31, 2012			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets (carried at fair value):				
Fixed maturities:				
U.S. government and agencies	$ -	$ 2,579,360	$ -	$ 2,579,360
Municipal securities	-	4,242,884	-	4,242,884
Corporate securities	-	10,969,306	1,164,919	12,134,225
Residential mortgage-backed securities	-	3,498,236	169,626	3,667,862
Commercial mortgage-backed securities	-	1,169,824	197	1,170,021
Asset-backed securities	-	3,588,673	2,658,846	6,247,519
Other debt obligations	-	40,121	141,828	181,949
Total fixed maturities	-	26,088,404	4,135,416	30,223,820
Equity securities:				
Financial services	-	191,062	14,829	205,891
Other	-	109,834	59,586	169,420
Total equity securities	-	300,896	74,415	375,311
Derivative instruments:				
Options	-	183,065	-	183,065
Interest rate swaps, credit default swaps and interest rate floors	-	36,620	-	36,620
Futures	87,287	-	-	87,287
Total derivative instruments	87,287	219,685	-	306,972
Reinsurance receivables - embedded derivatives from reinsurance ceded:				
Indexed annuity products ceded	-	-	44,356	44,356
Indexed annuity funds withheld	-	-	174,549	174,549
Total reinsurance receivables	-	-	218,905	218,905
Separate account assets	909,762	-	-	909,762
Financial liabilities (carried at fair value):				
Policyholder account balances - indexed life and annuity embedded derivatives	-	-	181,550	181,550
Derivative instruments:				
Interest rate swaps and credit default swaps	-	1,660	-	1,660

(Dollars in Thousands)

	December 31, 2011			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Financial assets (carried at fair value):				
Fixed maturities:				
U.S. government and agencies	$ -	$ 3,351,774	$ -	$ 3,351,774
Municipal securities	-	3,925,894	488	3,926,382
Corporate securities	-	8,776,716	888,707	9,665,423
Residential mortgage-backed securities	-	3,329,532	167,667	3,497,199
Commercial mortgage-backed securities	-	768,406	94	768,500
Asset-backed securities	-	3,290,716	2,524,842	5,815,558
Other debt obligations	-	40,948	144,245	185,193
Total fixed maturities	-	23,483,986	3,726,043	27,210,029
Equity securities:				
Financial services	-	228,412	11,444	239,856
Other	-	111,813	55,140	166,953
Total equity securities	-	340,225	66,584	406,809
Derivative instruments:				
Options	-	122,396	-	122,396
Interest rate swaps, credit default swaps and interest rate floors	-	38,876	-	38,876
Futures	74,070	-	-	74,070
Total derivative instruments	74,070	161,272	-	235,342
Reinsurance receivables - embedded derivatives from reinsurance ceded				
Indexed annuity products ceded	-	-	(15,850)	(15,850)
Indexed annuity funds withheld	-	-	144,330	144,330
Total reinsurance receivables	-	-	128,480	128,480
Separate account assets	884,513	-	-	884,513
Financial liabilities (carried at fair value):				
Policy account balances - indexed life and annuity embedded derivatives	-	-	(35,142)	(35,142)
Derivative instruments				
Interest rate swaps and credit default swaps	-	13,134	-	13,134

Approximately 14% of the total fixed maturities are included in the Level 3 group at December 31, 2012 and 2011.

(Dollars in Thousands)

The following tables summarize certain financial instruments categorized as Level 3 by valuation methodology as of December 31, 2012 and 2011:

	December 31, 2012		
	Third-party Source	Priced Internally	Total
Fixed maturities:			
Corporate securities	$ 28,893	$ 1,136,026	$ 1,164,919
Residential mortgage-backed securities	-	169,626	169,626
Commercial mortgage-backed securities	-	197	197
Asset-backed securities	-	2,658,846	2,658,846
Other debt obligations	-	141,828	141,828
Total fixed maturities	28,893	4,106,523	4,135,416
Equity securities:			
Financial services	-	14,829	14,829
Other	-	59,586	59,586
Total equity securities	-	74,415	74,415
Reinsurance receivables - embedded derivatives from reinsurance ceded:			
Indexed annuity products ceded	-	44,356	44,356
Indexed annuity funds withheld	-	174,549	174,549
Total reinsurance receivables	-	218,905	218,905
Policyholder account balances - indexed life and annuity embedded derivatives	-	181,550	181,550

(Dollars in Thousands)

	December 31, 2011		
	Third-party Source	Priced Internally	Total
Fixed maturities:			
Municipal securities	$ -	$ 488	$ 488
Corporate securities	37,017	851,690	888,707
Residential mortgage-backed securities	-	167,667	167,667
Commercial mortgage-backed securities	-	94	94
Asset-backed securities	-	2,524,842	2,524,842
Other debt obligations	-	144,245	144,245
Total fixed maturities	37,017	3,689,026	3,726,043
Equity securities:			
Financial services	-	11,444	11,444
Other	-	55,140	55,140
Total equity securities	-	66,584	66,584
Reinsurance receivables - embedded derivatives from reinsurance ceded:			
Indexed annuity products ceded	-	(15,850)	(15,850)
Indexed annuity funds withheld	-	144,330	144,330
Total reinsurance receivables	-	128,480	128,480
Policyholder account balances - indexed life and annuity embedded derivatives	-	(35,142)	(35,142)

(Dollars in Thousands)

Quantitative Information Regarding Internally Priced Level 3 Assets and Liabilities

The following table summarizes significant internally priced Level 3 Assets and Liabilities:

	December 31, 2012			
	Fair Value	Valuation Techniques	Unobservable Input	Range (Weighted Average)
Financial assets:				
Fixed maturities:				
Corporate securities	$ 1,136,026	Discounted cash flow	Vendor spread pricing	1.87% - 13.36% (3.65%)
			Discount rate	3.98% - 99.25% (9.66%)
			Spread over swaps	2.65% - 2.65% (2.65%)
		Matrix model	Spread over treasury	1.55% - 3.25% (2.68%)
		Recent trade	Recent trade price	.93% - 1.10% (1.01%)
		Illiquidity	Illiquidity factor	5.00%
		Credit tenant loan model	Spread over treasury	2.60% - 2.60% (2.60%)
Asset backed securities	2,658,846	Discounted cash flow	Spread over swaps	2.30% - 3.80% (2.46%)
			Spread over LIBOR	2.30% - 15.10% (2.63%)
			Vendor spread pricing	2.72% - 25.63% (10.47%)
		Recent trade	Recent trade price	1.00%
		Cap at call or maturity price	Call or maturity value	1.00%
Reinsurance receivables- embedded derivatives from reinsurance ceded:				
Indexed annuity funds withheld	174,549	Total return swap	Mortality	1 - 7% (2%)
			Surrender	3 - 21% (9%)
			Withdrawal	0 - 3% (2%)
			Credited rate	3 - 4% (3%)
			Own credit	2.09%
Indexed annuity products ceded	44,356	Discounted cash flow	Lapse	20%
			Withdrawal	20%
			Credit risk	2.09%
Financial liabilities:				
Policyholder account balances				
Indexed life and annuity embedded derivatives	181,550	Discounted cash flow	Mortality	0 - 20% (1%)
			Lapse	20 - 50% (20%)
			Withdrawal	0 - 20% (19%)
			Credit risk	2.09 - 2.33% (2.10%)

The table above excludes certain securities for which the fair value was based on non-binding broker quotes where the Company could not reasonably obtain the quantitative unobservable inputs.

The changes in financial instruments measured at fair value, excluding accrued interest income, for which Level 3 inputs were used to determine fair value during 2012 and 2011 are as follows:

(Dollars in Thousands)

	December 31, 2012								
		Realized and Unrealized Gains (Losses)							
	Beginning Balance	Included in Net Income	Included in OCI	Purchases	Sales	Issuances	Settlements	Transfers in and/or out of Level 3 (A)	Ending Balance
Financial assets (carried at fair value):									
Fixed maturities:									
Municipal securities	$ 488	$ -	$ -	$ -	$ -	$ -	$ -	$ (488)	$ -
Corporate securities	888,707	(2,085)	53,178	458,888	(206,662)	-	-	(27,107)	1,164,919
Residential mortgage-backed securities	167,667	(10,371)	21,284	22,845	(31,799)	-	-	-	169,626
Commercial mortgage-backed securities	94	9	-	-	(103)	-	-	197	197
Asset-backed securities	2,524,842	(1,289)	21,526	247,515	(84,953)	-	-	(48,795)	2,658,846
Other debt obligations	144,245	256	(2,593)	5,463	(5,542)	-	-	(1)	141,828
Total fixed maturities	3,726,043	(13,480)	93,395	734,711	(329,059)	-	-	(76,194)	4,135,416
Equity securities:									
Financial services	11,444	-	1,090	2,295	-	-	-	-	14,829
Other	55,140	-	4,446	-	-	-	-	-	59,586
Total equity securities	66,584	-	5,536	2,295	-	-	-	-	74,415
Reinsurance receivables - embedded derivatives from reinsurance ceded:									
Indexed annuity products ceded	(15,850)	51,717	-	-	-	1,911	6,578	-	44,356
Indexed annuity funds withheld	144,330	28,894	-	-	-	(6,389)	7,714	-	174,549
Total reinsurance receivables	128,480	80,611	-	-	-	(4,478)	14,292	-	218,905
Financial liabilities (carried at fair value):									
Policy account balances - indexed life and annuity embedded derivatives (B)	(35,142)	(194,576)	-	-	-	(13,265)	(8,851)	-	181,550

(Dollars in Thousands)

	December 31, 2011								
		Realized and Unrealized Gains (Losses)							
	Beginning Balance	Included in Net Income	Included in OCI	Purchases	Sales	Issuances	Settlements	Transfers in and/or out of Level 3 (A)	Ending Balance
Financial assets (carried at fair value):									
Fixed maturities:									
Municipal securities	$ -	$ -	$ -	$ 488	$ -	$ -	$ -	$ -	$ 488
Corporate securities	1,148,275	(2,024)	43,767	285,769	(163,361)	-	-	(423,719)	888,707
Residential mortgage-backed securities	205,743	(7,760)	(160)	-	(30,156)	-	-	-	167,667
Commercial mortgage-backed securities	94	-	-	-	-	-	-	-	94
Asset-backed securities	2,457,780	(42,298)	53,143	215,084	(101,398)	-	-	(57,469)	2,524,842
Other debt obligations	87,402	115	8,653	13,305	(4,780)	-	-	39,550	144,245
Total fixed maturities	3,899,294	(51,967)	105,403	514,646	(299,695)	-	-	(441,638)	3,726,043
Equity securities:									
Financial services	10,826	-	618	-	-	-	-	-	11,444
Other	39,823	2,654	47,794	1,298	(36,429)	-	-	-	55,140
Total equity securities	50,649	2,654	48,412	1,298	(36,429)	-	-	-	66,584
Reinsurance receivables - embedded derivatives from reinsurance ceded:									
Indexed annuity products ceded	(23,614)	1,468	-	-	-	3,661	2,635	-	(15,850)
Indexed annuity funds withheld	49,675	103,694	-	-	-	(5,096)	(3,943)	-	144,330
Total reinsurance receivables	26,061	105,162	-	-	-	(1,435)	(1,308)	-	128,480
Financial liabilities (carried at fair value):									
Policy account balances - embedded derivatives (B)	(40,622)	15,453	-	-	-	(13,259)	(7,674)	-	(35,142)

(Dollars in Thousands)

(A) Included in the transfers in and/or out line above is $146,768 of securities priced using unobservable data at December 31, 2011 that were valued by a pricing service using observable market data at December 31, 2012, and $71,742 of securities transferred into Level 3 that did not have enough observable data to include in Level 2 at December 31, 2012.

(B) Excludes host accretion and the timing of crediting index credits to policy holder, which are included in interest credited to policyholder account balances in the consolidated statements of income.

The total gains (losses) included in earnings related to financial instruments categorized at Level 3 still held at December 31, 2012, 2011 and 2010 are as follows:

	2012	2011	2010
Financial assets (carried at fair value):			
Fixed maturities:			
Corporate securities	$ (3,443)	$ (2,311)	$ (5,974)
Residential mortgage-backed securities	(7,482)	(2,376)	(3,607)
Commercial mortgage-backed securities	-	-	(33,515)
Asset-backed securities	(1)	-	(18,214)
Other debt obligations	93	115	106
Total fixed maturities	(10,833)	(4,572)	(61,204)
Reinsurance receivables - embedded derivatives from reinsurance ceded:			
Index annuity products ceded	51,717	1,468	(17,481)
Index annuity funds withheld	28,894	103,694	36,866
Total reinsurance receivables	80,611	105,162	19,385
Financial liabilities (carried at fair value):			
Policy account balances - indexed life and annuity embedded derivatives	(194,576)	15,453	66,780

(Dollars in Thousands)

The following table shows the investments which are included in other invested assets (primarily limited partnerships) in the consolidated balance sheets:

	December 31, 2012		December 31, 2011	
	Fair Value	Unfunded Commitments	Fair Value	Unfunded Commitments
Fixed income	$ 674,629	$ 37,002	$ 754,054	$ 50,660
Private equity	92,430	9,520	103,232	10,598
Real estate	39,314	28,157	43,870	28,157
Other	35,067	-	-	-
	$ 841,440	$ 74,679	$ 901,156	$ 89,415

Limited partnership interests are not redeemable at specific time periods. The Company receives periodic distributions from these investments while maintaining the investment for the long-term.

(Dollars in Thousands)

4. INVESTMENTS AND NET INVESTMENT INCOME

Available-for-sale securities

The amortized cost, estimated fair value, gross unrealized gains and gross unrealized losses of fixed maturities and equity securities classified as available-for-sale at December 31, 2012 and 2011 are as follows:

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government and agencies	$ 2,295,820	$ 283,999	$ 459	$ 2,579,360
Municipal securities	3,627,852	618,106	3,074	4,242,884
Corporate securities	11,050,132	1,183,988	99,895	12,134,225
Residential mortgage-backed securities	3,227,774	460,343	20,255	3,667,862
Commercial mortgage-backed securities	1,106,965	77,426	14,370	1,170,021
Asset-backed securities	6,085,542	218,191	56,214	6,247,519
Other debt obligations	168,543	14,067	661	181,949
Total fixed maturities	27,562,628	2,856,120	194,928	30,223,820
Equity securities:				
Financial services	211,479	8,466	14,054	205,891
Other	109,074	60,805	459	169,420
Total equity securities	320,553	69,271	14,513	375,311
Total available-for-sale	$ 27,883,181	$ 2,925,391	$ 209,441	$ 30,599,131

(Dollars in Thousands)

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government and agencies	$ 3,051,079	$ 300,695	$ -	$ 3,351,774
Municipal securities	3,564,475	369,986	8,079	3,926,382
Corporate securities	9,286,378	681,011	301,966	9,665,423
Residential mortgage-backed securities	3,108,442	439,600	50,843	3,497,199
Commercial mortgage-backed securities	779,233	41,345	52,078	768,500
Asset-backed securities	5,861,590	120,853	166,885	5,815,558
Other debt securities	170,670	16,011	1,488	185,193
Total fixed maturities	25,821,867	1,969,501	581,339	27,210,029
Equity securities:				
Financial services	232,567	17,018	9,729	239,856
Other	113,434	53,897	378	166,953
Total equity securities	346,001	70,915	10,107	406,809
Total available-for-sale	$ 26,167,868	$ 2,040,416	$ 591,446	$ 27,616,838

The amortized cost and estimated fair value of available-for-sale fixed maturities at December 31, 2012 and 2011, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties:

	2012		2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 106,623	$ 108,761	$ 92,256	$ 90,578
Due after one year through five years	2,053,367	2,217,143	1,904,366	1,928,601
Due after five years through ten years	5,526,589	6,184,287	4,404,354	4,736,432
Due after ten years	10,192,264	11,378,089	10,345,636	11,045,235
Securities not due at a single maturity date (primarily mortgage-backed securities)	9,683,785	10,335,540	9,075,255	9,409,183
Total fixed maturities	$27,562,628	$30,223,820	$25,821,867	$27,210,029

(Dollars in Thousands)

Gross unrealized losses

The Company's gross unrealized losses and fair value on its available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	December 31, 2012					
	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities:						
U.S. government and agencies	$ 16,827	$ 459	$ -	$ -	$ 16,827	$ 459
Municipal securities	58,513	1,498	35,283	1,576	93,796	3,074
Corporate securities	397,109	9,910	1,035,212	89,985	1,432,321	99,895
Residential mortgage-backed securities	60,588	977	156,368	19,278	216,956	20,255
Commercial mortgage-backed securities	164,416	329	128,306	14,041	292,722	14,370
Asset-backed securities	425,985	7,652	1,110,846	48,562	1,536,831	56,214
Other debt securities	5,767	7	26,786	654	32,553	661
Total fixed maturities	1,129,205	20,832	2,492,801	174,096	3,622,006	194,928
Equity securities:						
Financial services	-	-	43,705	14,054	43,705	14,054
Other	2,393	238	370	221	2,763	459
Total equity securities	2,393	238	44,075	14,275	46,468	14,513
Total available-for-sale	$ 1,131,598	$ 21,070	$ 2,536,876	$ 188,371	$ 3,668,474	$ 209,441

(Dollars in Thousands)

	December 31, 2011					
	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Fixed maturities:						
Municipal securities	$ 3,525	$ 143	$ 117,556	$ 7,936	$ 121,081	$ 8,079
Corporate securities	961,404	54,287	1,746,400	247,679	2,707,804	301,966
Residential mortgage-backed securities	75,095	3,318	307,938	47,525	383,033	50,843
Commercial mortgage-backed securities	59,963	2,174	162,433	49,904	222,396	52,078
Asset-backed securities	1,553,500	57,476	745,534	109,409	2,299,034	166,885
Other debt securities	3,200	33	31,327	1,455	34,527	1,488
Total fixed maturities	2,656,687	117,431	3,111,188	463,908	5,767,875	581,339
Equity securities:						
Financial services	-	-	33,868	9,729	33,868	9,729
Other	370	222	14,285	156	14,655	378
Total equity securities	370	222	48,153	9,885	48,523	10,107
Total available-for-sale	$ 2,657,057	$ 117,653	$ 3,159,341	$ 473,793	$ 5,816,398	$ 591,446

At December 31, 2012, the Company held 6,620 positions in fixed income and equity securities. The above table includes 303 securities of 229 issuers as of December 31, 2012. At December 31, 2012, 73% of the unrealized losses on fixed maturities were securities rated investment grade. Investment grade securities are defined as those securities rated AAA through BBB – by Standard & Poor’s. At December 31, 2012, 27% of the unrealized losses on fixed maturities were on securities rated below investment grade. Equity securities in the above table consist primarily of non-redeemable preferred stocks. These securities are reviewed for impairment in the same manner as the fixed income securities. At December 31, 2012, fixed income and equity securities in an unrealized loss position had fair value equal to approximately 95% of amortized cost.

The following summarizes the unrealized losses by investment category as of December 31, 2012.

U.S. Government and agencies

The U. S. government and agencies represent less than 1% of the unrealized losses at December 31, 2012. There were no unrealized losses in this category at December 31, 2011. The unrealized losses are applicable to securities with yields lower than the market yield available on similar securities at December 31, 2012. At this time the Company believes these impairments are temporary and the Company does not intend or believe it will be required to sell these securities before recovery of its amortized cost.

Municipal securities

The municipal category, which represents 1% of the unrealized losses at December 31, 2012, includes bonds issued by state and local governments and school district tax credit bonds. The unrealized losses in this category are primarily the result of concerns regarding possible defaults by state and local governments. The Company does not believe there will be significant defaults in this sector in the short or long-term. The Company believes it will receive all amounts contractually due and it does not intend or believe it will be required to sell these securities prior to recovery of amortized cost, therefore an OTTI has not been recognized in this sector.

Corporate securities

The largest unrealized losses in corporate securities, which represent 48% of unrealized losses at December 31, 2012, are in the financial services sector, primarily commercial banking. Approximately 23% of the unrealized loss in corporate securities is applicable to a group of subordinated notes with no stated maturity dates issued by banks and an insurance company. A significant majority of these securities pay a variable rate of interest based on LIBOR. The Company considers the unrealized losses to be the result of low current coupon yields benchmarked to LIBOR. During 2012, the Company recognized impairments of $1,669 it considered credit related losses on these securities. The other unrealized losses in the banking sector are primarily attributable to the economic uncertainty in Europe, continuing wide spreads relative to other corporate sectors and concerns regarding the underlying credit quality of loan portfolios. These concerns are impacting foreign banks and large U.S. national and regional banks. Other industry sectors with large unrealized losses include military housing, gaming and insurance. The Company reviews its security positions with unrealized losses on an on-going basis and recognizes OTTI if evidence indicates a loss will be incurred. In all other cases, if the Company does not intend to sell or believe it will be required to sell these securities before recovery of each security's amortized cost, the security is not considered to be other-than-temporarily impaired. During 2012, the Company recognized credit related impairment losses of $8,560 applicable to corporate securities.

Residential mortgage-backed securities ("RMBS")

The unrealized losses on RMBS, which represents 10% of unrealized losses at December 31, 2012, are concentrated in the non-agency sector and are primarily due to concerns regarding mortgage defaults on Alt-A and other risky mortgages. These concerns result in spreads widening on those securities that are being traded. The unrealized losses on these securities have narrowed as of December 31, 2012 compared to the unrealized losses at December 31, 2011 and 2010. The Company performs various stress tests on the cash flow projections for these securities and in situations where it is determined the projected cash flows cannot support the contractual amounts due the Company, an OTTI is recognized. In situations where the projected cash flows indicate the Company will receive the amounts it is contractually due and the Company does not intend or believe it will be required to sell these securities before recovery of its amortized cost, an OTTI is not recognized. During 2012, the Company recognized credit related impairment losses of $6,899 applicable to RMBS.

Commercial mortgage-backed securities ("CMBS")

The unrealized losses on CMBS, which represent 7% of unrealized losses at December 31, 2012, are primarily attributable to illiquidity applicable to certain securities in that sector and concerns regarding the potential for future commercial mortgage defaults. The market activity has improved for CMBS in 2012 and 2011 from prior levels. The unrealized losses on these securities have narrowed significantly as of December 31, 2012 compared to the unrealized losses at December 31, 2011 and 2010. The Company has reviewed payment performance, delinquency rates, and credit enhancements within the security structures and monitored the credit ratings of all its CMBS holdings. There was no OTTI in CMBS recognized in 2012. The Company has performed cash flow projection analyses on all of its CMBS and in those situations where it appears the Company will receive all amounts contractually due and it does not intend to sell or believe it will be required to sell these securities prior to recovery of amortized cost, an OTTI is not recognized.

Asset-backed securities ("ABS")

The unrealized losses in ABS, which represent 27% of unrealized losses at December 31, 2012, are primarily related to collateralized debt obligations backed by various consumer and commercial finance loans. This category also includes structured notes backed by diversified investment portfolios. The unrealized losses are primarily due to wide credit spreads in this sector, particularly related to private placement ABS. The Company stress tests the projected cash flows of its ABS and recognizes OTTI in situations where the testing indicates the Company will not receive all amounts contractually due from the securities. This category also includes fixed income securities containing embedded derivatives. The Company did not recognize OTTI on ABS during 2012 and 2011. Impairments were recognized in this sector during 2010. In those situations where it appears the Company will receive all amounts contractually due and it does not intend or believe it will be required to sell these securities prior to recovery of amortized cost, an OTTI is not recognized.

Other debt obligations

This category primarily consists of credit tenant loans. The unrealized losses in this category are the result of concerns regarding the credit worthiness of the building tenants and illiquidity in this market sector. The unrealized losses on these securities have narrowed as of December 31, 2012 compared to the unrealized losses at December 31, 2011. The Company monitors the creditworthiness of the obligors and recognizes OTTI in situations where it is determined the Company will not receive all amounts contractually due from the securities. In those situations where it appears the Company will receive all amounts contractually due and it does not intend or believe it will be required to sell these securities prior to recovery of amortized cost, an OTTI is not recognized.

Equity securities

This category, which represents 7% of unrealized losses at December 31, 2012, primarily consists of non-redeemable preferred stocks in the banking sector. The unrealized losses are concentrated in non-redeemable preferred stocks with variable dividend rates benchmarked to LIBOR. The low yield applicable to the dividends based on LIBOR and wide credit spreads applied to these securities are contributing to these unrealized losses. The Company monitors the credit ratings and length of time the securities have been in an unrealized loss position as part of its review for impairment. The Company has determined it does not intend to sell or believe it will be required to sell these securities prior to recovery of amortized cost, therefore an OTTI has not been recognized.

(Dollars in Thousands)

Other-than-temporary impairments

As a result of the Company's review of OTTI of investment securities, the Company recorded net impairment losses recognized in earnings during 2012, 2011 and 2010, as summarized in the following table:

	2012	2011	2010
Corporate securities	$ 8,560	$ 2,343	$ 14,783
Residential mortgage-backed securities	6,899	4,787	9,067
Commercial mortgage-backed securities	-	-	32,798
Asset-backed securities	-	-	13,898
Commercial mortgage loans	-	397	1,036
Net impairment loss recognized in earnings	$ 15,459	$ 7,527	$ 71,582

The following is a roll-forward of credit losses for the years ended December 31, 2012 and 2011 on fixed maturities held by the Company for which a non-credit portion of the OTTI impairment was recognized in OCI:

	2012	2011
Balance, January 1	$ 19,712	$ 30,476
Additions for newly impaired securities	2,407	3,366
Additions for previously impaired securities	356	-
Reductions for impaired securities sold	(254)	(14,130)
Balance, December 31	$ 22,221	$ 19,712

The amounts of non-credit related OTTI losses recorded on fixed maturities that remain in accumulated OCI at December 31, 2012 and 2011 are summarized as follows:

	2012	2011
Corporate securities	$ 28,407	$ 20,625
Residential mortgage-backed securities	2,684	2,621
Asset-backed securities	3	1,154
Total OTTI losses in accumulated OCI	$ 31,094	$ 24,400

(Dollars in Thousands)

Net investment income and investment gains (losses)

The major categories of investment income reflected in the consolidated statements of income are summarized as follows:

	2012	2011	2010
Gross investment income			
Fixed maturities	$ 1,234,265	$ 1,192,940	$ 1,101,486
Equity securities	18,324	24,836	24,824
Mortgage loans	37,334	17,354	14,246
Policy loans	23,665	23,456	22,068
Short-term investments	3,659	2,140	2,709
Derivative instruments	(29,554)	76,324	70,743
Other invested assets	108,045	95,857	201,803
Total gross investment income	1,395,738	1,432,907	1,437,879
Less: Investment expenses	35,342	30,395	30,171
Net investment income	$ 1,360,396	$ 1,402,512	$ 1,407,708

Investment expenses primarily consist of investment advisor fees, interest expense on securities lending, interest on FHLB advances and interest related to derivative collateral liabilities.

The major categories of realized investment gains and (losses) reflected in the consolidated statements of income are summarized as follows:

	2012	2011	2010
Fixed maturities	$ 45,830	$ (3,423)	$ 79,262
Equity securities	9,341	(1,892)	15,903
Mortgage loans	(2,442)	(2,891)	(491)
Short-term	(1,292)	-	(103)
Net realized investment gains	$ 51,437	$ (8,206)	$ 94,571

(Dollars in Thousands)

Proceeds from the sale of available-for-sale securities and the gross realized gains and losses on these sales (prior to gains (losses) ceded to reinsurer and excluding OTTI losses, maturities, calls, exchanges and prepayments) during 2012, 2011 and 2010 were as follows:

	2012		2011		2010	
	Fixed Maturities	Equity Securities	Fixed Maturities	Equity Securities	Fixed Maturities	Equity Securities
Proceeds from sales	$ 1,857,145	$ 21,205	$ 2,464,048	$ 104,955	$ 2,366,174	$ 197,853
Gross realized gains	73,406	1,155	97,286	6,933	133,475	21,327
Gross realized losses	(33,961)	(891)	(116,364)	(11,713)	(72,294)	(4,702)

Mortgage Loans

The carrying value and related allowance of the mortgage loan portfolio is as follows:

	2012	2011
Principle outstanding	$ 1,110,077	$ 492,031
Loan loss allowance	(3,053)	(2,000)
Carry Value	$ 1,107,024	$ 490,031

The following table includes a breakdown of the Company's mortgage loans by property type as of December 31:

	2012		2011	
	Carrying Value	Percent	Carrying Value	Percent
Retail	$ 343,306	31%	$ 78,725	16%
Office	337,515	30%	108,247	22%
Multi-family	219,305	20%	78,725	16%
Hotel	117,592	11%	147,609	30%
Medical	25,707	2%	9,841	2%
Residential	26,593	2%	29,522	6%
Industrial	16,894	2%	19,681	4%
Other	23,165	2%	19,681	4%
	$ 1,110,077	100%	$ 492,031	100%

(Dollars in Thousands)

Mortgage loans by geographic locations are as follows as of December 31:

	2012 Carrying Value	2012 Percent	2011 Carrying Value	2011 Percent
Pacific	$ 348,254	31%	$ 123,008	25%
South Atlantic Total	329,091	30%	137,769	28%
Middle Atlantic	145,956	13%	44,283	9%
Mountain	96,159	9%	83,645	17%
East North Central	86,839	8%	14,761	3%
West South Central Total	47,883	4%	9,841	2%
West North Central	32,294	3%	39,362	8%
East South Central	23,123	2%	39,362	8%
New England	478	0%	-	0%
	$ 1,110,077	100%	$ 492,031	100%

The Company's mortgage loans by origination year are as follows as of December 31, 2012:

	Carrying Value	Percent
2012	$ 695,285	63%
2011	301,142	27%
2010	56,763	5%
2009	-	0%
2008 and prior	56,887	5%
Total	$ 1,110,077	100%

The Company has outstanding commitments on mortgage loans of $8,649 at December 31, 2012.

The Company reviews its mortgage loans for impairment on an on-going basis. It considers such factors as delinquency of payments, decreases in the value of underlying properties, the financial condition of the mortgagee and the impact of general economic conditions in the geographic areas of the properties collateralizing the mortgages. Once the determination is made that a mortgage loan is impaired, the primary consideration used to determine the amount of the impairment is the fair market value of the underlying property. The Company assumes it would receive the proceeds from the sale of the underlying property less sale expenses. The Company determined the allowance through an analysis of specific loans that are believed to have a higher risk of credit impairment. The rollforward of the allowance for the years ended December 31, 2012 and 2011 is as follows:

(Dollars in Thousands)

	2012	2011
Balance at beginning of period	$ 2,000	$ -
Allowances established	2,460	2,000
Charge offs	(1,407)	-
Balance at end of period	$ 3,053	$ 2,000

Charge offs include the amount of loss resulting from writing specific mortgage loans to fair value and loans which were satisfied by taking ownership of the real estate. When the real estate is taken it is recorded at its fair value and the mortgage loan is recorded as fully paid.

During the years ended December 31, 2012 and 2011, six and three mortgages, respectively, were written down to fair value. The amount of allowance charge offs related to these write downs was $1,407 and $0 during the years ended December 31, 2012 and 2011, respectively. Subsequent to write down in 2012, the six mortgages were sold to an affiliate, Property Disposition, Inc., at fair value resulting in no additional gain or loss recorded. As of December 31, 2012 the Company has one additional loan with an unpaid balance of $1,823 that is delinquent and in process of being foreclosed. An amount of $264 was established in the allowance related to this loan. The Company did not restructure any mortgage loans during the years ended 2012 and 2011.

The Company did not take ownership of any real estate in 2012 to satisfy a mortgage loan. During 2011, three mortgages were satisfied by taking ownership of the real estate. The real estate is a component of other invested assets in the consolidated balance sheets.

The following table summarizes the activity in the real estate owned which was obtained in satisfaction of mortgage loans on real estate:

	2012	2011
Real estate owned at beginning of period	$ 7,777	$ 1,061
Real estate acquired in satisfaction of mortgage loans	-	6,716
Property improvements	495	-
Real estate owned at end of period	$ 8,272	$ 7,777

Credit risk concentration

The Company generally strives to maintain a diversified invested assets portfolio. Other than investments in U.S. Government or U.S. Government Agency or Authority, the Company had the following investments that exceeded 10% of the Company's stockholder's equity at December 31, 2012:

Guggenheim Partners Opportunistic Investment Grade Securities Fund, LLC	$ 494,922

Other

Federal Home Loan Bank of Des Moines

Midland National is a member of FHLB Des Moines. In order to maintain its membership and borrow funds, the Company was required to purchase FHLB equity securities that total $38,919 and $25,619 as of December 31, 2012 and 2011, respectively. These securities are included in equity securities and are carried at cost, which approximates fair value. Resale of these securities is restricted only to FHLB. As a member of FHLB, the Company can borrow money, provided that FHLB's collateral and stock ownership requirements are met. The maximum amount a member can borrow is twenty times its FHLB investment. The interest rate and repayment terms differ depending on the type of advance and the term selected. At December 31, 2012 and 2011, the Company had outstanding advances of $649,870 and $349,870, respectively from FHLB (see Note 7).

Deposits with regulatory authorities

At December 31, 2012 and 2011, securities with reported values of $3,729 and $3,563, respectively, were on deposit with regulatory authorities as required by law. These consist of fixed maturity securities reported in the consolidated balance sheets at fair value and have an amortized cost of $3,351 and $3,181, respectively.

(Dollars in Thousands)

5. DERIVATIVES AND DERIVATIVE INSTRUMENTS

The following table presents the notional amounts and fair value of derivatives and derivative instruments:

	December 31, 2012		December 31, 2011	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Assets:				
Derivative instruments:				
Interest rate swaps (1)	$ 261,660	$ 18,557	$ 433,914	$ 21,391
Credit default swaps - receive (1)	-	-	35,500	1,119
Credit default swaps - pay (1)	15,000	43	-	-
Interest rate floors (1)	113,000	16,880	113,000	14,201
Futures (1)	820,591	87,287	401,922	74,070
Call options (1)	4,528,154	183,065	3,885,115	122,396
Interest rate swaps - effective cash flow (2)	23,810	1,140	23,810	2,165
		$ 306,972		$ 235,342
Reinsurance receivables - embedded derivatives from reinsurance ceded:				
Indexed annuity products ceded (1)	N/A	$ 44,356	N/A	$ (15,850)
Indexed annuity funds withheld (1)	N/A	174,549	N/A	144,330
		$ 218,905		$ 128,480
Fixed maturities - asset-backed securities:				
Hybrid instruments (1)		$ 583,649		$ 405,958
Liabilities:				
Investment-type insurance contracts - embedded derivatives:				
Indexed life and annuity products (1)		$ 181,550		$ (35,142)
Derivative instruments:				
Interest rate swaps (1)	$ 2,376	$ 50	$ 3,609	$ 136
Credit default swaps - receive (1)	15,650	345	-	-
Credit default swaps - pay (1)	41,000	1,265	56,000	12,998
		$ 1,660		$ 13,134

(1) Not designated as hedging instruments

(2) Designated as hedging instruments

The notional values above approximate the level of activity throughout 2012 and 2011.

Cash flow hedges

The Company has a number of investments which pay interest on a variable rate tied to a benchmark interest rate. The Company has entered into interest rate swaps that effectively convert the variable cash flows on specific fixed maturity securities to fixed over the life of the swaps. These swaps pay the Company fixed rates while the Company is obligated to pay variable rates based on the same benchmark interest rate as the hedged asset. The swaps are part of the Company's overall risk and asset-liability management strategy to reduce the volatility of cash flows and provide a better match to the characteristics of the Company's liabilities. These swaps are accounted for as cash-flow hedges and are reported at fair value in the consolidated balance sheets with the change in fair value reported as a component of OCI for the effective portion of the hedge. Periodic cash flow interest swap settlements and current period changes in the swap accruals are reported as a component of net investment income in the consolidated statements of income with the payable or receivable included in accrued investment income in the consolidated balance sheets. The stated fair value of the applicable interest rate swaps excludes the current period accruals.

The following table presents the impact of cash flow hedges on the consolidated financial statements before adjustments to DAC, DSI, and deferred income taxes:

	For the Year Ended				
	Effective Portion			Ineffective Portion	
Cash Flow Hedging Relationships	Gain (Loss) in OCI	Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Gain (Loss) Reclassified from Accumulated OCI into Income	Location of Gain (Loss) in Income	Ineffective Gain (Loss) in Income
December 31, 2012					
Interest rate swaps	$ (1,025)	Net realized investment gains (losses)	$ -	Net gains (losses) on derivative instruments	$ -
December 31, 2011					
Interest rate swaps	$ 272	Net realized investment gains (losses)	$ -	Net gains (losses) on derivative instruments	$ -
December 31, 2010					
Interest rate swaps	$ 611	Net realized investment gains (losses)	$ -	Net gains (losses) on derivative instruments	$ -

Fair value hedges

The Company had entered into interest rate swap agreements that paid a variable rate of interest to the Company and the Company paid a fixed rate of interest to the counterparty. These swaps hedged the fair value of specific available-for-sale fixed income securities and were important components of the Company's asset-liability management. During 2010, these interest rate swaps matured and, as a result, the Company had no fair value interest rate swaps in effect as of December 31, 2012 and 2011.

It was anticipated that changes in the fair values of the fixed income securities due to changes in interest rates would be offset by a corresponding opposite change in the fair values of the interest rate swaps. These swaps were considered effective hedges and were reported in the consolidated balance sheets at fair value with the changes in fair value of the swaps and hedged available-for-sale fixed income investments reported as components of net gains (losses) on derivatives and derivative instruments in the consolidated statements of income.

The following table presents the impact of fair value hedges on the consolidated statements of income.

	Gain (Loss) in Income 2010
Gains (losses) recognized in net gains (losses) on derivatives and derivative instruments:	
Interest rate swaps	$ 508
Fixed rate fixed income securities	(314)
	$ 194

Indexed options and futures

The Company has indexed annuity and indexed universal life products that provide for a guaranteed base return and a higher potential return tied to several major equity market indices. In order to fund these benefits, the Company purchases over-the-counter index options that compensate the Company for any appreciation over the strike price and offsets the corresponding increase in the policyholder obligation. The Company also enters futures contracts and options to compensate it for increases in the same indices. The Company classifies these options and futures as derivative instruments.

The Company amortizes the cost of the indexed options against investment income over the term of the option, which is typically one year. When the options are exercised at maturity, the value received by the Company is reflected as net investment income in the consolidated statements of income.

The futures contracts have no initial cost and are marked to market daily. That daily mark-to-market is settled through the Company's variation margin accounts maintained with the counterparty. The Company reports the change in the difference between market value and amortized cost of indexed options and the change in the futures variation margin accounts as gains (losses) on derivatives and derivative instruments in the consolidated statements of income.

Embedded derivatives related to indexed life and annuity products

The Company's indexed life and annuity products contain embedded derivatives. The fair value of the embedded options related to these direct and ceded policyholder obligations are based upon current and expected index levels and returns as well as assumptions regarding general policyholder behavior, primarily lapses and withdrawals. These projected benefit values are discounted to the current date using an assumed interest rate consistent with the duration of the liability adjusted to reflect the Company's credit risk and additional provision for adverse deviation. This value is then compared to the carrying value of the liability to calculate any gain or loss that is reflected in the consolidated statements of income as net gains (losses) on derivatives and derivative instruments.

The Company has two coinsurance with funds withheld reinsurance agreements with an unaffiliated reinsurer. Under applicable guidance, the Company's reinsurance agreements contain embedded derivatives that require bifurcation due to credit risks the reinsurer is assuming that are not clearly and closely related to the creditworthiness of the Company. The embedded derivatives contained in the funds withheld liability have characteristics similar to a total return swap since the Company cedes the total return on a designated investment portfolio to the outside reinsurer. The reinsurer assumes the interest credited to the policyholders on the policies covered by the treaties, which interest is relatively fixed. The Company has developed models based on the expected cash flows of the ceded annuity business to estimate the fair value of the policy liabilities. The value of the derivative embedded in the funds withheld coinsurance agreements is equal to the difference between the fair value of the assets in the funds withheld portfolio and the fair value of the policy liabilities estimated from cash flow models. The value of the embedded derivative is reported in the consolidated balance sheets in reinsurance receivables. The net change in the reported value of the embedded derivatives is reported in net gains (losses) on derivatives and derivative instruments in the consolidated statements of income.

See Note 10 for further discussion related to the Company's coinsurance with funds withheld reinsurance agreements.

Embedded derivatives related to hybrid financial instruments

The Company holds hybrid financial instruments, fixed income securities with embedded derivatives, and has elected fair value measurement. These securities are reported in the consolidated balance sheets in fixed maturities, available-for-sale, at fair value. Any change in the fair value of the security is reported as net gains (losses) on derivatives and derivative instruments in the consolidated statements of income. The amortized cost and fair value of the Company's hybrid financial instruments at December 31, 2012 was $580,000 and $583,649, respectively. The amortized cost and fair value of the Company's hybrid financial instruments at December 31, 2011 was $410,600 and $405,958, respectively. The decision to elect fair value measurement is made on an instrument-by-instrument basis under the guidance. The Company will consider making an election of fair value measurement at the time of any future acquisitions of hybrid financial instruments.

(Dollars in Thousands)

Other derivative instruments

The Company has also entered into interest rate floor, interest rate swap and credit default swap agreements to help manage its overall exposure to interest rate changes and credit events. These swaps do not hedge specific assets or liabilities and as such are not accounted for as effective hedges. Included in the non-hedge swaps are credit default swaps where the Company is a protection provider and a protection buyer. The Company holds interest rate floor agreements to protect itself against interest rates decreasing below its policy reserve guarantees. These swaps and floors are reported at fair value in the consolidated balance sheets and changes in the fair value are reported as a component of net gains (losses) on derivatives and derivative instruments in the consolidated statements of income. Included in the non-hedge swaps is the ineffective portions of cash flow swaps. Periodic interest rate and credit default swap settlements and current period changes in the swap accruals for these non-hedge swaps are reported as a component of net investment income in the consolidated statements of income with the payable or receivable included in accrued investment income in the consolidated balance sheets. The stated fair value of the applicable interest rate and credit default swaps excludes the current period accruals.

The following table presents the impact of derivatives and derivative instruments not designated as hedging instruments on the consolidated statements of income:

	2012	2011	2010
Gains (losses) recognized in net gains (losses) on derivatives and derivative instruments:			
Interest rate swaps	$ (2,747)	$ 9,663	$ 11,215
Credit default swaps - receive	(1,285)	877	7,052
Credit default swaps - pay	11,776	(3,274)	6,869
Interest rate floors	2,679	9,218	1,354
Embedded derivatives in:			
Indexed life and annuity products	(216,692)	(5,480)	66,780
Indexed annuity products ceded	52,005	39,576	(7,881)
Indexed annuity funds withheld	30,220	94,654	36,867
Hybrid instruments	(5,232)	19,852	11,324
Futures	105,352	(47,765)	102,694
Options	59,396	(111,554)	(45,097)
	$ 35,472	$ 5,767	$ 191,177
Gains (losses) recognized in net investment income:			
Interest rate swaps	$ 12,557	$ 13,554	$ 9,706
Options	(42,111)	62,770	61,037
	$ (29,554)	$ 76,324	$ 70,743

(Dollars in Thousands)

Collateral on derivative instruments

Collateral posted by counterparties at December 31, 2012 and 2011 applicable to derivative instruments was $118,914 and $63,809, respectively, and is reflected in the consolidated balance sheets in short-term investments. The obligation to repay the collateral is reflected in the consolidated balance sheets in repurchase agreements, other borrowings and collateral on derivative instruments. Collateral posted by the Company at December 31, 2012 and 2011 applicable to derivative instruments was $310 and $11,510, respectively, and is reflected in the consolidated balance sheets as other receivables, other assets and property, plant and equipment.

6. NONCONTROLLING INTERESTS AND VARIABLE INTEREST ENTITIES

The Company is a limited partner in a variable interest entity, Guggenheim Partners Opportunistic Investment Grade Securities Fund, LLC (the "Fund”). The Fund is a private investment company that seeks to maximize total return by investing in a variety of fixed income sectors and assets. The Company held a 27% and 35% interest in the Fund as of December 31, 2012 and 2011, respectively. The general partner of the Fund is a related party, Guggenheim Partners Investment Management, Inc. The Fund qualifies as a VIE as a result of the holders of the equity investment at risk lacking the power to direct the activities that most significantly impact the Fund’s performance. This power is held solely by the general partner. The Company lacks the power on its own to direct the activities of the Fund. Though the general partner is a related party, neither the Company nor SEI, have the power to influence the decision making of the general partner.

In addition, the Company has other investments in limited partnerships and a re-securitization trust that are reviewed to determine if they are VIEs. The VIEs are primarily limited partnerships formed for the purpose of purchasing fixed income and private equity securities. Financing for these VIEs is primarily accomplished through limited partnership contributions. The Company is a limited partner with no voting rights in the limited partnership VIEs. The Company’s involvement with the re-securitization trust is limited due to a third-party manager. Certain of these investments were determined to be VIEs, but in each case the Company has determined it is not the primary beneficiary. The determination was based on the conclusion that the Company does not have the power to direct the activities of the VIEs that most significantly impact the entities’ economic performance nor does the Company absorb the significant losses of the VIEs or have rights to a significant portion of their expected benefits. Except for amounts contractually required, the Company did not provide any further financial or other support to the VIEs.

The Company’s maximum exposure to loss is based on additional commitments made to limited partnerships and the remaining beneficial interests held for the re-securitization trust. The Company’s carrying amount of its asset compared to its maximum exposure to loss as of December 31, 2012 is as follows:

Limited partnerships	
Carrying amount of asset	$ 838,113
Maximum exposure to loss	912,792
Resecuritization trust	
Beneficial interests held in trust	146,352
Maximum exposure to loss	146,352

7. BORROWINGS

At December 31, 2012 and 2011, the Company had outstanding borrowings of $649,870 and $349,870, respectively from the FHLB in accordance with the terms of its membership agreement. The purpose of the borrowings is to complement the Company's security lending program. The borrowings are reported as a component of repurchase agreements, other borrowings and collateral on derivative instruments in the consolidated balance sheets. The borrowings outstanding at December 31, 2012 have maturity dates in June and November of 2013, March of 2014 and December of 2015. The interest rates on the outstanding borrowings range from 0.42% to 0.72%. Interest expense incurred during 2012, 2011 and 2010 was $2,002, $1,940 and $2,381, respectively, and is reported as a component of net investment income in the consolidated statements of income. The fair value of this borrowing approximates its reported value due to its short maturity.

In accordance with the FHLB membership agreement, the Company was required to purchase FHLB common stock. At December 31, 2012 and 2011 the Company held $38,919 and $25,619 of FHLB common stock, respectively. In addition, the Company has posted mortgage loans and agency MBS/CMO fixed income securities with fair values in excess of the amount of the borrowing as collateral.

On December 31, 2011 Solberg Re, an indirect wholly owned limited purpose subsidiary domiciled in the State of Iowa, secured an irrevocable standby letter of credit ("LOC") from a large commercial bank. The LOC, which has an initial term of 13 years, has an aggregate maximum issuance amount of $475,000, of which $325,161 and $244,715 were issued and outstanding at December 31, 2012 and December 31, 2011, respectively. The purpose of the LOC is to support redundant statutory required reserves on specific term life insurance policies issued by Midland National and North American and ceded to Solberg Re. The LOC can be drawn upon when actual policy benefits applicable to the specific life insurance term policies exceed specified thresholds. Solberg Re does not anticipate drawing funds against the LOC. Fees and expenses of $176 and $5,639 were paid in 2012 and 2011, respectively, related to this LOC, which were capitalized and are included in other receivables, other assets and property, plant and equipment on the consolidated balance sheets. The capitalized fees will be amortized over the life of the facility. Amortization expense of $447 and $0 was recorded in 2012 and 2011, respectively. The Company expects to amortize $447 in each of the next five years. In addition, a quarterly fee equal to 1.45% per annum of the outstanding LOC will be paid during the life of the facility. Fees of $4,054 and $0 was paid in 2012 and 2011, respectively.

On December 31, 2012 MNL Re, another indirect wholly owned limited purpose subsidiary domiciled in the State of Iowa, secured a contingent note guarantee of specific risks on certain permanent life insurance policies assumed from Midland National and North American from an unrelated third party. This contingent note guarantee functions in a manner similar to a letter of credit. Prior to December 31, 2012, the specific risks on a portion of the permanent life insurance policies noted above were secured by an affiliate guarantee provided by SEI. The contingent note guarantee has an initial term of 23 years and an aggregate maximum guarantee amount of $560,000, of which $140,723 was utilized at December 31, 2012. MNL Re pays a fee to the guarantee provider equal to 0.65% per annum, payable quarterly, applied to the amount of the guarantee utilized. The contingent note guarantee can be drawn upon when actual policy benefits applicable to the specific permanent life insurance policies exceed certain thresholds. MNL Re does not anticipate drawing funds against the contingent note guarantee. For the year ended December 31, 2012, $229 in fees was paid related to this contingent note guarantee.

(Dollars in Thousands)

8. DAC, DSI and PVFP

Policy acquisition costs of new and acquired business deferred and amortized for the years ended December 31, 2012, 2011 and 2010 are as follows:

	2012	2011	2010
DAC, beginning of year	$1,247,354	$ 1,346,860	$ 1,798,826
Reclassification of DAC from prior periods			(170,580)
Adjusted BOY DAC balance			$ 1,628,246
Commissions deferred	255,404	219,380	225,883
Underwriting and acquisition expenses deferred	13,112	12,631	10,253
Change in offset to unrealized (gains) losses	(108,999)	(137,401)	(314,992)
Amortization related to operations	(206,802)	(202,734)	(208,449)
Amortization related to realized (gains) losses	(2,434)	2,681	(642)
Amortization related to derivatives	7,885	5,937	6,561
DAC, end of year	$1,205,520	$ 1,247,354	$ 1,346,860

The composition of DSI for the years ended December 31, 2012, 2011 and 2010 is summarized below:

	2012	2011	2010
DSI, beginning of year	$ 374,891	$ 456,382	$ 626,447
Reclassification of DSI from prior periods			852
Adjusted BOY DSI balance			$ 627,299
Sales inducement costs deferred	88,791	81,990	92,331
Increase due to recapture of reinsurance	-	-	258
Change in offset to unrealized (gains)	(60,497)	(84,826)	(182,643)
Amortization related to operations	(82,074)	(84,532)	(82,681)
Amortization related to realized (gains) losses	(1,170)	1,578	131
Amortization related to derivatives	4,321	4,299	1,687
DSI, end of year	$ 324,262	$ 374,891	$ 456,382

(Dollars in Thousands)

The composition of the PVFP for the years ended December 31, 2012, 2011 and 2010 is summarized below:

	2012	2011	2010
PVFP, beginning of year	$ 17,176	$ 21,015	$ 21,767
Increase due to recapture of reinsurance ceded	-	-	3,567
Amortization	(1,092)	(3,839)	(4,319)
PVFP, end of year	$ 16,084	$ 17,176	$ 21,015

9. PROPERTY, PLANT AND EQUIPMENT

The major classifications of property, plant and equipment recorded in the consolidated balance sheets as a component of other receivables, other assets and property, plant and equipment are as follows:

	Range of Useful Lives	2012	2011
Land	-	$ 3,029	$ 3,029
Buildings and improvements	20 - 39 years	18,746	18,746
Leasehold improvements	10 - 40 years	1,961	1,855
Furniture and fixtures	10 years	7,578	7,293
Computer equipment and software	3 - 10 years	49,019	37,421
Other	3 - 5 years	40	40
		80,373	68,384
Accumulated depreciation		(33,993)	(27,935)
		$ 46,380	$ 40,449

Depreciation expense was $6,423, $6,099 and $5,594 for the years ended December 31, 2012, 2011 and 2010, respectively.

10. REINSURANCE

The Company is primarily involved in the cession and, to a lesser degree, assumption of life and annuity reinsurance with other companies. Reinsurance premiums and claims ceded and assumed for the years ended December 31 are as follows:

	2012		2011		2010	
	Ceded	Assumed	Ceded	Assumed	Ceded	Assumed
Premiums and deposits on investment contracts	$ 461,561	$ 112,130	$ 533,766	$ 9,034	$ 353,374	$ 1,340
Claims and investment contract withdrawals	257,257	27,281	212,969	1,337	210,711	1,763

The Company is party to two funds withheld coinsurance agreements with a third-party reinsurer. These are indemnity agreements that cover 50% of substantially all policies of specific annuity plans issued from January 1, 2002 through March 31, 2005, 60% of substantially all policies of specific annuity plans issued from April 1, 2005 through February 29, 2008, and 50% of substantially all policies of specific annuity plans issued from March 1, 2008 through November 30, 2012. In these agreements, the Company agrees to withhold, on behalf of the assuming company, assets equal to the statutory liabilities associated with these policies. The Company has netted the funds withheld liability of $4,148,863 and $4,113,910 against the reserve credits of $4,889,736 and $4,840,062 in reinsurance receivables in the December 31, 2012 and 2011 consolidated balance sheets, respectively. The reserve credits contain embedded derivatives as discussed in Note 5.

The Company is a party to a coinsurance agreement with GLAC. This is an indemnity agreement that covers 100% of all policies issued from January 1, 2008 through September 30, 2009 of specific annuity plans. Reserve credits of $553,124 and $584,429 associated with this agreement are reported as a component of reinsurance receivables in the December 31, 2012 and 2011 consolidated balance sheets, respectively.

On December 31, 2010, MNL Re entered into a coinsurance agreement with North American, which was subsequently amended and restated on December 31, 2012. In accordance with the coinsurance agreement North American ceded a defined block of permanent life insurance products to MNL Re. At December 31, 2012 and 2011, MNL Re assumed reserves of $34,995 and $480, respectively, which are included in reinsurance receivables. MNL Re received premiums of $42,135 and $5,227 from North American in 2012 and 2011, respectively. MNL Re paid experience refunds to North American of $1,152, $4,738 and $0 in 2012, 2011 and 2010, respectively.

On December 31, 2011, Solberg Re entered into a coinsurance agreement with North American. In accordance with the coinsurance agreement North American ceded a defined block of term life insurance to Solberg Re. At December 31, 2012 and 2011, Solberg Re assumed reserves of $74,822 and $56,395, respectively, which are included in reinsurance receivables. Solberg Re received premiums of $42,266 and $7,668 from North American in 2012 and 2011, respectively. In addition, in 2012 Solberg Re received a reinsurance assumed risk charge of $8,685 from North American, paid an expense allowance of $14,480 and paid claims of $10,683 to North American.

Premiums, interest sensitive life and investment product charges, and benefits incurred are stated net of the amounts of premiums and claims assumed and ceded. Policyholder account balances, policy benefit reserves, and policy claims and benefits payable are reported gross of the related reinsurance receivables. These receivables are recognized in a manner consistent with the liabilities related to the underlying reinsured contracts.

(Dollars in Thousands)

11. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of accumulated OCI are as follows:

	2012	2011 [1]
Net unrealized gain		
Available-for-sale securities	$ 2,743,416	$ 1,469,788
Certain interest rate swaps	1,140	2,165
Non-credit portion of OTTI losses	(31,094)	(24,400)
Intangibles	(429,915)	(238,766)
Pension liability:		
Unrecognized actuarial net gains	(21,298)	(22,075)
Postretirement liability:		
Unrecognized actuarial net gains	(6,658)	(9,547)
Unrecognized prior service costs	487	931
Deferred income taxes	(789,627)	(412,333)
Accumulated other comprehensive income	$ 1,466,451	$ 765,763

[1] As amended for the impact of adoption of ASU 2010-26

(Dollars in Thousands)

The following table sets forth the changes in each component of accumulated OCI:

	2012	2011 [1]	2010
Net unrealized gain			
Available-for-sale securities	$ 1,313,309	$ 1,243,917	$ 1,549,789
Certain interest rate swaps	(1,025)	272	611
Non-credit portion of OTTI losses	(6,694)	(4,387)	(7,193)
Intangibles	(191,149)	(202,463)	(466,911)
Reclassification adjustment for (gains) losses released into income	(39,681)	12,445	(161,232)
Pension liability:			
Amortization of net loss in net periodic benefit expense	2,363	1,450	647
Net gain (loss) recognized in accrued benefit costs	(1,585)	(6,464)	(5,676)
Postretirement liability:			
Amortization of net gain in net periodic benefit expense	236	504	103
Amortization of prior service costs	(34)	(117)	(117)
Net gain (loss) recognized in accrued benefit costs	1,997	(6,303)	(1,854)
Transfer from affiliates	245	-	-
Deferred income taxes	(377,294)	(363,598)	(317,858)
Total other comprehensive income	$ 700,688	$ 675,256	$ 590,309

[1] As amended for the impact of adoption of ASU 2010-26

The unrealized gain (loss) on available-for-sale securities, certain interest rate swaps, and non-credit portion of OTTI losses is adjusted by intangibles and deferred income taxes and is included in the statements of comprehensive income.

12. INCOME TAXES

The significant components of income tax expense (benefit) are as follows:

	2012	2011	2010
Current	$ 55,326	$ 18,207	$ 111,757
Deferred	86,702	90,205	16,678
Total income tax expense	$ 142,028	$ 108,412	$ 128,435

(Dollars in Thousands)

Total income tax expense attributable to income before taxes differs from the amounts that would result from applying the U.S. Federal statutory income tax rate of 35% in 2012, 2011 and 2010 as follows:

	2012	2011	2010
At statutory federal income tax rate	$ 170,926	$ 138,128	$ 166,060
Dividends received deductions	(1,726)	(1,112)	(1,484)
Tax credits	(33,680)	(33,010)	(32,473)
Other, net	6,508	4,406	(3,668)
Total income tax expense	$ 142,028	$ 108,412	$ 128,435

The tax effects of temporary differences that give rise to significant portions of deferred income tax assets and deferred income tax liabilities at December 31, 2012 and 2011 are as follows:

	2012	2011
Deferred income tax assets		
Policy liabilities and reserves	$ 635,596	$ 609,070
Other, net	56,335	50,282
Total deferred income tax assets	691,931	659,352
Deferred income tax liabilities		
Present value of future profits of acquired business	(5,629)	(6,012)
Investments	(1,044,392)	(516,328)
Deferred policy acquisition costs and deferred sales inducements	(418,350)	(450,804)
Total deferred income tax liabilities	(1,468,371)	(973,144)
Net deferred income tax asset (liability)	$ (776,440)	$ (313,792)

If the Company determines that any of its deferred tax assets will not result in future tax benefits, a valuation allowance must be established for the portion of these assets that are not expected to be realized. Based upon a review of the Company's anticipated future taxable income and after considering all other available evidence, both positive and negative, the Company's management concluded that it is more likely than not that the gross deferred tax assets will be realized, and no valuation allowance is necessary.

The Company has not established a liability for unrecognized tax benefits and does not expect this to change during the next twelve months. The Company recognizes interest and/or penalties as a component of tax expense. The Company did not have any accrued interest and penalties at December 31, 2012 and 2011.

The IRS concluded an examination of the Company's income tax returns for 2007 and 2008 during the year ended December 31, 2011. No material adjustments were recorded as a result of the examination.

13. STATUTORY FINANCIAL DATA AND DIVIDEND RESTRICTIONS

The Company is domiciled in Iowa and its statutory-basis financial statements are prepared in accordance with accounting practices prescribed or permitted by the insurance department of the domiciliary state. “Prescribed” statutory accounting practices include state laws, regulations, and general administrative rules, as well as a variety of publications of the National Association of Insurance Commissioners (“NAIC”). “Permitted” statutory accounting practices encompass all accounting practices that are not prescribed. Such practices differ from state to state and company to company.

The prescribed and permitted practices used by the Company in 2012 include the following:

1. In 2006 Iowa issued a prescribed practice that allows other than market value for assets held in separate accounts where general account guarantees are present on such separate accounts. As a result, the Company carries the assets of the separate accounts related to its bank owned life insurance products at book value.

2. In 2008 Iowa issued a prescribed practice to account for call option derivative assets that hedge the growth in interest credited to the hedged policy as a direct result of changes in the related indices at amortized cost. Other derivative instruments such as indexed futures, swaps and swaptions that may be used to hedge the growth in interest credited to the policy as a direct result of changes in the related indices would still be accounted for at fair value since an amortized cost for these instruments does not exist. As a result, the Company elected to establish a voluntary reserve to offset increases in the values of these other derivative instruments. The prescribed practice also provides guidance to determine indexed annuity reserve calculations based on the Guideline 35 Reserve assuming the market value of the call option(s) associated with the current index term is zero, regardless of the observable market for such option(s). At the conclusion of the index term, credited interest is reflected in the reserve as realized, based on actual index performance. The Company adopted this prescribed practice in 2008.

A permitted practice request by the Company was approved by the Commissioner of Insurance of the State of Iowa for 2012 financial reporting purposes. The permitted practice allows the Company to report an investment in a limited partnership as an admitted asset with the limited partnership audited on a special purpose financial statement report basis and not audited on a U.S. GAAP basis. Without audited U.S. GAAP financial statements, a limited partnership would be reported as a non-admitted asset under NAIC SAP. The limited partnership is Orpheus Holdings, LLC, and the Company reports an equity interest of $78,440 in Schedule BA. The impact of applying this permitted practice in 2012 has no impact on the 2012 statutory net income; however, Capital and Surplus as of December 31, 2012 was higher by $78,440 as a result of this permitted practice.

(Dollars in Thousands)

The combined effect of applying these prescribed and permitted practices in 2012 decreased the Company's statutory-based surplus by $58,829. The risk-based capital excluding the effect of these prescribed practices would not have resulted in a regulatory trigger event.

Generally, the net assets of an Iowa domiciled insurance company available for distribution to its stockholders are limited to the amounts by which the net assets, as determined in accordance with statutory accounting practices, exceed minimum regulatory statutory capital requirements. All payments of dividends or other distributions to stockholders are subject to notification of regulatory authorities. The maximum amount of dividends that can be paid by the Company during any 12-month period, without prior approval of the Iowa insurance commissioner, is limited according to statutory regulations and is a function of statutory equity and statutory income (generally, the greater of prior year statutory-basis net gain from operations or 10% of prior year-end statutory-basis surplus). The Company paid dividends of $75,523, $114,692 and $92,260 in 2012, 2011 and 2010, respectively. Dividends payable in 2013 up to approximately $422,000 will not require prior approval of regulatory authorities.

The statutory net gain from operations of the Company for the years ended December 31, 2012, 2011 and 2010, was $359,533, $326,031 and $284,969, respectively, and reported surplus at December 31, 2012, 2011 and 2010, was $2,124,326, $1,854,241 and $1,639,725, respectively, in accordance with statutory accounting principles.

14. OPERATING LEASES

The Company leases certain equipment and office space. Rental expense of $3,824, $4,224 and $4,231 was incurred in 2012, 2011 and 2010, respectively. Approximate future minimum lease payments under noncancellable leases are as follows:

Year ending December 31,	
2013	$ 2,969
2014	2,708
2015	2,511
2016	1,963
2017	2,064
Thereafter	5,845
	$ 18,060

15. EMPLOYEE BENEFIT PLANS

Defined benefit pension plan and post-retirement health care benefits

The Company has a noncontributory defined benefit pension plan ("Pension Plan") covering certain full-time employees. In addition, the Company provides certain post-retirement health care benefits through a health and welfare benefit plan ("Other Benefit Plan") and life insurance benefits for eligible active and retired employees.

(Dollars in Thousands)

The information for the Pension Plan and Other Benefits Plan, which reflects an allocation of the Company's portion of the SEI plans at December 31, is as follows:

	Pension Plan		Other Benefit Plan	
	2012	**2011**	**2012**	**2011**
Obligation and funded status				
Accumulated benefit obligation	$ (58,297)	$ (53,974)	$ (31,051)	$ (24,168)
Fair value of plan assets	49,254	45,527	-	-
Underfunded status	(9,043)	(8,447)	(31,051)	(24,168)
Accrued benefit liability recognized in other liabilities	(9,043)	(8,447)	(31,051)	(24,168)
Changes in liability for benefits recognized in accumulated OCI (pre-tax)				
Beginning balance	$ (22,076)	$ (17,061)	$ (8,615)	$ (2,700)
Net (gain) loss amortized into net periodic benefit cost	2,363	1,450	202	387
Net gain (loss) arising during the period	(1,585)	(6,464)	1,997	(6,303)
Transfer from affilate	-	-	245	-
Balance at December 31	(21,298)	(22,075)	(6,171)	(8,616)
Changes in deferred taxes recognized in accumulated OCI	$ 272	$ (1,755)	$ 856	$ (2,071)

	Pension Plan			Other Benefit Plan		
	2012	**2011**	**2010**	**2012**	**2011**	**2010**
Additional information						
Net periodic benefit income (costs)	$ (1,374)	$ (849)	$ (345)	$ 2,495	$ 2,218	$ (1,403)
Net periodic benefit cost reclassified from accumulated OCI	(2,363)	(1,450)	(647)	(202)	(387)	14
Employer contributions	-	5,000	5,000	269	263	430
Employee contributions	-	-	-	325	185	152
Benefit payments	1,242	531	449	697	525	582
Actuarial assumptions						
Weighted-average assumptions used to determine benefit obligations as of December 31:						
Discount rate	3.82%	4.27%	5.33%	3.95%	4.28%	5.12%
Expected return on plan assets	7.00%	7.00%	7.00%	N/A	N/A	N/A
Weighted-average assumptions used to determine net costs for the years ended December 31:						
Discount rate	4.27%	5.33%	5.88%	4.28%	5.12%	5.50%
Expected return on plan assets	7.00%	7.00%	7.00%	N/A	N/A	N/A

(Dollars in Thousands)

The following estimated future benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years indicated:

	Pension Plan	Other Benefit Plan
Year ending December 31,		
2013	$ 1,326	$ 848
2014	1,497	908
2015	1,664	962
2016	1,813	1,050
2017	1,953	1,133
2018-2022	12,943	7,126

Pension Plan

Effective December 31, 2004, the Company approved a plan amendment to freeze the participants' accounts of the noncontributory defined benefit Pension Plan. This has the effect of establishing each participant's earned accrued benefit as of December 31, 2004. In addition, the participants' benefits shall be payable pursuant to the terms of the Pension Plan to the extent each participant is or becomes 100% vested in such accrued benefits.

In 2012, 2011 and 2010, the Pension Plan recorded an actuarial loss of $3,322, $8,220 and $5,082, respectively, due to demographic experience, including assumption changes, and investment returns that vary from assumptions made during the prior year.

For 2012 and 2011, the Company's weighted-average expected long-term rate of return on assets was 7.00%. In developing this assumption, the Company evaluated input from its third party pension plan asset managers, including their review of asset class return expectations and long-term inflation assumptions. The Company also considered its historical average return, which was in line with the expected long-term rate of return assumption for 2012.

The Pension Plan asset allocation as of the measurement date and target asset allocation, presented as a percentage of total plan assets, were as follows:

	2012 Target	2012	2011
Cash and cash equivalents, and fixed income investments	65%	63%	65%
Equity correclated investments	35%	37%	35%
Total	100%	100%	100%

It is the Company's policy to invest Pension Plan assets in a diversified portfolio consisting of an array of assets matching the target asset allocations investment strategies above. The assets are managed with a view to ensuring that sufficient liquidity will be available to meet the expected cash flow requirements of the plan. The investment risk of the assets is limited by appropriate diversification both within and between asset classes. To achieve the desired returns, the plan assets are invested primarily in a variety of individual fixed income securities matched to the plan's liabilities as well as diversified equity portfolio comprised of assets that are expected to generate an excess return over the return associated with the plan liabilities. This equity portfolio is expected to achieve long-term returns similar to the return on equities with reduced volatility through the use of option overlay, geographic diversification and a focus on strategies with higher income generation capacity.

(Dollars in Thousands)

The following table summarizes the valuation of the Company's Pension Plan assets carried at fair value as of December 31, 2012 and 2011 by asset class:

	December 31, 2012			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and cash equivalents (A)	$ 6	$ 634	$ -	$ 640
Fixed income investments (B)				
Asset backed securities	-	2,179	167	2,346
Corporate bonds	-	24,260	307	24,567
Mortage backed securities	-	1,942	-	1,942
Municipal bonds	-	1,585	-	1,585
Pooled funds (C)	17,211	-	546	17,757
Receivables (D)	417	-	-	417
	$ 17,634	$ 30,600	$ 1,020	$ 49,254

	December 31, 2011			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash and cash equivalents (A)	$ 7	$ 1,947	$ -	$ 1,954
Fixed income investments (B)				
Corporate debt instruments	-	23,966	-	23,966
Foreign debt obligations	-	1,134	-	1,134
Other government/ municipal agencies	-	2,312	-	2,312
Pooled funds (C)	15,160	-	-	15,160
Receivables (D)	160	-	841	1,001
	$ 15,327	$ 29,359	$ 841	$ 45,527

(A) Cash equivalents are held in a readily accessible money market fund invested in short-term U.S. Treasury securities. Bids/pricing of such securities held by the fund is received from individual brokers based on specific yields and maturities.

(B) Fixed income investments are generally based on quoted prices in active markets. When quoted prices are not available, fair value is determined based on valuation models that use inputs such as interest-rate yield curves, cross-currency basis index spreads and country-specific credit spreads similar to the bond in terms of issuer maturity and seniority.

(C) Pooled funds include mutual funds and hedge funds. Mutual funds are registered investments that are priced at net asset value ("NAV") at the end of each day. Mutual funds are invested in equities and commodities across a broad investment spectrum, including mid-cap, large-cap, emerging and developed market, liquid real estate and infrastructure. Hedge funds are primarily valued by each fund's administrator based upon the valuation of the underlying assets by applying methodologies as appropriate to the specific security/ instrument.

(D) Receivables are primarily accrued interest on fixed income investments.

Pension plan contributions in 2013 are expected to be $0.

The estimated amortization of net loss for the pension plan in 2013 is $2,718. The estimated 2013 net periodic benefit expense for the pension plan is $1,869. In 2013 a 50 basis point increase to the discount rate projected at 3.82% would decrease the net periodic cost by $1,370 and a 50 basis point decrease would increase the net periodic cost by $2,421. In 2013 a 50 basis point increase to the expected rate of return on assets projected at 6.50% would decrease the net periodic cost by $1,634 and a 50 basis point decrease would increase the net periodic cost by $2,103.

Other Benefit Plan

Effective January 1, 2012 the obligations for the postretirement health plan associated with the employees of an affiliated insurer, North American, were transferred to the Company. This transfer corresponded with the transfer of all active employees from the affiliated insurer to the Company. The transfer of $7,102 of benefit obligation was supported by $7,102 of cash which resulted in no impact to the Company's postretirement health costs in 2012.

In 2012, 2011 and 2010, the Other Benefit Plan recorded an actuarial loss of $1,557, $2,933, and $1,854, respectively, due to assumption changes and demographic experience different from rates assumed during the prior year.

For measurement purposes, a 7.60% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2011, and that rate was assumed to decrease gradually to 4.20% by 2084. For 2012, a 6.10% assumed annual rate of increase in the per capita cost of covered healthcare benefits were assumed, and that rate was assumed to decrease gradually to 4.20% by 2084.

The estimated 2013 amortization of net loss and prior service cost for the Other Benefit Plan is $290. The estimated 2013 net periodic benefit expense for the Other Benefit Plan is $2,792.

Employee stock ownership plan

The Company participates in an Employee Stock Ownership Plan ("ESOP") sponsored by SEI covering certain full-time employees. Prior to 2010, the majority of SEI's stock was held in the Charles A. Sammons 1987 Charitable Remainder Trust Number Two (the "CRT"). Prior to his death in 1988, Charles A. Sammons, the founder of SEI, established the CRT. The death of his widow, Elaine D. Sammons, in January 2009, initiated the process of settling the CRT. In January 2010, the 7,664,402 shares of the SEI stock held by the CRT were transferred to the ESOP (the

"Transfer") as unallocated shares, which completed the settlement of the CRT. As of December 31, 2012 the ESOP owns 99.99% of the outstanding stock of SEI.

Compensation expense of $18,680, $13,301 and $12,247 for 2012, 2011 and 2010, respectively, was recorded related to the ESOP.

16. OTHER RELATED PARTY TRANSACTIONS

The Company pays fees to SEI under management contracts that cover certain investment, accounting, employee benefits and management services. The Company was charged $9,568, $7,940 and $11,200 in 2012, 2011 and 2010, respectively, related to these contracts.

Guggenheim Partners Investment Management, Inc. ("Guggenheim") provides investment management services for the Company. During 2012, 2011 and 2010, the Company incurred $27,989, $24,764 and $23,674, respectively, for these investment management services. The fee is calculated based on the average fair value of invested assets under management multiplied by a contractual rate.

At December 31, 2012, the Company had a $70,000 reverse repurchase agreement with Guggenheim Aircraft Opportunity Fund, L.P. (a limited partnership managed by Guggenheim) that originated on December 27, 2012. The reverse repurchase agreement is reported in short-term investments in the consolidated balance sheets, has an initial term of 364 days, is renewable and earns an interest rate of 3.96%. The Company earned $41 from this agreement in 2012.

The Company held a mortgage loan on the property of an indirect affiliate, The Grove Park Inn. On May 1, 2012 SEI sold their interest in the Grove Park Inn and the related mortgage balance of $48,317 was paid in full. The Company earned interest income on the loan of $251, $3,675 and $3,741 in 2012, 2011 and 2010 respectively.

The Company is also a party to two coinsurance agreements with a reinsurer that is a subsidiary of Guggenheim. The Company receives fees under a service contract that became effective December 2009 which covers specified accounting and financial reporting services. The service fees received were $402, $355 and $304 in 2012, 2011 and 2010, respectively. See Note 10 for further discussion of these transactions.

The Company pays sales commissions to Sammons Securities, Inc. ("SSI"), a broker-dealer company, associated with the variable life and annuity premiums placed with the Company's separate account funds and other fixed annuity product sales. The Company incurred commissions of approximately $557, $516 and $711 in 2012, 2011 and 2010, respectively, related to SSI sales.

17. COMMITMENTS AND CONTINGENCIES

The Company has, in the normal course of business, claims and lawsuits filed against it. In some cases the damages sought are substantially in excess of contractual policy benefits. The Company believes these claims and lawsuits, either individually or in aggregate, will not materially affect the Company's financial position or results of operations.

At December 31, 2012, the Company had outstanding capital commitments to limited partnerships of $74,679.

The Company makes funding commitments to various private placement bond issuers. As of December 31, 2012, the Company had $46,057 of outstanding private placement bond funding commitments.

The Company has outstanding commitments on mortgage loans of $8,649 at December 31, 2012.

Under insurance guaranty fund laws, in most states insurance companies doing business therein can be assessed up to prescribed limits for policyholder losses incurred by insolvent companies. The Company does not believe such assessments will be materially different from amounts already provided for in the consolidated financial statements. Most of these laws do provide, however, that an assessment may be excused or deferred if it would threaten an insurer's own financial strength.

18. SUBSEQUENT EVENTS

The Company evaluated subsequent events through April 9, 2013 which is the date the consolidated financial statements were available to be issued. There were no subsequent event transactions that required disclosure in the consolidated financial statements.