



**Protective Life Corporation
Financial Statements and Notes
For the Year Ended December 31, 2021**

Financial Statements and Supplementary Data

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Independent Auditors' Report

The Shareowner and Board of Directors
Protective Life Corporation:

Opinion

We have audited the consolidated financial statements of Protective Life Corporation and its subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, and the related consolidated statements of income, comprehensive income (loss), shareowner's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 2 to the consolidated financial statements, as of January 1, 2020, the Company adopted new accounting guidance ASC Topic 326, *Financial Instruments - Credit Losses*. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher



than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

KPMG LLP

Birmingham, Alabama
March 1, 2022

PROTECTIVE LIFE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

| | For The Years Ended December 31, | |
|--|----------------------------------|----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Revenues | | |
| Gross premiums and policy fees | \$ 4,348 | \$ 4,032 |
| Reinsurance ceded | (1,389) | (1,048) |
| Net premiums and policy fees | 2,959 | 2,984 |
| Net investment income | 3,188 | 3,071 |
| Net realized gains (losses) | 139 | (185) |
| Other income | 562 | 661 |
| Total revenues | 6,848 | 6,531 |
| Benefits and expenses | | |
| Benefits and settlement expenses, net of reinsurance ceded: (2021 - \$1,427; 2020 - \$885) | 4,986 | 4,914 |
| Amortization of deferred policy acquisition costs and value of business acquired | 320 | 209 |
| Other operating expenses, net of reinsurance ceded: (2021 - \$238; 2020 - \$238) | 967 | 947 |
| Goodwill impairment | 200 | — |
| Total benefits and expenses | 6,473 | 6,070 |
| Income before income tax | 375 | 461 |
| Income tax expense | | |
| Current | 145 | 99 |
| Deferred | (47) | — |
| Total income tax expense | 98 | 99 |
| Net income | \$ 277 | \$ 362 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

| | For The Years Ended December 31, | |
|--|---|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Net income | \$ 277 | \$ 362 |
| Other comprehensive income (loss): | | |
| Change in net unrealized gains (losses) on investments, net of income tax: (2021 - \$(295); 2020 - \$546) | (1,110) | 2,054 |
| Reclassification adjustment for investment amounts included in net income, net of income tax: (2021 - \$(11); 2020 - \$17) | (41) | 63 |
| Change in net unrealized gains (losses) for which a credit loss has been recognized in net income, net of income tax: (2021 - \$0; 2020 - \$6) | (1) | 24 |
| Change in accumulated gain (loss)—derivatives, net of income tax: (2021 - \$0; 2020 - \$(1)) | — | (2) |
| Reclassification adjustment for derivative amounts included in net income, net of income tax: (2021 - \$0; 2020 - \$1) | 1 | 2 |
| Change in postretirement benefits liability adjustment, net of income tax: (2021 - \$7; 2020 - \$(5)) | 25 | (17) |
| Total other comprehensive income (loss) | (1,126) | 2,124 |
| Total comprehensive income (loss) | \$ (849) | \$ 2,486 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED BALANCE SHEETS

| | As of December 31, | |
|--|-----------------------|-------------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Assets | | |
| Fixed maturities, at fair value (amortized cost: 2021 - \$68,207; 2020 - \$65,817; allowance for credit losses: 2021 - \$1; 2020 - \$23) | \$ 73,205 | \$ 72,727 |
| Equity securities, at fair value (cost: 2021 - \$844; 2020 - \$674) | 868 | 706 |
| Commercial mortgage loans, net of allowance for credit losses (2021 - \$103; 2020 - \$222) | 10,863 | 10,006 |
| Policy loans | 1,527 | 1,593 |
| Other long-term investments | 3,595 | 3,197 |
| Short-term investments | 971 | 475 |
| Total investments | 91,029 | 88,704 |
| Cash | 544 | 751 |
| Accrued investment income | 705 | 708 |
| Accounts and premiums receivable | 136 | 131 |
| Reinsurance receivables, net of allowance for credit losses (2021 - \$97; 2020 - \$98) | 4,208 | 4,223 |
| Deferred policy acquisition costs and value of business acquired | 3,906 | 3,428 |
| Goodwill | 752 | 826 |
| Other intangibles, net of accumulated amortization (2021 - \$374; 2020 - \$312) | 564 | 541 |
| Property and equipment, net of accumulated depreciation (2021 - \$87; 2020 - \$64) | 217 | 208 |
| Other assets | 344 | 434 |
| Assets related to separate accounts | | |
| Variable annuity | 13,648 | 12,378 |
| Variable universal life | 1,982 | 1,286 |
| Reinsurance assumed | 13,883 | 13,325 |
| Total assets | \$ 131,918 | \$ 126,943 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED BALANCE SHEETS
(continued)

| | As of December 31, | |
|---|-----------------------|-------------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Liabilities | | |
| Future policy benefits and claims | \$ 54,067 | \$ 54,109 |
| Unearned premiums | 1,102 | 881 |
| Total policy liabilities and accruals | 55,169 | 54,990 |
| Stable value product account balances | 8,526 | 6,056 |
| Annuity account balances | 15,846 | 15,478 |
| Other policyholders' funds | 1,820 | 1,865 |
| Other liabilities | 5,074 | 5,422 |
| Deferred income taxes | 1,531 | 1,832 |
| Secured financing liabilities | 1,572 | 496 |
| Debt | 1,935 | 1,853 |
| Subordinated debt | 606 | 606 |
| Liabilities related to separate accounts | | |
| Variable annuity | 13,648 | 12,378 |
| Variable universal life | 1,982 | 1,286 |
| Reinsurance assumed | 13,883 | 13,325 |
| Total liabilities | 121,592 | 115,587 |
| Commitments and contingencies—Note 15 | | |
| Shareowner's equity | | |
| Common Stock, 2021 and 2020 - \$0.01 par value; shares authorized: 5,000; shares issued: 1,000 | — | — |
| Additional paid-in-capital | 5,804 | 5,804 |
| Retained earnings | 2,140 | 2,044 |
| Accumulated other comprehensive income (loss): | | |
| Net unrealized gains on investments, net of income tax: (2021 - \$642; 2020 - \$948) | 2,416 | 3,567 |
| Net unrealized losses on investments for which a credit loss has been recognized in net income, net of income tax: (2021 - \$(1); 2020 - \$(1)) | (3) | (2) |
| Accumulated loss - derivatives, net of income tax: (2021 - \$(2); 2020 - \$(2)) | (7) | (8) |
| Postretirement benefits liability adjustment, net of income tax: (2021 - \$(6); 2020 - \$(13)) | (24) | (49) |
| Total shareowner's equity | 10,326 | 11,356 |
| Total liabilities and shareowner's equity | \$ 131,918 | \$ 126,943 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED STATEMENTS OF SHAREOWNER'S EQUITY

| | Common Stock | Additional Paid-In- Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareowner's equity |
|------------------------------|-------------------------|--|------------------------------|--|--|
| | (Dollars In Millions) | | | | |
| Balance, December 31, 2019 | \$ — | \$ 5,804 | \$ 2,052 | \$ 1,384 | \$ 9,240 |
| Net income | | | 362 | | 362 |
| Other comprehensive income | | | | 2,124 | 2,124 |
| Comprehensive income | | | | | 2,486 |
| Cumulative effect adjustment | | | (138) | | (138) |
| Dividends to parent | | | (232) | | (232) |
| Balance, December 31, 2020 | \$ — | \$ 5,804 | \$ 2,044 | \$ 3,508 | \$ 11,356 |
| Net income | | | 277 | | 277 |
| Other comprehensive loss | | | | (1,126) | (1,126) |
| Comprehensive loss | | | | | (849) |
| Dividends to parent | | | (181) | | (181) |
| Balance, December 31, 2021 | \$ — | \$ 5,804 | \$ 2,140 | \$ 2,382 | \$ 10,326 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | For The Years Ended December 31, | |
|--|----------------------------------|-------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Cash flows from operating activities | | |
| Net income | \$ 277 | \$ 362 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Net realized (gains) losses | (139) | 185 |
| Amortization of deferred acquisition costs and value of business acquired | 320 | 209 |
| Capitalization of deferred acquisition costs | (572) | (461) |
| Depreciation and amortization expense | 87 | 81 |
| Deferred income tax | (47) | — |
| Accrued income tax | (73) | 22 |
| Interest credited to universal life and investment products | 1,520 | 1,593 |
| Goodwill impairment | 200 | — |
| Trading securities purchases, sales, and maturities, net | 12 | (139) |
| Other, net | (34) | — |
| Change in: | | |
| Policy fees assessed on universal life and investment products | (1,834) | (1,798) |
| Reinsurance receivables | 15 | 146 |
| Accrued investment income and other receivables | (2) | 29 |
| Policy liabilities and other policyholders' funds of traditional life and health products | (612) | (1,079) |
| Amortization of premiums and accretion of discounts on investments and commercial mortgage loans | 245 | 382 |
| Other liabilities | 104 | 624 |
| Other, net | 232 | (171) |
| Net cash used in operating activities | (301) | (15) |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

| | For The Year Ended December 31, | |
|---|---------------------------------|----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Cash flows from investing activities | | |
| Maturities and principal reductions of investments, available-for-sale | 5,862 | 5,296 |
| Sale of investments, available-for-sale | 3,110 | 6,301 |
| Cost of investments acquired, available-for-sale | (11,766) | (13,996) |
| Commercial mortgage loans: | | |
| New loan originations | (2,182) | (1,611) |
| Repayments | 1,415 | 749 |
| Change in policy loans, net | 66 | 82 |
| Change in other long-term investments, net | (325) | (9) |
| Purchase of other long-term investments | (500) | — |
| Change in short-term investments, net | (490) | 1,024 |
| Net unsettled security transactions | 86 | 141 |
| Purchase of property, equipment, and intangibles | (42) | (29) |
| Payment for business acquisition, net of cash acquired | 24 | — |
| Net cash used in investing activities | (4,742) | (2,052) |
| Cash flows from financing activities | | |
| Borrowings under line of credit arrangements, debt, and subordinated debt | 505 | 610 |
| Principal payments on line of credit arrangement, debt, and subordinated debt | (420) | (420) |
| Issuance (repayment) of non-recourse funding obligations | — | (21) |
| Change in secured financing liabilities | 1,076 | 160 |
| Dividends to shareowner | (181) | (232) |
| Deposits to universal life and investment contracts | 7,830 | 6,627 |
| Withdrawals from universal life and investment contracts | (3,924) | (4,147) |
| Other financing activities, net | (50) | (3) |
| Net cash provided by financing activities | 4,836 | 2,574 |
| Change in cash | (207) | 507 |
| Cash at beginning of period | 751 | 244 |
| Cash at end of period | \$ 544 | \$ 751 |

See Notes to Consolidated Financial Statements

PROTECTIVE LIFE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Basis of Presentation

Protective Life Corporation (the “Company”) is a wholly owned subsidiary of Dai-ichi Life Holdings, Inc., a *kabushiki kaisha* organized under the laws of Japan (“Dai-ichi Life”). The Company is a holding company with subsidiaries that provide financial services through the production, distribution, and administration of insurance and investment products. The Company markets individual life insurance, guaranteed investment contracts, guaranteed funding agreements, fixed and variable annuities, and extended service contracts throughout the United States. The Company also maintains a separate segment devoted to the acquisition of insurance policies from other companies. Founded in 1907, Protective Life Insurance Company (“PLICO”) is the Company’s largest operating subsidiary.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Such accounting principles differ from statutory reporting practices used by insurance companies in reporting to state regulatory authorities (see also Note 21, *Statutory Reporting Practices and Other Regulatory Matters*).

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

Beginning in the first quarter of 2020, the outbreak of COVID-19, created significant economic and social disruption and impacted various operational and financial aspects of the Company’s business. Certain impacts from COVID-19 continued into 2021, including increased claims in both the life insurance and annuity blocks. In addition, the Asset Protection segment had a reduction in sales in the second half of 2021 due to supply chain issues. The pandemic may continue to impact the Company’s earnings based on, amongst other factors, the volume and severity of claims related to COVID-19 and the financial disruption caused by the pandemic, which could impact the Company’s investment portfolio.

Entities Included

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates include those used in determining deferred policy acquisition costs (“DAC”) and related amortization periods, goodwill recoverability, value of business acquired (“VOBA”), certain investments and certain derivatives fair values, the allowance for credit losses, other-than-temporary impairments, future policy benefits, pension and other postretirement benefits, provisions for income taxes, reserves for contingent liabilities, reinsurance risk transfer assessments, and reserves for losses in connection with unresolved legal matters.

Further, certain estimates and assumptions include the direct and indirect impact of the COVID-19 pandemic on the Company’s business, financial condition and results of operations. The economic impact of the pandemic on the Company’s business depends on its severity and duration, which in turn depend on highly uncertain factors such as the nature and extent of containment efforts and the timing and efficacy of vaccines. The high level of uncertainty regarding this economic impact means that management’s estimates and assumptions, specifically those related to investments and certain derivatives fair values, the allowance for credit losses, and future policy benefits are subject to change – perhaps substantial change – as the situation develops and new information becomes available.

Significant Accounting Policies

Income Statement

Net Investment Income

Investment income is recognized when earned, net of applicable management or other fees. Investment income on fixed maturity securities includes coupon interest, amortization of any premium and accretion of any discount. Investment income on equity securities includes dividend income and preferred coupons interest.

Investment income on commercial mortgage-backed securities (“CMBS”), residential mortgage-backed securities (“RMBS”), and other asset-backed securities is initially based upon yield, cash flow and prepayment assumptions at the date of purchase. Subsequent revisions in those assumptions are recorded using the retrospective or prospective method. Under the retrospective method used primarily for mortgage-backed and asset-backed securities of high credit quality which cannot be contractually prepaid in such a manner that we would not recover a substantial portion of the initial investment, amortized cost of the security is adjusted to the amount that would have existed had the revised assumptions been in place at the date of purchase. The adjustments to amortized cost are recorded as a charge or credit to net investment income. Under the prospective method, which is used for all other mortgage-backed and asset-backed securities, future cash flows are estimated and interest income is recognized going forward using the new internal rate of return.

Net realized gains (losses)

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

Other Income

Other income consists primarily of advisory and administration service fees assessed on investment contract holder account values, marketing and distribution fees, rider charges associated with guaranteed benefits, distribution company revenues and other fees. In addition, any gains related to final settlements related to its acquisitions are included in other income.

Balance Sheet

Valuation of Investment Securities

The Company determines the appropriate classification of investment securities at the time of purchase and periodically re-evaluates such designations. Investment securities are classified as either trading or available-for-sale securities. Investment securities classified as trading are recorded at fair value with changes in fair value recorded in *net realized gains (losses)*. Investment securities purchased for long term investment purposes are classified as available-for-sale and are recorded at fair value with changes in unrealized gains and losses, net of taxes, reported as a component of other comprehensive income (loss). Interest income on available-for-sale securities include the amortization of premiums and accretion of discounts and are recorded in investment income.

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

of the rate of future prepayments of principal and underlying collateral support over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and rates of prepayments previously experienced at the interest rate levels projected for the underlying collateral. The basis for the cost of securities sold was determined at the Committee on Uniform Securities Identification Procedures (“CUSIP”) level on a first in first out basis. The committee supplies a unique nine-character identification, called a CUSIP number, for each class of security approved for trading in the U.S., to facilitate clearing and settlement. These numbers are used when any buy and sell orders are recorded.

Allowance for Credit Losses – Fixed Maturity and Structured Investments

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

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

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

Corporate-Owned Life Insurance

The Company has purchased corporate-owned life insurance (“COLI”) on the lives of certain employees. COLI is carried at the cash surrender value of the policies, which is based upon the underlying fair value of the portfolio of assets. Changes in the cash surrender value are reported currently in earnings. COLI is included in *other long-term investments* on the Company’s balance sheet and the cash surrender value was \$710 million and \$179 million as of December 31, 2021 and 2020, respectively.

Derivative Financial Instruments

The Company records its derivative financial instruments at fair value in the consolidated balance sheet in *other long-term investments* and *other liabilities*. The Company designates derivatives as either a *cash flow* hedge which hedges the variability of cash flows specific to a recognized asset or liability or forecasted transaction; a *fair value* hedge, which hedges the fair value of a recognized asset or liability or unrecognized firm commitment; or a derivative that does not qualify for hedge accounting. The Company assesses the effectiveness of a hedge at its inception and subsequently on a quarterly basis. For cash flow hedges, the effective portion of their gain or loss is reported as a component of other comprehensive income (loss) and reclassified into earnings in the period during which the hedged item impacts earnings. Any remaining gain or loss, the ineffective portion, is recognized in *net realized gains (losses)*. For fair value hedges, their gain or loss as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in *net realized gains (losses)*. The Company reports changes in fair values of derivatives that are not part of a qualifying hedge relationship in *net realized gains (losses)*. For additional information, see Note 6, *Derivative Financial Instruments*.

Commercial Mortgage Loans

The Company's commercial mortgage loans are stated at unpaid principal balance, adjusted for any unamortized premium or discount, and net of the allowance for credit losses ("ACL"). Interest income is accrued on the principal amount of the loan based on the loan's contractual interest rate. Amortization of premiums and discounts is recorded using the effective yield method. Interest income, amortization of premiums and discounts and prepayment fees are reported in *net investment income*.

Allowance for Credit Losses – Commercial Mortgage Loans and Unfunded Commitments

Effective January 1, 2020, the ACL represents the Company's best estimate of expected credit losses over the contractual term of the loans. The allowance for credit losses for unfunded loan commitments is recognized as a component of *other liabilities* on the consolidated condensed balance sheet. Changes in the allowance for credit losses for both funded and unfunded commercial mortgage loans are recognized in *net realized gains (losses)*. Prior to January 1, 2020, the Company calculated a valuation allowance based on the analysis of specific loans that were believed to have a higher risk of credit impairment consistent with the applicable guidance for loan impairments in ASC Subtopic 310.

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

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

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

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

Certain loans which meet the definition of collateral dependent are identified as part of the Company's ongoing loan surveillance process. Loans are considered to be collateral dependent if foreclosure is deemed probable, or if a borrower is in financial difficulty and repayment is expected to be provided substantially through the operation or sale of the underlying collateral. The ACL for loans identified as collateral dependent is measured based on the fair value of the underlying collateral, less costs to sell.

The Company presents accrued interest receivable separately from other components of the amortized cost basis of its commercial mortgage loans and has made an accounting policy election not to measure an allowance for credit losses for accrued interest receivable. It is the Company's policy to cease to carry accrued interest on loans that are over 90 days delinquent. For loans less than 90 days delinquent, interest is accrued unless it is determined that the accrued interest is not collectible. In each scenario, accrued income is reversed through investment income. See Note 8, *Commercial Mortgage Loans*, for additional information.

Short-term Investments

Short-term investments primarily consist of highly liquid securities and other investments with remaining maturities of one year or less, but greater than three months, at the time of purchase. These securities and investments are generally carried at fair value or amortized cost that approximates fair value.

Cash

Cash includes all demand deposits reduced by the amount of outstanding checks and drafts. As a result of the Company's cash management system, checks issued from a particular bank but not yet presented for payment may create negative book cash balances with the bank at certain reporting dates. Such negative balances are included in other liabilities and were \$184 million and \$185 million as of December 31, 2021 and 2020, respectively. 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 a material loss.

Policy Loans

Policy loans are stated at unpaid principal balances. Interest income is recorded as earned using the contractual interest rate. Generally, accrued interest is capitalized on the policy's anniversary date. Any unpaid principal and accrued interest is deducted from the cash surrender value or the death benefit prior to settlement of the insurance policy.

Deferred Policy Acquisition Costs ("DAC")

The incremental direct costs associated with successfully acquired insurance policies are deferred to the extent such costs are deemed recoverable from future profits. Such costs include commissions, costs of policy issuance and underwriting and certain other costs that are directly related to the successful acquisition of traditional life and health insurance, credit insurance, universal life insurance, and investment products. DAC is subject to recoverability testing at the end of each accounting period. Traditional life and health insurance acquisition costs are amortized over the premium-payment period of the related policies in proportion to the ratio of annual premium income to the present value of the total anticipated premium income. Credit insurance acquisition costs are being amortized in proportion to earned premium. Acquisition costs for universal life and investment products are amortized over the lives of the policies in relation to the present value of estimated gross profits before amortization. Acquisition costs for stable value contracts are amortized over the term of the contracts using the effective yield method.

The Company makes certain assumptions regarding the mortality, persistency, expenses, and interest rates (equal to the rate used to compute liabilities for future policy benefits, currently 1.00% to 7.86%) the Company expects to experience in future periods when determining the present value of estimated gross profits ("EGPs"). These assumptions are best estimates and are periodically updated whenever actual experience and/or expectations for the future change from that assumed. Additionally, DAC is also impacted by unrealized investment gains (losses) which would have been recognized if such gains and losses had been realized. The Company includes the impact of these credits or charges, net of tax, in accumulated other comprehensive income ("AOCI").

Value of Businesses Acquired ("VOBA")

In conjunction with the Merger and the acquisition of insurance policies or investment contracts, a portion of the purchase price is allocated to the right to receive future gross profits from cash flows and earnings of associated insurance policies and investment contracts. This intangible asset, called VOBA, is based on the actuarially estimated present value of future cash flows from associated insurance policies and investment contracts acquired. The estimated present value of future cash flows used in the calculation of the VOBA is based on certain assumptions, including mortality, persistency, expenses, and interest rates that the Company believes to be those of a market participant. The Company amortizes VOBA in proportion to gross premiums for traditional life products, or estimated gross margins ("EGMs") for participating traditional life products within the MONY Life Insurance Company ("MONY") block. For interest sensitive products, the Company uses various amortization bases including EGPs, revenues, account values, or insurance in-force. VOBA is subject to annual recoverability testing.

Included within the *deferred policy acquisition costs and value of business acquired* line of the Company's consolidated balance sheets are amounts related to certain contracts or blocks of business that have negative VOBA. These amounts are presented on a net basis with positive VOBA amounts within this line on the Company's consolidated balance sheets. Negative VOBA is amortized over the life of the related policies based on the amount of insurance in-force (for life insurance) or account values (for annuities). Such amortization is recorded in the *amortization of deferred policy acquisition costs and value of business acquired* line of the Company's consolidated statements of income on a net basis with any positive VOBA amortization.

Other Intangible Assets

Other intangible assets with definite lives are amortized over the estimated useful life of the asset and reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Amortizable intangible assets primarily consist of distribution relationships, trade names, technology, and software. Intangible assets with indefinite lives, primarily insurance licenses, are not amortized, but are reviewed for impairment on an annual basis or whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Software is generally amortized over a three - five year useful life.

Other intangible assets recognized by the Company included the following:

| | As of December 31, | | Estimated Useful Life |
|---|-----------------------|---------------|--------------------------|
| | 2021 | 2020 | |
| | (Dollars In Millions) | | (In Years) |
| Distribution relationships | \$ 381 | \$ 340 | 14 - 22 |
| Trade names | 62 | 65 | 13 - 17 |
| Technology | 59 | 71 | 7 - 14 |
| Other | 30 | 33 | |
| Total intangible assets subject to amortization | 532 | 509 | |
| Insurance licenses | 32 | 32 | Indefinite |
| Total other intangible assets | <u>\$ 564</u> | <u>\$ 541</u> | |

Other identified intangible assets were valued using the excess earnings method, relief from royalty method or cost approach, as appropriate.

Amortizable intangible assets will be amortized straight line over their assigned useful lives. The following is a schedule of future estimated aggregate amortization expense:

| Year | Amount |
|------|-----------------------|
| | (Dollars In Millions) |
| 2022 | \$ 59 |
| 2023 | 56 |
| 2024 | 53 |
| 2025 | 48 |
| 2026 | 47 |

Property and Equipment

The Company depreciates its assets using the straight-line method over the estimated useful lives of the assets. The Company's home office is depreciated over twenty-five years, furniture is depreciated over a ten year useful life, office equipment and machines are depreciated over a five year useful life, and computers are depreciated over a four year useful life. Land is not depreciated. Major repairs or improvements are capitalized and depreciated over the estimated useful lives of the assets. Other repairs are expensed as incurred. The cost and related accumulated depreciation of property and equipment sold or retired are removed from the accounts, and resulting gains or losses are included in income. Leases are recorded on the balance sheet as right-of-use assets and liabilities within *property and equipment* and *other liabilities*, respectively.

Property and equipment consisted of the following:

| | As of December 31, | |
|--|-----------------------|--------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Home office building | \$ 160 | \$ 159 |
| Data processing equipment | 39 | 36 |
| Capital leases | 55 | 29 |
| Other, principally furniture and equipment | 25 | 23 |
| Total property and equipment subject to depreciation | 279 | 247 |
| Accumulated depreciation | (87) | (64) |
| Land | 25 | 25 |
| Total property and equipment | \$ 217 | \$ 208 |

Separate Accounts

The separate account assets represent funds for which the Company does not bear the investment risk. These assets are carried at fair value and are equal to the separate account liabilities, which represent the policyholder's equity in those assets. The investment income and investment gains and losses on the separate account assets accrue directly to the policyholder. These amounts are reported separately as assets and liabilities related to separate accounts in the accompanying consolidated financial statements. Amounts assessed against policy account balances for the costs of insurance, policy administration, and other services are included in premiums and policy fees in the accompanying consolidated statements of income. Fees are generally based on the daily net assets of the policyholder's account value and recognized as revenue when assessed. Assets and liabilities related to separate accounts include balances related to separate accounts assumed through reinsurance. These balances relate to variable annuity and variable life policies that we have reinsured on a modified coinsurance basis.

Stable Value Product Account Balances

The Stable Value Products segment sells fixed and floating rate funding agreements directly to qualified institutional investors. The segment also issues funding agreements to the Federal Home Loan Bank ("FHLB"), and markets guaranteed investment contracts ("GICs") to 401(k) and other qualified retirement savings plans. GICs are contracts which specify a return on deposits for a specified period and often provide flexibility for withdrawals at book value in keeping with the benefits provided by the plan.

The Company records its stable value contract liabilities in the consolidated balance sheets in "stable value product account balances" at the deposit amount plus accrued interest, adjusted for any unamortized premium or discount. Interest on the contracts is accrued based upon contract terms. Any premium or discount is amortized using the effective yield method.

The segment's products complement the Company's overall asset/liability management in that the terms may be tailored to the needs of PLICO as the seller of the contracts. Stable value product account balances include GICs and funding agreements the Company has issued. As of December 31, 2021 and 2020, the Company had \$6,573 million and \$4,032 million, respectively, of stable value product account balances marketed through structured programs. Most GICs and funding agreements the Company has written have maturities of one to twelve years.

As of December 31, 2021, future maturities of stable value products were as follows:

| <u>Year of Maturity</u> | <u>Amount</u> |
|-------------------------|-----------------------|
| | (Dollars In Millions) |
| 2022 | \$ 2,559 |
| 2023 - 2024 | 3,551 |
| 2025 - 2026 | 1,347 |
| Thereafter | 1,069 |

Insurance Liabilities and Reserves

Establishing an adequate liability for the Company's obligations to policyholders requires the use of certain assumptions. Estimating liabilities for future policy benefits on life and health insurance products requires the use of assumptions relative to future investment yields, mortality, morbidity, persistency, and other assumptions based on the

Company's historical experience, modified as necessary to reflect anticipated trends and to include provisions for possible adverse deviation. Determining liabilities for the Company's property and casualty insurance products also requires the use of assumptions, including the projected levels of used vehicle prices, the frequency and severity of claims, and the effectiveness of internal processes designed to reduce the level of claims. The Company's results depend significantly upon the extent to which its actual claims experience is consistent with the assumptions the Company used in determining its reserves and pricing its products. The Company's reserve assumptions and estimates require significant judgment and, therefore, are inherently uncertain. The Company cannot determine with precision the ultimate amounts that it will pay for actual claims or the timing of those payments.

Guaranteed Living Withdrawal Benefits

The Company also establishes reserves for guaranteed living withdrawal benefits ("GLWB") on its variable annuity ("VA") products. The GLWB is valued in accordance with FASB guidance under the ASC Derivatives and Hedging Topic which utilizes the valuation technique prescribed by the ASC Fair Value Measurements and Disclosures Topic, which requires the embedded derivative to be recorded at fair value using current interest rates and implied volatilities for the equity indices. The fair value of the GLWB is impacted by equity market conditions and can result in the GLWB embedded derivative being in an overall net asset or net liability position. In times of favorable equity market conditions the likelihood and severity of claims is reduced and expected fee income increases. Since claims are generally expected later than fees, these favorable equity market conditions can result in the present value of fees being greater than the present value of claims, which results in a net GLWB embedded derivative asset. In times of unfavorable equity market conditions the likelihood and severity of claims is increased and expected fee income decreases and can result in the present value of claims exceeding the present value of fees resulting in a net GLWB embedded derivative liability. The methods used to estimate the embedded derivative employ assumptions about mortality, lapses, policyholder behavior, equity market returns, interest rates, and market volatility. The Company assumes age-based mortality from the Ruark 2015 ALB table adjusted for company experience. Differences between the actual experience and the assumptions used result in variances in profit and could result in losses. As of December 31, 2021 and 2020, our net GLWB liability held was \$475 million and \$822 million, respectively.

Goodwill

The balance recognized as goodwill is not amortized, but is reviewed for impairment on an annual basis, or more frequently as events or circumstances may warrant, including those circumstances which would more likely than not reduce the fair value of the Company's reporting units below its carrying amount. Accounting for goodwill requires an estimate of the future profitability of the associated lines of business within the Company's reporting units to assess the recoverability of the capitalized goodwill. The Company's material goodwill balances are attributable to certain of its reportable segments. Each of the Company's reportable segments are considered separate reporting units, with the exception of the Retail Life and Annuity segment. This reportable segment contains the Protection and Retirement divisions which are considered separate reporting units. The Company evaluates the carrying value of goodwill at the reporting units level at least annually and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Such circumstances could include, but are not limited to: 1) a significant adverse change in legal factors or in business climate, 2) unanticipated competition, or 3) an adverse action or assessment by a regulator. When evaluating whether goodwill is impaired, the Company first determines through qualitative analysis whether relevant events and circumstances indicate that it is more likely than not that a reporting unit's goodwill balances is impaired as of the testing date. If the qualitative analysis does not indicate that an impairment of a reporting unit's goodwill is more likely than not then no other specific quantitative impairment testing is required.

If it is determined that it is more likely than not that impairment exists, the Company performs a quantitative assessment and compares its estimate of the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. The Company utilizes a fair value measurement (which includes a discounted cash flows analysis) to assess the carrying value of the reporting unit in consideration of the recoverability of the goodwill balance assigned to each reporting unit as of the measurement date. The cash flows used to determine the fair value of the Company's reporting units are dependent on a number of significant assumptions. The Company's estimates, which consider a market participant view of fair value, are subject to change given the inherent uncertainty in predicting future results and cash flows, which are impacted by such things as policyholder behavior, competitor pricing, capital limitations, new product introductions, and specific industry and market conditions. See Note 10, *Goodwill* for additional information on the Company's annual impairment review.

Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return that includes both life insurance companies and non-life insurance companies.

The Company uses the asset and liability method of accounting for income taxes. Generally, most items in pretax book income are also included in taxable income in the same year. However, some items are recognized for book purposes and for tax purposes in different years or are never recognized for either book or tax purposes. Those differences that will never be recognized for either book or tax purposes are permanent differences (e.g., investment income not subject to tax). As a result, the effective tax rate reflected in the financial statements may differ from the statutory rate reflected in the tax return. Those differences that are reported in different years for book and tax purposes are temporary and will reverse over time (e.g., the valuation of future policy benefits). These temporary differences are accounted for in the intervening periods as deferred tax assets and liabilities. Deferred tax assets generally represent revenue that is taxable before it is recognized in financial income and expenses that are deductible after they are recognized in financial income. Deferred tax liabilities generally represent revenues that are taxable after they are recognized in financial income or expenses or losses that are deductible before they are recognized in financial income. Components of AOCI are presented net of tax, and it is the Company's policy to use the aggregate portfolio approach to clear the disproportionate tax effects that remain in AOCI as a result of tax rate changes and certain other events. Under the aggregate portfolio approach, disproportionate tax effects are cleared only when the portfolio of investments that gave rise to the deferred tax item is sold or otherwise disposed of in its entirety.

The Company evaluates the recoverability of the Company's deferred tax assets and establishes a valuation allowance, if necessary, to reduce the Company's deferred tax assets to an amount that is more likely than not to be realized. Considerable judgment is required in determining whether a valuation allowance is necessary, and if so, the amount of such valuation allowance. In evaluating the need for a valuation allowance the Company may consider many factors, including: (1) the nature of the deferred tax assets and liabilities; (2) whether they are ordinary or capital; (3) in which tax jurisdictions they were generated and the timing of their reversal; (4) taxable income in prior carryback years as well as projected taxable earnings exclusive of reversing temporary differences and carryforwards; (5) the length of time that carryovers can be utilized in the various taxing jurisdictions; (6) any unique tax rules that would impact the utilization of the deferred tax assets; and (7) any tax planning strategies that the Company would employ to avoid a tax benefit from expiring unused. Although realization is not assured, management believes it is more likely than not that the deferred tax assets, net of valuation allowances, will be realized.

GAAP prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on tax returns. The application of this guidance is a two-step process, the first step being recognition. The Company determines whether it is more likely than not, based on the technical merits, that the tax position will be sustained upon examination. If a tax position does not meet the more likely than not recognition threshold, the benefit of that position is not recognized in the financial statements. The second step for the tax positions that meet the more likely than not criteria is measurement. The Company measures the tax position as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate resolution with a taxing authority that has full knowledge of all relevant information. This measurement considers the amounts and probabilities of the outcomes that could be realized upon ultimate settlement using the facts, circumstances, and information available at the reporting date.

The Company's liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service ("IRS") or other taxing jurisdictions. Audit periods remain open for review until the statute of limitations expires. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards, the statute of limitations does not close until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The Company classifies all interest and penalties related to tax uncertainties as income tax expense. See Note 18, *Income Taxes*, for additional information regarding income taxes.

Policyholder Liabilities, Revenues, and Benefits Expense

Future Policy Benefits and Claims

Liabilities for life and annuity benefit reserves consist of liabilities for traditional life insurance, cash values associated with universal life insurance, immediate annuity benefit reserves, and other benefits associated with life and annuity benefits. The unpaid life claim liabilities consist of current pending claims as well as an estimate of incurred but not reported life insurance claims.

Other policy benefit reserves consist of certain health insurance policies that are in runoff. The unpaid claim liabilities associated with other policy benefits includes current pending claims, the present value of estimated future claim payments for policies currently receiving benefits and an estimate of claims incurred but not yet reported.

Traditional Life, Health, and Credit Insurance Products

Traditional life insurance products consist principally of those products with fixed and guaranteed premiums and benefits, and they include whole life insurance policies, term and term-like life insurance policies, limited payment life insurance policies, and certain annuities with life contingencies. In accordance with ASC 805, the liabilities for future policy benefits on traditional life insurance products, when combined with the associated VOBA, were recorded at fair value on the date of the Merger. These values, subsequent to the Merger, are computed using assumptions that include interest rates, mortality, lapse rates, expense estimates, and other assumptions based on the Company's experience, modified as necessary to reflect anticipated trends and to include provisions for possible adverse deviation.

Liabilities for future policy benefits on traditional life insurance products have been computed using a net level method including assumptions as to investment yields, mortality, persistency, and other assumptions based on the Company's experience, modified as necessary to reflect anticipated trends and to include provisions for possible adverse deviation. Reserve investment yield assumptions on December 31, 2021, range from approximately 2.50% to 5.50%. The liability for future policy benefits and claims on traditional life, health, and credit insurance products includes estimated unpaid claims that have been reported to us and claims incurred but not yet reported. Policy claims are charged to expense in the period in which the claims are incurred.

Traditional life insurance premiums are recognized as revenue when due. Health and credit insurance premiums are recognized as revenue over the terms of the policies. Benefits and expenses are associated with earned premiums so that profits are recognized over the life of the contracts. This is accomplished by means of the provision for liabilities for future policy benefits and the amortization of DAC and VOBA. Gross premiums in excess of net premiums related to immediate annuities are deferred and recognized over the life of the policy.

Universal Life and Investment Products

Universal life and investment products include universal life insurance, guaranteed investment contracts, guaranteed funding agreements, deferred annuities, and annuities without life contingencies. Premiums and policy fees for universal life and investment products consist of fees that have been assessed against policy account balances for the costs of insurance, policy administration, and surrenders. Such fees are recognized when assessed and earned. Benefit reserves for universal life and investment products represent policy account balances before applicable surrender charges plus certain deferred policy initiation fees that are recognized in income over the term of the policies. Policy benefits and claims that are charged to expense include benefit claims incurred in the period in excess of related policy account balances and interest credited to policy account balances. Interest rates credited to universal life products ranged from 1.0% to 8.75% and investment products ranged from 0.05% to 9.81% in 2021.

The Company establishes liabilities for fixed indexed annuity ("FIA") products. These products are deferred fixed annuities with a guaranteed minimum interest rate plus a contingent return based on equity market performance. The FIA product is considered a hybrid financial instrument under FASB ASC Topic 815 - *Derivatives and Hedging* which allows the Company to make the election to value the liabilities of these FIA products at fair value. This election was made for the FIA products issued through 2009. These products are no longer being marketed. The future changes in the fair value of the liability for these FIA products are recorded in *Benefit and settlement expenses* with the liability being recorded in *Annuity account balances*. For more information regarding the determination of fair value of annuity account balances please refer to Note 5, *Fair Value of Financial Instruments*. Premiums and policy fees for these FIA products consist of fees that have been assessed against the policy account balances for surrenders. Such fees are recognized when assessed and earned.

The Company currently markets a deferred fixed annuity with a guaranteed minimum interest rate plus a contingent return based on equity market performance and the products are considered hybrid financial instruments under the FASB's ASC Topic 815 - *Derivatives and Hedging*. As a result, the Company accounts for the provision that provides for a contingent return based on equity market performance as an embedded derivative. The embedded derivative is bifurcated from the host contract and recorded at fair value in *Other liabilities*. Changes in the fair value of the embedded derivative are recorded in *net realized gains (losses)*. For more information regarding the determination of fair value of the FIA embedded derivative refer to Note 5, *Fair Value of Financial Instruments*. The host contract is accounted for as a universal life ("UL") type insurance contract in accordance with ASC Topic 944 - *Financial Services—Insurance* and is recorded in *Annuity account balances* with any discount to the minimum account value being accreted using the effective yield method.

The Company markets universal life products with a guaranteed minimum interest rate plus a contingent return based on equity market performance and the products are considered hybrid financial instruments under the FASB's ASC Topic 815 - *Derivatives and Hedging*. The Company has not elected to value these indexed universal life ("IUL") products at fair value prior to the Merger date. As a result, the Company accounts for the provision that provides for a contingent return based on equity market performance as an embedded derivative. The embedded derivative is bifurcated from the host contract and

recorded at fair value in *Other liabilities*. Changes in the fair value of the embedded derivative are recorded in *net realized gains (losses)*. For more information regarding the determination of fair value of the IUL embedded derivative refer to Note 5, *Fair Value of Financial Instruments*. The host contract is accounted for as a debt instrument in accordance with ASC Topic 944 - *Financial Services - Insurance* and is recorded in *Future policy benefits and claims* with any discount to the minimum account value being accreted using the effective yield method. Benefits and settlement expenses include accrued interest and benefit claims incurred during the period.

The Company's accounting policies with respect to variable universal life ("VUL") and VA are identical to those noted above for universal life and investment products except that policy account balances (excluding account balances that earn a fixed rate) are valued at fair value and reported as components of assets and liabilities related to separate accounts.

The Company establishes liabilities for guaranteed minimum death benefits ("GMDB") on its VA products. The methods used to estimate the liabilities employ assumptions about mortality and the performance of equity markets. The Company assumes age-based mortality from the Ruark 2015 ALB table adjusted for company experience. Future declines in the equity market would increase the Company's GMDB liability. Differences between the actual experience and the assumptions used result in variances in profit and could result in losses. A portion of the Company's GMDB is subject to a dollar-for-dollar reduction upon withdrawal of related annuity deposits on contracts issued prior to January 1, 2003. As of December 31, 2021 and 2020, the GMDB reserve was \$38 million and \$43 million, respectively.

Annuity Account Balances and Other Policyholders' Funds

Annuity account balances consists of the fixed account value of deferred annuities and the host contract value of indexed annuities. Other policyholders' funds consists of immediate benefit accounts and supplementary contracts without life contingencies.

Property and Casualty Insurance Products

Property and casualty insurance products include service contract business, surety bonds, and guaranteed asset protection ("GAP"). Premiums and fees associated with service contracts and GAP products are recognized based on expected claim patterns. For all other products, premiums are generally recognized over the terms of the contract on a pro-rata basis. Commissions and fee income associated with other products are recognized as earned when the related services are provided to the customer. Unearned premium reserves are maintained for the portion of the premiums that is related to the unexpired period of the policy. Such reserves are computed by pro rata methods or methods related to anticipated claims. Benefit reserves are recorded when insured events occur. Benefit reserves include case basis reserves for known but unpaid claims as of the balance sheet date as well as incurred but not reported ("IBNR") reserves for claims where the insured event has occurred but has not been reported to the Company as of the balance sheet date. The case basis reserves and IBNR are calculated based on historical experience and on assumptions relating to claim severity and frequency, the level of used vehicle prices, and other factors. These assumptions are modified as necessary to reflect anticipated trends.

Reinsurance

The Company uses reinsurance extensively in certain of its segments and accounts for reinsurance and the recognition of the impact of reinsurance costs in accordance with the ASC Financial Services - Insurance Topic. The following summarizes some of the key aspects of the Company's accounting policies for reinsurance.

Reinsurance Accounting Methodology—Ceded premiums of the Company's traditional life insurance products are treated as an offset to direct premium and policy fee revenue and are recognized when due to the assuming company. Ceded claims are treated as an offset to direct benefits and settlement expenses and are recognized when the claim is incurred on a direct basis. Ceded policy reserve changes are also treated as an offset to benefits and settlement expenses and are recognized during the applicable financial reporting period. Expense allowances paid by the assuming companies which are allocable to the current period are treated as an offset to other operating expenses. Since reinsurance treaties typically provide for allowance percentages that decrease over the lifetime of a policy, allowances in excess of the "ultimate" or final level allowance are capitalized. Amortization of capitalized reinsurance expense allowances representing recovery of acquisition costs is treated as an offset to direct amortization of DAC or VOBA. Amortization of deferred expense allowances is calculated as a level percentage of expected premiums in all durations given expected future lapses and mortality and accretion due to interest.

The Company utilizes reinsurance on certain short duration insurance contracts (primarily issued through the Asset Protection segment). As part of these reinsurance transactions the Company receives reinsurance allowances which reimburse the Company for acquisition costs such as commissions and premium taxes. A ceding fee is also collected to cover other administrative costs and profits for the Company. As a component of reinsurance costs, reinsurance allowances are accounted for in accordance with the relevant provisions of ASC Financial Services—Insurance Topic, which state that reinsurance costs should be amortized over the contract period of the reinsurance if the contract is short-duration. Accordingly, reinsurance

allowances received related to short-duration contracts are capitalized and charged to expense in proportion to premiums earned. Ceded unamortized acquisition costs are netted with direct unamortized acquisition costs in the balance sheet.

Ceded premiums and policy fees on the Company's fixed universal life ("UL"), VUL, bank-owned life insurance ("BOLI"), and annuity products reduce premiums and policy fees recognized by the Company. Ceded claims are treated as an offset to direct benefits and settlement expenses and are recognized when the claim is incurred on a direct basis. Ceded policy reserve changes are also treated as an offset to benefits and settlement expenses and are recognized during the applicable valuation period.

Since reinsurance treaties typically provide for allowance percentages that decrease over the lifetime of a policy, allowances in excess of the "ultimate" or final level allowance are capitalized. Amortization of capitalized reinsurance expense allowances are amortized based on future expected gross profits. Assumptions regarding mortality, lapses, and interest rates are continuously reviewed and may be periodically changed. These changes will result in "unlocking" that changes the balance in the ceded deferred acquisition cost and can affect the amortization of DAC and VOBA. Ceded unearned revenue liabilities are also amortized based on expected gross profits. Assumptions are based on the best current estimate of expected mortality, lapses and interest spread.

The Company has also assumed certain policy risks written by other insurance companies through reinsurance agreements. *Premiums and policy fees* as well as *Benefits and settlement expenses* include amounts assumed under reinsurance agreements and are net of reinsurance ceded. Assumed reinsurance is accounted for in accordance with ASC Financial Services—Insurance Topic.

Reinsurance Allowances—Long-Duration Contracts—Reinsurance allowances are intended to reimburse the ceding company for some portion of the ceding company's commissions, expenses, and taxes. The amount and timing of reinsurance allowances (both first year and renewal allowances) are contractually determined by the applicable reinsurance contract and do not necessarily bear a relationship to the amount and incidence of expenses actually paid by the ceding company in any given year.

Ultimate reinsurance allowances are defined as the lowest allowance percentage paid by the reinsurer in any policy duration over the lifetime of a universal life policy (or through the end of the level term period for a traditional life policy). Ultimate reinsurance allowances are determined during the negotiation of each reinsurance agreement and will differ between agreements.

The Company determines its "cost of reinsurance" to include amounts paid to the reinsurer (ceded premiums) net of amounts reimbursed by the reinsurer (in the form of allowances). As noted within ASC 944, *Financial Services—Insurance Topic*, "The difference, if any, between amounts paid for a reinsurance contract and the amount of the liabilities for policy benefits relating to the underlying reinsured contracts is part of the estimated cost to be amortized." The Company's policy is to amortize the cost of reinsurance over the life of the underlying reinsured contracts (for long-duration policies) in a manner consistent with the way in which benefits and expenses on the underlying contracts are recognized. For the Company's long-duration contracts, it is the Company's practice to defer reinsurance allowances as a component of the cost of reinsurance and recognize the portion related to the recovery of acquisition costs as a reduction of applicable unamortized acquisition costs in such a manner that net acquisition costs are capitalized and charged to expense in proportion to net revenue recognized. The remaining balance of reinsurance allowances are included as a component of the cost of reinsurance and those allowances which are allocable to the current period are recorded as an offset to operating expenses in the current period consistent with the recognition of benefits and expenses on the underlying reinsured contracts. This practice is consistent with the Company's practice of capitalizing direct expenses (e.g. commissions), and results in the recognition of reinsurance allowances on a systematic basis over the life of the reinsured policies on a basis consistent with the way in which acquisition costs on the underlying reinsured contracts would be recognized. In some cases reinsurance allowances allocable to the current period may exceed non-deferred direct costs, which may cause net other operating expenses (related to specific contracts) to be negative.

Amortization of Reinsurance Allowances—Reinsurance allowances do not affect the methodology used to amortize DAC and VOBA, or the period over which such DAC and VOBA are amortized. Reinsurance allowances offset the direct expenses capitalized, reducing the net amount that is capitalized. DAC and VOBA on traditional life policies are amortized based on the pattern of estimated gross premiums of the policies in force. Reinsurance allowances do not affect the gross premiums, so therefore they do not impact traditional life amortization patterns. DAC and VOBA on universal life products are amortized based on the pattern of estimated gross profits of the policies in force. Reinsurance allowances are considered in the determination of estimated gross profits, and therefore do impact amortization patterns.

Reinsurance Assets and Liabilities—Claim liabilities and policy benefits are calculated consistently for all policies, regardless of whether or not the policy is reinsured. Once the claim liabilities and policy benefits for the underlying policies are estimated, the amounts recoverable from the reinsurers are estimated based on a number of factors including the terms of the reinsurance contracts, historical payment patterns of reinsurance partners, and the financial strength and credit worthiness of reinsurance partners and recorded as *Reinsurance receivables* on the balance sheet.

Liabilities for unpaid reinsurance claims are produced from claims and reinsurance system records, which contain the relevant terms of the individual reinsurance contracts. The Company monitors claims due from reinsurers to ensure that balances are settled on a timely basis. Incurred but not reported claims are reviewed to ensure that appropriate amounts are ceded.

The Company analyzes and monitors the credit-worthiness of each of its reinsurance partners to minimize collection issues. For newly executed reinsurance contracts with reinsurance companies that do not meet predetermined standards, the Company requires collateral such as assets held in trusts or letters of credit.

Reinsurance assets and liabilities related to agreements with funds withheld at interest where no net risk is retained by the Company are presented on a net basis. Reinsurance receivables were presented net of approximately \$2.3 billion in reinsurance liabilities as of December 31, 2021 and 2020, respectively.

Allowance for Credit Losses – Reinsurance Receivables

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

As of December 31, 2021 and 2020, the Reinsurance ACL was \$97 million and \$98 million, respectively. There were no write-offs or recoveries during the year ended December 31, 2021 and 2020.

The Company had total reinsurance receivables of \$4.2 billion as of December 31, 2021, which includes both ceded policy benefit reserves and receivables for claims. Receivables for claims represented approximately 11% of total reinsurance receivables as of December 31, 2021. Receivables for claims are short-term in nature, and generally carry minimal credit risk. Of reserves ceded as of December 31, 2021, approximately 84% were receivables from reinsurers rated by A.M. Best Company. Of the total rated by A.M. Best, 54% were rated A+ or better, 16% were rated A, and 30% were rated A- or lower. The Company monitors the concentration of credit risk the Company has with any reinsurer, as well as the financial condition of its reinsurers, on an ongoing basis. Certain of the Company’s reinsurance receivables are supported by letters of credit, funds held or trust agreements.

Components of Reinsurance Cost—The following income statement lines are affected by reinsurance cost:

Premiums and policy fees (“reinsurance ceded” on the Company’s financial statements) represent consideration paid to the assuming company for accepting the ceding company’s risks. Ceded premiums and policy fees increase reinsurance cost.

Benefits and settlement expenses include incurred claim amounts ceded and changes in ceded policy reserves. Ceded benefits and settlement expenses decrease reinsurance cost.

Amortization of deferred policy acquisition cost and value of business acquired reflects the amortization of capitalized reinsurance allowances representing recovery of acquisition costs. Ceded amortization decreases reinsurance cost.

Other expenses include reinsurance allowances paid by assuming companies to the Company less amounts representing recovery of acquisition costs. Reinsurance allowances decrease reinsurance cost.

The Company’s reinsurance programs do not materially impact the other income line of the Company’s income statement. In addition, net investment income generally has no direct impact on the Company’s reinsurance cost. However, it should be noted that by ceding business to the assuming companies, the Company forgoes investment income on the reserves ceded to the assuming companies. Conversely, the assuming companies will receive investment income on the reserves assumed which will increase the assuming companies’ profitability on business assumed from the Company.

Accounting Pronouncements Recently Adopted

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

Accounting Pronouncements Not Yet Adopted

ASU No. 2018-12 - Financial Services - Insurance (Topic 944): Targeted Improvements to Accounting for Long-Duration Contracts. The amendments in this Update are designed to make improvements to the existing recognition, measurement, presentation, and disclosure requirements for certain long-duration contracts issued by an insurance company. The new amendments require insurance entities to provide a more current measure of the liability for future policy benefits for traditional and limited-payment contracts by regularly refining the liability for actual past experience and updated future assumptions. This differs from current requirements where assumptions are locked-in at contract issuance for these contract types. In addition, the updated liability will be discounted using an upper-medium grade (low-credit-risk) fixed income instrument yield that reflects the characteristics of the liability which differs from currently used rates based on the invested assets supporting the liability. In addition, the amendments introduce new requirements to assess market-based insurance contract options and guarantees for Market Risk Benefits and measure them at fair value. This Update also requires insurance entities to amortize deferred acquisition costs on a constant-level basis over the expected life of the contract. Finally, this Update requires new disclosures including liability rollforwards and information about significant inputs, judgments, assumptions, and methods used in the measurement. In November 2020, FASB issued ASU No. 2020-11 - *Financial Services - Insurance (Topic 944); Effective Date and Early Application* which deferred the effective date until the year ending December 31, 2025. The Company is currently reviewing its policies, processes, and applicable systems to determine the impact this standard will have on its operations and financial results.

3. RECENT TRANSACTIONS

Revolos

On January 1, 2021, the Company closed its previously announced transaction to acquire Warranty Topco, Inc. via an Agreement and Plan of Merger signed on September 24, 2020. Warranty Topco, Inc. and its subsidiaries (doing business as the Revolos family of companies) offer a suite of finance and insurance products, including vehicle service contracts, guaranteed asset protection (“GAP”) coverage and ancillary products serving the automotive, recreational vehicle and powersports industries. The transaction was announced on September 25, 2020. The aggregate purchase price was \$92 million.

The following table details the allocation of assets acquired and liabilities assumed from the Revolos transaction as of the date of the Closing.

| | Fair Value as of January 1, 2021 |
|----------------------------|--|
| | (Dollars In Millions) |
| ASSETS | |
| Fixed maturities | \$ 21 |
| Cash | 116 |
| Goodwill | 126 |
| VOBA | 16 |
| Other intangibles | 78 |
| Other assets | 105 |
| Total assets | 462 |
| LIABILITIES | |
| Unearned premiums | 285 |
| Other liabilities | 85 |
| Total liabilities | 370 |
| NET ASSETS ACQUIRED | \$ 92 |

The amount of revenue and income (loss) before income tax of Revolos since the transaction date, January 1, 2021, included in the consolidated statements of income for the year ended December 31, 2021, amounted to \$86 million and \$(1) million, respectively.

Intangible assets recognized by the Company included the following (excluding goodwill):

| | Estimated Fair Value on Acquisition Date | Estimated Useful Life |
|----------------------------|---|-----------------------|
| | (Dollars In Millions) | (In Years) |
| Distribution relationships | \$ 71 | 20 |
| Technology | 3 | 4 |
| Trade name | 4 | 7 |
| Total intangible assets | \$ 78 | |

4. INVESTMENT OPERATIONS

Major categories of net investment income are summarized as follows:

| | For The Year Ended December 31, | |
|---------------------------|---------------------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Fixed maturities | \$ 2,518 | \$ 2,484 |
| Equity securities | 27 | 24 |
| Commercial mortgage loans | 505 | 443 |
| Investment real estate | 1 | 1 |
| Short-term investments | 167 | 149 |
| | 3,218 | 3,101 |
| Investment expenses | 30 | 30 |
| Net investment income | \$ 3,188 | \$ 3,071 |

Net realized gains (losses) are summarized as follows:

| | For The Year Ended December 31, | |
|--|---------------------------------|----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Fixed maturities | \$ 46 | \$ 46 |
| Equity securities | (5) | 41 |
| Modco trading portfolios | (76) | 182 |
| Change in net expected credit losses - fixed maturities | 6 | (125) |
| Commercial mortgage loans | 133 | (152) |
| Other investments | (2) | (3) |
| Net realized gains (losses) - investments | 102 | (11) |
| Net realized gains (losses) - derivatives ⁽¹⁾ | 37 | (174) |
| Net realized gains (losses) | \$ 139 | \$ (185) |

(1) See Note 6, *Derivative Financial Instruments*

The chart below summarizes the sales proceeds and gains (losses) realized on securities classified as AFS.

| | For The Year Ended December 31, | |
|--|---------------------------------|----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Securities in an unrealized gain position: | | |
| Sales proceeds | \$ 1,544 | \$ 2,021 |
| Realized gains | \$ 47 | \$ 51 |
| Securities in an unrealized loss position: | | |
| Sales proceeds | \$ 31 | \$ 34 |
| Realized losses | \$ (1) | \$ (5) |

The net gains (losses) from equity securities still held at period end, was \$(9) million and \$12 million for the year ended December 31, 2021 and 2020, respectively. The Company recognized gains of \$4 million and \$29 million on equity securities sold during the period for the year ended December 31, 2021 and 2020, respectively.

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

| As of December 31, 2021 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Allowance for Expected Credit Losses | Fair Value |
|--|------------------|------------------------|-------------------------|--------------------------------------|------------------|
| (Dollars In Millions) | | | | | |
| Fixed maturities: | | | | | |
| Residential mortgage-backed securities | \$ 6,876 | \$ 31 | \$ (102) | \$ — | \$ 6,805 |
| Commercial mortgage-backed securities | 2,239 | 75 | (7) | — | 2,307 |
| Other asset-backed securities | 1,391 | 31 | (2) | — | 1,420 |
| U.S. government-related securities | 826 | 12 | (25) | — | 813 |
| Other government-related securities | 685 | 75 | (2) | — | 758 |
| States, municipalities, and political subdivisions | 3,750 | 410 | (1) | — | 4,159 |
| Corporate securities | 49,350 | 4,651 | (157) | (1) | 53,843 |
| Redeemable preferred stocks | 297 | 10 | — | — | 307 |
| | 65,414 | 5,295 | (296) | (1) | 70,412 |
| Short-term investments | 889 | — | — | — | 889 |
| | <u>\$ 66,303</u> | <u>\$ 5,295</u> | <u>\$ (296)</u> | <u>\$ (1)</u> | <u>\$ 71,301</u> |
| As of December 31, 2020 | | | | | |
| Fixed maturities: | | | | | |
| Residential mortgage-backed securities | \$ 6,510 | \$ 159 | \$ (1) | \$ — | \$ 6,668 |
| Commercial mortgage-backed securities | 2,429 | 128 | (19) | (4) | 2,534 |
| Other asset-backed securities | 1,546 | 40 | (7) | (1) | 1,578 |
| U.S. government-related securities | 1,492 | 26 | (3) | — | 1,515 |
| Other government-related securities | 627 | 96 | (1) | — | 722 |
| States, municipalities, and political subdivisions | 3,902 | 519 | (1) | — | 4,420 |
| Corporate securities | 46,266 | 6,085 | (99) | (18) | 52,234 |
| Redeemable preferred stocks | 183 | 11 | — | — | 194 |
| | 62,955 | 7,064 | (131) | (23) | 69,865 |
| Short-term investments | 399 | — | — | — | 399 |
| | <u>\$ 63,354</u> | <u>\$ 7,064</u> | <u>\$ (131)</u> | <u>\$ (23)</u> | <u>\$ 70,264</u> |

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

| | As of December 31, | |
|--|-----------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Fixed maturities: | | |
| Residential mortgage-backed securities | \$ 133 | \$ 209 |
| Commercial mortgage-backed securities | 209 | 214 |
| Other asset-backed securities | 185 | 163 |
| U.S. government-related securities | 33 | 91 |
| Other government-related securities | 64 | 30 |
| States, municipals, and political subdivisions | 286 | 282 |
| Corporate securities | 1,875 | 1,860 |
| Redeemable preferred stocks | 8 | 13 |
| | 2,793 | 2,862 |
| Equity securities | 13 | 20 |
| Short-term investments | 82 | 76 |
| | <u>\$ 2,888</u> | <u>\$ 2,958</u> |

The amortized cost and fair value of AFS fixed maturities as of December 31, 2021, by expected maturity, are shown below. Expected maturities of securities without a single maturity date are allocated based on estimated rates of prepayment that may differ from actual rates of prepayment.

| | Available-for-sale | |
|--|-----------------------|------------------|
| | Amortized Cost | Fair Value |
| | (Dollars In Millions) | |
| Due in one year or less | \$ 1,713 | \$ 1,725 |
| Due after one year through five years | 11,091 | 11,500 |
| Due after five years through ten years | 15,528 | 16,232 |
| Due after ten years | 37,082 | 40,955 |
| | <u>\$ 65,414</u> | <u>\$ 70,412</u> |

The following chart is a rollforward of the allowance for expected credit losses on fixed maturities classified as AFS:

| | For The Year Ended December 31, 2021 | | | | For The Year Ended December 31, 2020 | | | |
|--|--------------------------------------|------|------|-------|--------------------------------------|------|------|-------|
| | Corporate Securities | CMBS | ABS | Total | Corporate Securities | CMBS | ABS | Total |
| | (Dollars In Millions) | | | | | | | |
| Beginning Balance | \$ 18 | \$ 4 | \$ 1 | \$ 23 | \$ — | \$ — | \$ — | \$ — |
| Additions for securities for which an allowance was not previously recorded | — | — | — | — | 62 | 4 | 1 | 67 |
| Adjustments on previously recorded allowances due to change in expected cash flows | (1) | (4) | — | (5) | 20 | — | 1 | 21 |
| Reductions on previously recorded allowances due to disposal of security in the current period | — | — | (1) | (1) | (1) | — | (1) | (2) |
| Write-offs of previously recorded allowances due to intent or requirement to sell | (16) | — | — | (16) | (63) | — | — | (63) |
| Ending Balance | \$ 1 | \$ — | \$ — | \$ 1 | \$ 18 | \$ 4 | \$ 1 | \$ 23 |

The following table includes the gross unrealized losses and fair value of the Company's AFS fixed maturities, for which an allowance for credit losses has not been recorded aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2021:

| | Less Than 12 Months | | 12 Months or More | | Total | |
|--|-----------------------|-----------------|-------------------|-----------------|------------|-----------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| | (Dollars In Millions) | | | | | |
| Residential mortgage-backed securities | \$ 4,614 | \$ (102) | \$ 15 | \$ — | \$ 4,629 | \$ (102) |
| Commercial mortgage-backed securities | 129 | (1) | 88 | (6) | 217 | (7) |
| Other asset-backed securities | 249 | (1) | 47 | (1) | 296 | (2) |
| U.S. government-related securities | 307 | (14) | 158 | (11) | 465 | (25) |
| Other government-related securities | 78 | (2) | — | — | 78 | (2) |
| States, municipalities, and political subdivisions | 39 | (1) | 4 | — | 43 | (1) |
| Corporate securities | 4,895 | (120) | 515 | (37) | 5,410 | (157) |
| Redeemable preferred stocks | 20 | — | — | — | 20 | — |
| | \$ 10,331 | \$ (241) | \$ 827 | \$ (55) | \$ 11,158 | \$ (296) |

The corporate securities category had gross unrealized losses greater than twelve months of \$37 million as of December 31, 2021, excluding losses of \$1 million that were considered credit-related. These losses are deemed temporary due to positive factors supporting the recoverability of the respective investments. Positive factors considered include credit ratings, the financial health of the issuer, the continued access of the issuer to capital markets, interest rate movement, and other pertinent information.

As of December 31, 2021, the Company had a total of 770 positions that were in an unrealized loss position, including 5 positions for which an allowance for credit losses was established. For unrealized losses for which an allowance for credit losses was not established, the Company does not consider these unrealized loss positions to be credit-related. This is based on the aggregate factors discussed previously and because the Company has the ability and intent to hold these investments until the fair values recover. The Company does not intend to sell or expect to be required to sell the securities before recovering the Company's amortized cost of the securities.

The following table includes the gross unrealized losses and fair value of the Company's AFS fixed maturities, for which an allowance for credit losses has not been aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2020:

| | Less Than 12 Months | | 12 Months or More | | Total | |
|--|---------------------|-----------------|-------------------|-----------------|-----------------|-----------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| (Dollars In Millions) | | | | | | |
| Residential mortgage-backed securities | \$ 386 | \$ (1) | \$ 9 | \$ — | \$ 395 | \$ (1) |
| Commercial mortgage-backed securities | 263 | (15) | 30 | (4) | 293 | (19) |
| Other asset-backed securities | 146 | (2) | 326 | (5) | 472 | (7) |
| U.S. government-related securities | 311 | (3) | 1 | — | 312 | (3) |
| Other government-related securities | 19 | — | 7 | (1) | 26 | (1) |
| States, municipalities, and political subdivisions | 34 | (1) | 5 | — | 39 | (1) |
| Corporate securities | 1,067 | (33) | 729 | (66) | 1,796 | (99) |
| Redeemable preferred stocks | — | — | — | — | — | — |
| | <u>\$ 2,226</u> | <u>\$ (55)</u> | <u>\$ 1,107</u> | <u>\$ (76)</u> | <u>\$ 3,333</u> | <u>\$ (131)</u> |

As of December 31, 2021, the Company had securities in its available-for-sale portfolio which were rated below investment grade with a fair value of \$2.5 billion and had an amortized cost of \$2.3 billion. In addition, included in the Company's trading portfolio, the Company held \$129 million of securities which were rated below investment grade. The Company held \$551 million of the below investment grade securities that were not publicly traded.

The change in unrealized gains (losses), net of the allowance for expected credit losses and income taxes on fixed maturities classified as AFS is summarized as follows:

| | For The Year Ended December 31, | |
|-----------------------|---------------------------------|----------|
| | 2021 | 2020 |
| (Dollars In Millions) | | |
| Fixed maturities | \$ (1,527) | \$ 3,276 |

The Company held \$21 million and \$28 million of non-income producing securities for the year ended December 31, 2021 and 2020, respectively.

Included in the Company's invested assets are \$1.5 billion and \$1.6 billion of policy loans as of December 31, 2021 and 2020. As of December 31, 2021 and 2020, the interest rates on standard policy loans range from 3.0% to 8.0%.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of December 31, 2021:

| | Measurement Category | Level 1 | Level 2 | Level 3 | Total |
|---|-------------------------|-----------|-----------|----------|-----------|
| (Dollars In Millions) | | | | | |
| Assets: | | | | | |
| Fixed maturity securities - AFS | | | | | |
| Residential mortgage-backed securities | 4 | \$ — | \$ 6,765 | \$ 40 | \$ 6,805 |
| Commercial mortgage-backed securities | 4 | — | 2,127 | 180 | 2,307 |
| Other asset-backed securities | 4 | — | 905 | 515 | 1,420 |
| U.S. government-related securities | 4 | 416 | 397 | — | 813 |
| Other government-related securities | 4 | — | 758 | — | 758 |
| States, municipalities, and political subdivisions | 4 | — | 4,159 | — | 4,159 |
| Corporate securities | 4 | — | 52,261 | 1,582 | 53,843 |
| Redeemable preferred stocks | 4 | 307 | — | — | 307 |
| Total fixed maturity securities - AFS | | 723 | 67,372 | 2,317 | 70,412 |
| Fixed maturity securities—trading | | | | | |
| Residential mortgage-backed securities | 3 | — | 133 | — | 133 |
| Commercial mortgage-backed securities | 3 | — | 209 | — | 209 |
| Other asset-backed securities | 3 | — | 92 | 93 | 185 |
| U.S. government-related securities | 3 | 27 | 6 | — | 33 |
| Other government-related securities | 3 | — | 48 | 16 | 64 |
| States, municipalities, and political subdivisions | 3 | — | 286 | — | 286 |
| Corporate securities | 3 | — | 1,867 | 8 | 1,875 |
| Redeemable preferred stocks | 3 | 8 | — | — | 8 |
| Total fixed maturity securities—trading | | 35 | 2,641 | 117 | 2,793 |
| Total fixed maturity securities | | 758 | 70,013 | 2,434 | 73,205 |
| Equity securities | 3 | 673 | 40 | 155 | 868 |
| Other long-term investments ⁽¹⁾ | 3&4 | 59 | 1,093 | 243 | 1,395 |
| Short-term investments | 3 | 792 | 179 | — | 971 |
| Total investments | | 2,282 | 71,325 | 2,832 | 76,439 |
| Cash | 3 | 544 | — | — | 544 |
| Other assets | 3 | 46 | — | — | 46 |
| Assets related to separate accounts | | | | | |
| Variable annuity | 3 | 13,648 | — | — | 13,648 |
| Variable universal life | 3 | 1,982 | — | — | 1,982 |
| Total assets measured at fair value on a recurring basis | | \$ 18,502 | \$ 71,325 | \$ 2,832 | \$ 92,659 |
| Liabilities: | | | | | |
| Annuity account balances ⁽²⁾ | 3 | \$ — | \$ — | \$ 63 | \$ 63 |
| Other liabilities ⁽¹⁾ | 3&4 | 20 | 810 | 1,907 | 2,737 |
| Total liabilities measured at fair value on a recurring basis | | \$ 20 | \$ 810 | \$ 1,970 | \$ 2,800 |

Measurement category 3 represents fair value through net income and 4 represents fair value through other comprehensive income (loss).

(1) Includes certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of December 31, 2020:

| | Measurement Category | Level 1 | Level 2 | Level 3 | Total |
|---|-------------------------|-----------|-----------|----------|-----------|
| (Dollars In Millions) | | | | | |
| Assets: | | | | | |
| Fixed maturity securities—AFS | | | | | |
| Residential mortgage-backed securities | 4 | \$ — | \$ 6,668 | \$ — | \$ 6,668 |
| Commercial mortgage-backed securities | 4 | — | 2,502 | 32 | 2,534 |
| Other asset-backed securities | 4 | — | 1,143 | 435 | 1,578 |
| U.S. government-related securities | 4 | 1,014 | 501 | — | 1,515 |
| Other government-related securities | 4 | — | 722 | — | 722 |
| State, municipalities, and political subdivisions | 4 | — | 4,420 | — | 4,420 |
| Corporate securities | 4 | — | 50,802 | 1,432 | 52,234 |
| Redeemable preferred stocks | 4 | 125 | 69 | — | 194 |
| Total fixed maturity securities—AFS | | 1,139 | 66,827 | 1,899 | 69,865 |
| Fixed maturity securities—trading | | | | | |
| Residential mortgage-backed securities | 3 | — | 209 | — | 209 |
| Commercial mortgage-backed securities | 3 | — | 214 | — | 214 |
| Other asset-backed securities | 3 | — | 92 | 71 | 163 |
| U.S. government-related securities | 3 | 79 | 12 | — | 91 |
| Other government-related securities | 3 | — | 30 | — | 30 |
| State, municipalities, and political subdivisions | 3 | — | 282 | — | 282 |
| Corporate securities | 3 | — | 1,842 | 18 | 1,860 |
| Redeemable preferred stocks | 3 | 13 | — | — | 13 |
| Total fixed maturity securities—trading | | 92 | 2,681 | 89 | 2,862 |
| Total fixed maturity securities | | 1,231 | 69,508 | 1,988 | 72,727 |
| Equity securities | 3 | 605 | — | 101 | 706 |
| Other long-term investments ⁽¹⁾ | 3&4 | 52 | 1,285 | 245 | 1,582 |
| Short-term investments | 3 | 416 | 59 | — | 475 |
| Total investments | | 2,304 | 70,852 | 2,334 | 75,490 |
| Cash | 3 | 751 | — | — | 751 |
| Other assets | 3 | 38 | — | — | 38 |
| Assets related to separate accounts | | | | | |
| Variable annuity | 3 | 12,378 | — | — | 12,378 |
| Variable universal life | 3 | 1,286 | — | — | 1,286 |
| Total assets measured at fair value on a recurring basis | | \$ 16,757 | \$ 70,852 | \$ 2,334 | \$ 89,943 |
| Liabilities: | | | | | |
| Annuity account balances ⁽²⁾ | 3 | \$ — | \$ — | \$ 67 | \$ 67 |
| Other liabilities ⁽¹⁾ | 3&4 | 14 | 857 | 2,190 | 3,061 |
| Total liabilities measured at fair value on a recurring basis | | \$ 14 | \$ 857 | \$ 2,257 | \$ 3,128 |

Measurement category 3 represents fair value through net income and 4 represents fair value through other comprehensive income (loss).

(1) Includes certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

Determination of Fair Values

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

The fair value of fixed maturity, short-term, and equity securities is determined by management after considering one of three primary sources of information: third party pricing services, non-binding independent broker quotations, or pricing matrices. Security pricing is applied using a "waterfall" approach whereby publicly available prices are first sought from third party pricing services, the remaining unpriced securities are submitted to independent brokers for non-binding prices, or lastly, securities are priced using a pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. Third party pricing services price 91.9% of the Company's available-for-sale and trading fixed maturity securities. Based on the typical trading volumes and the lack of quoted market prices for available-for-sale and trading fixed maturities, third party pricing services derive the majority of security prices from observable market inputs such as recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information outlined above. If there are no recent reported trades, the third party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Certain securities are priced via independent non-binding broker quotations. When using non-binding independent broker quotations, when available the Company obtains two quotes per security. Where multiple broker quotes are obtained, the Company reviews the quotes and selects the quote that provides the best estimate of the price a market participant would pay for these specific assets in an arm's length transaction. A pricing matrix is used to price securities for which the Company is unable to obtain or effectively rely on either a price from a third party pricing service or an independent broker quotation.

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

For securities that are priced via non-binding independent broker quotations, the Company assesses whether prices received from independent brokers represent a reasonable estimate of fair value. The Company's assessment incorporates various metrics (yield curves, credit spreads, prepayment rates, etc.) along with other information available to the Company from both internal and external sources to determine the valuation of such holdings. As a result of this analysis, if the Company determines there is a more appropriate fair value based upon the analytics, the price received from the independent broker is adjusted accordingly. The Company did not adjust any quotes or prices received from brokers during the years ended December 31, 2021 and 2020.

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

Asset-Backed Securities

This category mainly consists of RMBS, CMBS, and other asset-backed securities (collectively referred to as asset-backed securities or "ABS"). As of December 31, 2021, the Company held \$10.2 billion of ABS classified as Level 2. These securities are priced from information provided by a third party pricing service and independent broker quotes. The third party pricing services and brokers mainly value securities using both a market and income approach to valuation. As part of this valuation process they consider the following characteristics of the item being measured to be relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, and 7) credit ratings of the securities.

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

As of December 31, 2021, the Company held \$828 million of Level 3 ABS, which included \$735 million of other asset-backed securities classified as available-for-sale and \$93 million of other asset-backed securities classified as trading. These securities are predominantly ARS whose underlying collateral is at least 97% guaranteed by the FFELP. As a result of the ARS market collapse during 2008, the Company prices its ARS using an income approach valuation model. As part of the valuation process the Company reviews the following characteristics of the ARS in determining the relevant inputs: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) types of underlying assets, 4) weighted-average coupon rate of the underlying assets, 5) weighted-average years to maturity of the underlying assets, 6) seniority level of the tranches owned, 7) credit ratings of the securities, 8) liquidity premium, and 9) paydown rate. In periods where market activity increases and there are transactions at a price that is not the result of a distressed or forced sale we consider those prices as part of our valuation. If the market activity during a period is solely the result of the issuer redeeming positions we consider those transactions in our valuation, but still consider them to be level three measurements due to the nature of the transaction.

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

As of December 31, 2021, the Company classified \$59.8 billion of corporate securities, redeemable preferred stocks, U.S. government-related securities, states, municipals, and political subdivisions, and other government-related securities as Level 2. The fair value of the Level 2 securities is predominantly priced by broker quotes and a third party pricing service. The Company has reviewed the valuation techniques of the brokers and third party pricing service and has determined that such techniques used Level 2 market observable inputs. The following characteristics of the securities are considered to be the primary relevant inputs to the valuation: 1) weighted-average coupon rate, 2) weighted-average years to maturity, 3) seniority, and 4) credit ratings. The Company reviews the methodologies and valuation techniques (including the ability to observe inputs) in assessing the information received from external pricing services and in consideration of the fair value presentation.

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

As of December 31, 2021, the Company classified \$1.6 billion of securities as Level 3 valuations. Level 3 securities primarily represent investments in illiquid bonds for which no price is readily available. To determine a price, the Company uses a discounted cash flow model with both observable and unobservable inputs. These inputs are entered into an industry standard pricing model to determine the final price of the security. These inputs include: 1) principal and interest payments, 2) coupon rate, 3) sector and issuer level spread over treasury, 4) underlying collateral, 5) credit ratings, 6) maturity, 7) embedded options, 8) recent new issuance, 9) comparative bond analysis, and 10) an illiquidity premium.

Equities

As of December 31, 2021, the Company held \$155 million of equity securities classified as Level 3. Of this total, \$148 million represents FHLB stock. The Company believes that the cost of the FHLB stock approximates fair value.

Other Long-Term Investments and Other Liabilities

Derivative Financial Instruments

Other long-term investments and other liabilities include free-standing and embedded derivative financial instruments. Refer to Note 6, *Derivative Financial Instruments* for additional information related to derivatives. Derivative financial instruments are valued using exchange prices, independent broker quotations, or pricing valuation models, which utilize market data inputs. Excluding embedded derivatives, as of December 31, 2021, 99.3% of derivatives based upon notional values were priced using exchange prices or independent broker quotations. Inputs used to value derivatives include, but are not limited to, interest swap rates, credit spreads, interest rate and equity market volatility indices, equity index levels, and treasury rates. The Company performs monthly analysis on derivative valuations that includes both quantitative and qualitative analyses.

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

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

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

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

Embedded derivatives are carried at fair value in *other long-term investments* and *other liabilities* on the Company's consolidated balance sheet. The changes in fair value of embedded derivatives are recorded as *net realized gains (losses)*. Refer to Note 6, *Derivative Financial Instruments* for more information related to each embedded derivatives gains and losses.

The fair value of the GLWB embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using multiple risk neutral stochastic equity scenarios and policyholder behavior assumptions. The risk neutral scenarios are generated using the current swap curve and projected equity volatilities and correlations. The projected equity volatilities are based on a blend of historical volatility and near-term equity market implied volatilities. The equity correlations are based on historical price observations. For policyholder behavior assumptions, expected lapse and utilization assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the Ruark 2015 ALB table, with attained age factors varying from 88% - 100% based on company experience. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR plus a credit spread (to represent the Company's non-performance risk). For expected lapse and utilization, assumptions are used and updated for actual experience, as necessary, using an internal predictive model developed by the Company. As a result of using significant unobservable inputs, the GLWB embedded derivative is categorized as Level 3. Policyholder assumptions are reviewed on an annual basis.

The balance of the FIA embedded derivative is impacted by policyholder cash flows associated with the FIA product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the FIA embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior, assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality from the 2015 Ruark ALB mortality table with attained age factors varying from 88% - 100% based on company experience. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company's non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the FIA embedded derivative is categorized as Level 3.

The balance of the indexed universal life ("IUL") embedded derivative is impacted by policyholder cash flows associated with the IUL product that are allocated to the embedded derivative in addition to changes in the fair value of the embedded derivative during the reporting period. The fair value of the IUL embedded derivative is derived through the income method of valuation using a valuation model that projects future cash flows using current index values and volatility, the hedge budget used to price the product, and policyholder assumptions (both elective and non-elective). For policyholder behavior assumptions, expected lapse and withdrawal assumptions are used and updated for actual experience, as necessary. The Company assumes age-based mortality factors varying from 43% - 110% that are applied to the base table, which is defined as 90% of 2015 VBT Primary Tables adjusted for 5.5 years of 2020 SOA HMI. The present value of the cash flows is determined using the discount rate curve, which is based upon LIBOR up to one year and constant maturity treasury rates plus a credit spread (to represent the Company's non-performance risk) thereafter. Policyholder assumptions are reviewed on an annual basis. As a result of using significant unobservable inputs, the IUL embedded derivative is categorized as Level 3.

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

Annuity Account Balances

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

Separate Accounts

Separate account variable annuity and variable life assets represent segregated funds that are invested for certain customers which are invested in open-ended mutual funds and are included in Level 1. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company’s consolidated balance sheets.

Valuation of Level 3 Financial Instruments

The following table presents the valuation method for material financial instruments included in Level 3 as of December 31, 2021, as well as the unobservable inputs used in the valuation of those financial instruments:

| | Fair Value As of December 31, 2021 (Dollars In Millions) | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|--|---|---------------------------|-----------------------|--|
| Assets: | | | | |
| Residential mortgage-backed securities | \$ 40 | Trade Price | Spread | 1.03% - 1.10% (1.07%) |
| Commercial mortgage-backed securities | 180 | Discounted cash flow | Spread over treasury | 1.04% - 2.47% (1.30%) |
| Other asset-backed securities | 436 | Liquidation | Liquidation value | \$98.63 - \$99.75 (\$99.07) |
| | | | Liquidity premium | 0.11% - 2.14% (1.54%) |
| | | Discounted cash flow | Liquidation value | \$60.00 - \$113.88 (\$112.92) |
| | | | Paydown rate | 11.20% - 13.41% (12.30%) |
| Corporate securities | 1,588 | Discounted cash flow | Spread over treasury | 0.00% - 4.00% (1.50%) |
| Liabilities:⁽¹⁾ | | | | |
| Embedded derivatives—GLWB ⁽²⁾ | \$ 475 | Actuarial cash flow model | Mortality | 88% to 100% of Ruark 2015 ALB table |
| | | | Lapse | PL-RBA Predictive Model |
| | | | Utilization | PL-RBA Predictive Model |
| | | | Nonperformance risk | 0.19% - 0.82% |
| Embedded derivative—FIA | 647 | Actuarial cash flow model | Expenses | \$214 per policy |
| | | | Withdrawal rate | 0.4%-2.4% prior to age 72 RMD for ages 70+ or WB withdrawal rate Assume underutilized RMD for nonWB policies ages 72-88 |
| | | | Mortality | 88% to 100% of Ruark 2015 ALB table |
| | | | Lapse | 0.2%-50% depending on duration/surrender charge period. Dynamically adjusted for WB moneyiness and projected market rates vs credited rates. |
| | | | Nonperformance risk | 0.19% - 0.82% |
| Embedded derivative—IUL | 269 | Actuarial cash flow model | Mortality | 43% - 110% of base table (90% of 2015 VBT Primary Tables adjusted for 5.5 years of 2020 SOA HMI) |
| | | | | 94% - 248% of duration 8 point in scale 2015 VBT Primary Tables, depending on type of business |
| | | | Lapse | 0.375% - 7.5%, depending on duration/distribution channel and smoking class |
| | | | Nonperformance risk | 0.19% - 0.82% |

(1) Excludes modified coinsurance arrangements.

(2) Fair value is presented as a net liability.

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

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The following table presents the valuation method for material financial instruments included in Level 3 as of December 31, 2020, as well as the unobservable inputs used in the valuation of those financial instruments:

| | Fair Value As of December 31, 2020 (Dollars In Millions) | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|--|---|-------------------------------------|-----------------------|--|
| Assets: | | | | |
| Commercial mortgage-backed securities | \$ 32 | Discounted cash flow | Spread over treasury | 2.78%-2.92% (2.87%) |
| Other asset-backed securities | 435 | Liquidation Discounted cash flow | Liquidation value | \$95.00 - \$97.00 (\$96.19) |
| | | | Liquidity premium | 0.54% - 2.30% (1.63%) |
| | | | Paydown rate | 8.79% - 12.49% (11.39%) |
| Corporate securities | 1,432 | Discounted cash flow | Spread over treasury | 0.00%-4.75% (1.89%) |
| Liabilities:⁽¹⁾ | | | | |
| Embedded derivatives—GLWB ⁽²⁾ | \$ 822 | Actuarial cash flow model | Mortality | 88% to 100% of Ruark 2015 ALB table |
| | | | Lapse | PL-RBA Predictive Model |
| | | | Utilization | PL-RBA Predictive Model |
| | | | Nonperformance risk | 0.19% - 0.81% |
| Embedded derivative—FIA | 627 | Actuarial cash flow model | Expenses | \$207 per policy |
| | | | Withdrawal rate | 0.4%-2.4% prior to age 70 RMD for ages 70+ or WB withdrawal rate Assume underutilized RMD for nonWB policies ages 72-88 |
| | | | | 88% to 100% of Ruark 2015 ALB table |
| | | | | 0.2%-50% depending on duration/surrender charge period. Dynamically adjusted for WB money and projected market rates vs credited rates. |
| | | | Lapse | 0.19% - 0.81% |
| Embedded derivative - IUL | 201 | Actuarial cash flow model | Mortality | 36% - 161% of 2015 VBT Primary Tables |
| | | | Lapse | 94% - 248% of duration 8 point in scale 2015 VBT Primary Tables, depending on type of business |
| | | | | 0.375% - 10.0%, depending on duration/distribution channel and smoking class |
| | | | Nonperformance risk | 0.19% - 0.81% |

(1) Excludes modified coinsurance arrangements.

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

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

The Company has considered all reasonably available quantitative inputs as of December 31, 2021 and 2020, but the valuation techniques and inputs used by some brokers in pricing certain financial instruments are not shared with the Company. This resulted in \$197 million and \$116 million of financial instruments being classified as Level 3 as of December 31, 2021 and 2020, of which \$172 million and \$88 million were other asset-backed securities, \$3 million and \$17 million were corporate securities, and \$6 million and \$11 million are equity securities. Also included in the Level 3 as of December 31, 2021 were \$16 million of other government securities.

In certain cases, the Company has determined that book value materially approximates fair value. As of December 31, 2021 and 2020, the Company held \$148 million and \$90 million of financial instruments, respectively, where book value approximates fair value which predominantly consisted of FHLB stock.

The asset-backed securities classified as Level 3 are predominantly ARS. A change in the paydown rate (the projected annual rate of principal reduction) of the ARS can significantly impact the fair value of these securities. A decrease in the paydown rate would increase the projected weighted average life of the ARS and increase the sensitivity of the ARS' fair value

to changes in interest rates. An increase in the liquidity premium would result in a decrease in the fair value of the securities, while a decrease in the liquidity premium would increase the fair value of these securities. The liquidation value for these securities are sensitive to the issuer's available cash flows and ability to redeem the securities, as well as the current holders' willingness to liquidate at the specified price.

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

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

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

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

The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the year ended December 31, 2021, for which the Company has used significant unobservable inputs (Level 3):

| | Total Realized and Unrealized Gains | | | | Total Realized and Unrealized Losses | | | | | | | | Total Gains (losses) included in Net income related to Instruments still held at the Reporting Date | | | | | | | |
|---|---|---------------------------|---|---------------------------|---|-----------|-------|-----------|-------------|-----------------------------------|-------|-------------------|--|-------|----|-----|----|-----|----|-------|
| | Beginning Balance | Included in Net Income | Included in Other Comprehensive Income | Included in Net Income | Included in Other Comprehensive Income | Purchases | Sales | Issuances | Settlements | Transfers in/out of Level 3 | Other | Ending Balance | | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | |
| (Dollars In Millions) | | | | | | | | | | | | | | | | | | | | |
| Assets: | | | | | | | | | | | | | | | | | | | | |
| Fixed maturity securities | | | | | | | | | | | | | | | | | | | | |
| AFS | | | | | | | | | | | | | | | | | | | | |
| Residential mortgage-backed securities | \$ | — | \$ | — | \$ | — | \$ | — | \$ | — | \$ | 40 | \$ | — | \$ | — | \$ | 40 | \$ | — |
| Commercial mortgage-backed securities | | 32 | | — | | — | | — | | (2) | | — | | — | | 150 | | — | | 180 |
| Other asset-backed securities | | 435 | | — | | 3 | | — | | (1) | | 67 | | (4) | | — | | 14 | | 1 |
| Corporate securities | | 1,432 | | — | | 11 | | — | | (34) | | 274 | | (212) | | — | | 112 | | (1) |
| Total fixed maturity securities—AFS | | 1,899 | | — | | 14 | | — | | (37) | | 381 | | (216) | | — | | 276 | | — |
| Fixed maturity securities—trading | | | | | | | | | | | | | | | | | | | | |
| Other asset-backed securities | | 71 | | — | | 3 | | — | | — | | 22 | | (19) | | — | | 16 | | — |
| Other government-related securities | | — | | — | | — | | — | | — | | — | | — | | — | | 16 | | — |
| Corporate securities | | 18 | | — | | — | | — | | (1) | | 2 | | (6) | | — | | — | | — |
| Total fixed maturity securities—trading | | 89 | | — | | 3 | | — | | (1) | | 24 | | (25) | | — | | 27 | | — |
| Total fixed maturity securities | | 1,988 | | — | | 17 | | — | | (38) | | 405 | | (241) | | — | | 303 | | — |
| Equity securities | | 101 | | — | | — | | — | | — | | 91 | | (32) | | — | | (5) | | — |
| Other long-term investments ⁽¹⁾ | | 245 | | 183 | | — | | (185) | | — | | — | | — | | — | | — | | — |
| Total investments | | 2,334 | | 183 | | 17 | | (185) | | (38) | | 496 | | (273) | | — | | 298 | | — |
| Total assets measured at fair value on a recurring basis | \$ | 2,334 | \$ | 183 | \$ | 17 | \$ | (185) | \$ | (38) | \$ | 496 | \$ | (273) | \$ | — | \$ | 298 | \$ | — |
| Liabilities: | | | | | | | | | | | | | | | | | | | | |
| Annuity account balances ⁽²⁾ | \$ | 67 | \$ | — | \$ | — | \$ | (4) | \$ | — | \$ | — | \$ | — | \$ | 8 | \$ | — | \$ | 63 |
| Other liabilities ⁽¹⁾ | | 2,190 | | 845 | | — | | (562) | | — | | — | | — | | — | | — | | 1,907 |
| Total liabilities measured at fair value on a recurring basis | \$ | 2,257 | \$ | 845 | \$ | — | \$ | (566) | \$ | — | \$ | — | \$ | — | \$ | 8 | \$ | — | \$ | 1,970 |
| | | | | | | | | | | | | | | | | | | | | |

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the year ended December 31, 2021, there were \$336 million of securities transferred into Level 3 from Level 2. These transfers resulted from securities that were priced by independent pricing services or brokers in previous periods but were priced internally using significant unobservable inputs where market observable inputs were not available as of December 31, 2021.

For the year ended December 31, 2021, there were \$38 million of securities transferred into Level 2 from Level 3.

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The following table presents a reconciliation of the beginning and ending balances for fair value measurements for the year ended December 31, 2020, for which the Company has used significant unobservable inputs (Level 3):

| | Total Realized and Unrealized Gains | | | | Total Realized and Unrealized Losses | | | | | | | | | | Total Gains (losses) included in Net Income related to Instruments still held at the Reporting Date | |
|---|---|---------------------------|---|------------|--|---|----------|------|-----------|-------|-----------|-------------|-----------------------------------|--------|---|-------------------|
| | Beginning Balance | Included in Net Income | Included in Other Comprehensive Income | | Included in Net Income | Included in Other Comprehensive Income | | | Purchases | Sales | Issuances | Settlements | Transfers in/out of Level 3 | Other | | Ending Balance |
| (Dollars In Millions) | | | | | | | | | | | | | | | | |
| Assets: | | | | | | | | | | | | | | | | |
| Fixed maturity securities | | | | | | | | | | | | | | | | |
| AFS | | | | | | | | | | | | | | | | |
| Commercial mortgage-backed securities | \$ 10 | \$ — | \$ 1 | \$ — | \$ (1) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 22 | \$ — | \$ 32 | \$ — |
| Other asset-backed securities | 421 | — | 8 | — | (13) | — | (2) | — | — | — | — | — | 22 | (1) | 435 | — |
| Corporate securities | 1,374 | — | 135 | — | (83) | 436 | (562) | — | — | — | — | — | 135 | (3) | 1,432 | — |
| Total fixed maturity securities—AFS | 1,805 | — | 144 | — | (97) | 436 | (564) | — | — | — | — | — | 179 | (4) | 1,899 | — |
| Fixed maturity securities—trading | | | | | | | | | | | | | | | | |
| Other asset-backed securities | 65 | 6 | — | (9) | — | 12 | (2) | — | — | — | — | — | (1) | — | 71 | 2 |
| Corporate securities | 11 | 1 | — | — | — | 8 | (2) | — | — | — | — | — | — | — | 18 | — |
| Total fixed maturity securities—trading | 76 | 7 | — | (9) | — | 20 | (4) | — | — | — | — | — | (1) | — | 89 | 2 |
| Total fixed maturity securities | 1,881 | 7 | 144 | (9) | (97) | 456 | (568) | — | — | — | — | — | 178 | (4) | 1,988 | 2 |
| Equity securities | 74 | 2 | — | (1) | — | 26 | (5) | — | — | — | — | — | 5 | — | 101 | — |
| Other long-term investments ⁽¹⁾ | 176 | 233 | — | (164) | — | — | — | — | — | — | — | — | — | — | 245 | 69 |
| Total investments | 2,131 | 242 | 144 | (174) | (97) | 482 | (573) | — | — | — | — | — | 183 | (4) | 2,334 | 71 |
| Total assets measured at fair value on a recurring basis | \$ 2,131 | \$ 242 | \$ 144 | \$ (174) | \$ (97) | \$ 482 | \$ (573) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 183 | \$ (4) | \$ 2,334 | \$ 71 |
| Liabilities: | | | | | | | | | | | | | | | | |
| Annuity account balances ⁽²⁾ | \$ 70 | \$ — | \$ — | \$ (3) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 6 | \$ — | \$ — | \$ 67 | \$ — |
| Other liabilities ⁽¹⁾ | 1,332 | 926 | — | (1,784) | — | — | — | — | — | — | — | — | — | — | 2,190 | (858) |
| Total liabilities measured at fair value on a recurring basis | \$ 1,402 | \$ 926 | \$ — | \$ (1,787) | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — | \$ 6 | \$ — | \$ — | \$ 2,257 | \$ (858) |

(1) Represents certain freestanding and embedded derivatives.

(2) Represents liabilities related to fixed indexed annuities.

For the year ended December 31, 2020, there were \$184 million of securities transferred into Level 3 from Level 2. These transfers resulted from securities that were priced by independent pricing services or brokers in previous periods but were priced internally using significant unobservable inputs where market observable inputs were not available as of December 31, 2020.

For the year ended December 31, 2020, there were \$1 million of securities transferred into Level 2 from Level 3.

Total realized and unrealized gains (losses) on Level 3 assets and liabilities are primarily reported in either *net realized gains (losses)* within the consolidated statements of income or other comprehensive income (loss) within shareowner's equity based on the appropriate accounting treatment for the item.

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

The Company reviews the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur. The asset transfers in the table(s) above primarily related to positions moved from Level 3 to Level 2 as the Company determined that certain inputs were observable.

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

Estimated Fair Value of Financial Instruments

The carrying amounts and estimated fair values of the Company's financial instruments that are not reported at fair value as of the periods shown below are as follows:

| | Fair Value Level | As of December 31, | | | |
|--|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | | 2021 | | 2020 | |
| | | Carrying Amounts | Fair Values | Carrying Amounts | Fair Values |
| | | (Dollars In Millions) | (Dollars In Millions) | (Dollars In Millions) | (Dollars In Millions) |
| Assets: | | | | | |
| Commercial mortgage loans ⁽¹⁾ | 3 | \$ 10,863 | \$ 11,386 | \$ 10,006 | \$ 10,788 |
| Policy loans | 3 | 1,527 | 1,527 | 1,593 | 1,593 |
| Other long-term investments ⁽²⁾ | 3 | 1,930 | 1,990 | 1,186 | 1,283 |
| Liabilities: | | | | | |
| Stable value product account balances | 3 | \$ 8,526 | \$ 8,598 | \$ 6,056 | \$ 6,231 |
| Future policy benefits and claims ⁽³⁾ | 3 | 1,457 | 1,504 | 1,580 | 1,603 |
| Other policyholders' funds ⁽⁴⁾ | 3 | 102 | 108 | 102 | 108 |
| Debt:⁽⁵⁾ | | | | | |
| Bank borrowings ⁽⁶⁾ | 3 | \$ 875 | \$ 875 | \$ 790 | \$ 790 |
| Senior Notes | 2 | 1,060 | 1,163 | 1,063 | 1,184 |
| Subordinated debentures | 2 | 496 | 509 | 496 | 497 |
| Subordinated funding obligations | 3 | 110 | 116 | 110 | 121 |

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

- (1) The carrying amount is net of allowance for credit losses.
- (2) Other long-term investments represents a Modco receivable, which is related to invested assets such as fixed income and structured securities, which are legally owned by the ceding company. The fair value is determined in a manner consistent with other similar invested assets held by the Company. In addition, it includes the cash surrender value of the Company's COLI policy.
- (3) Single premium immediate annuity without life contingencies.
- (4) Supplementary contracts without life contingencies.
- (5) Excludes immaterial capital lease obligations.
- (6) Includes the Term Loan Credit Agreement.

Fair Value Measurements

Commercial mortgage loans

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

Policy loans

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

Other long-term investments

In addition to free-standing and embedded derivative financial instruments discussed above, other long-term investments includes \$1.2 billion of amounts receivable under certain modified coinsurance agreements and \$710 million of cash surrender value of the Company's COLI policies. The amounts receivable under the modified coinsurance agreements represent funds withheld in connection with certain reinsurance agreements in which the Company acts as the reinsurer. Under the terms of these agreements, assets equal to statutory reserves are withheld and legally owned by the ceding company, and any excess or shortfall is settled periodically. In some cases, these modified coinsurance agreements contain embedded derivatives which are discussed in more detail above. The fair value of amounts receivable under modified coinsurance

agreements, including the embedded derivative component, correspond to the fair value of the underlying assets withheld. The COLI amounts are based on the fair value of the underlying assets.

Stable value product and other investment contract balances

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

Debt

Bank borrowings

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

Senior notes and subordinated debentures

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

Funding obligations

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

6. DERIVATIVE FINANCIAL INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies

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

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

Derivatives Related to Interest Rate Risk Management

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

Derivatives Related to Foreign Currency Exchange Risk Management

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

Derivatives Related to Risk Mitigation of Certain Annuity Contracts

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

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

Accounting for Derivative Instruments

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

It is the Company's policy not to offset assets and liabilities associated with open derivative contracts. However, the Chicago Mercantile Exchange ("CME") rules characterize variation margin transfers as settlement payments, as opposed to adjustments to collateral. As a result, derivative assets and liabilities associated with centrally cleared derivatives for which the CME serves as the central clearing party are presented as if these derivatives had been settled as of the reporting date.

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

The Company reports changes in fair values of derivatives that are not part of a qualifying hedge relationship through operations in the period of change. Changes in the fair value of those derivatives are recognized in *net realized gains (losses)*.

Derivative Instruments Designated and Qualifying as Hedging Instruments

Cash-Flow Hedges

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

Derivative Instruments Not Designated and Not Qualifying as Hedging Instruments

The Company uses various other derivative instruments for risk management purposes that do not qualify for hedge accounting treatment. Changes in the fair value of these derivatives are recognized in *net realized gains (losses)* during the period of change.

Derivatives Related to Variable Annuity Contracts

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

Derivatives Related to Fixed Indexed Annuity Contracts

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

Derivatives Related to Indexed Universal Life Contracts

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

Other Derivatives

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

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

Net realized gains (losses)—derivative financial instruments

| | For The Year Ended December 31, | |
|--|---------------------------------|----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Derivatives related to VA contracts: | | |
| Interest rate futures | \$ 15 | \$ 1 |
| Equity futures | (12) | 109 |
| Currency futures | 11 | (10) |
| Equity options | (108) | (29) |
| Interest rate swaps | (136) | 275 |
| Total return swaps | (189) | (50) |
| Embedded derivative - GLWB | 347 | (405) |
| Total derivatives related to VA contracts | (72) | (109) |
| Derivatives related to FIA contracts: | | |
| Embedded derivative | 3 | (83) |
| Equity futures | 5 | (5) |
| Equity options | 72 | 48 |
| Other derivatives | (3) | (1) |
| Total derivatives related to FIA contracts | 77 | (41) |
| Derivatives related to IUL contracts: | | |
| Embedded derivative | (28) | 3 |
| Equity futures | — | (2) |
| Equity options | 16 | 9 |
| Total derivatives related to IUL contracts | (12) | 10 |
| Embedded derivative - Modco reinsurance treaties | 46 | (49) |
| Other derivatives | (2) | 15 |
| Total net realized gains (losses)—derivatives | \$ 37 | \$ (174) |

Based on expected cash flows of the underlying hedged items, the Company expects to reclassify \$1 million out of accumulated other comprehensive income (loss) into *net realized gains (losses)* during the next twelve months.

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

| As of December 31, | | | | |
|--|------------------|-----------------|------------------|-----------------|
| 2021 | | 2020 | | |
| Notional Amount | Fair Value | Notional Amount | Fair Value | |
| (Dollars In Millions) | | | | |
| Other long-term investments | | | | |
| Derivatives not designated as hedging instruments: | | | | |
| Interest rate swaps | \$ 1,478 | \$ 72 | \$ 1,478 | \$ 185 |
| Total return swaps | 239 | 8 | 158 | 2 |
| Embedded derivative - Modco reinsurance treaties | 1,268 | 62 | 1,249 | 101 |
| Embedded derivative - GLWB | 3,066 | 169 | 2,067 | 138 |
| Embedded derivative - FIA | 159 | 12 | 99 | 6 |
| Interest rate futures | 561 | 5 | 690 | 4 |
| Equity futures | 312 | 6 | 203 | 4 |
| Currency futures | 27 | — | — | — |
| Equity options | 8,852 | 1,061 | 7,208 | 1,142 |
| | <u>\$ 15,962</u> | <u>\$ 1,395</u> | <u>\$ 13,152</u> | <u>\$ 1,582</u> |
| Other liabilities | | | | |
| Cash flow hedges: | | | | |
| Foreign currency swaps | \$ 117 | \$ 13 | \$ 117 | \$ 10 |
| Derivatives not designated as hedging instruments: | | | | |
| Interest rate swaps | 1,354 | — | 1,354 | — |
| Total return swaps | 1,168 | 39 | 1,003 | 15 |
| Embedded derivative - Modco reinsurance treaties | 2,465 | 248 | 2,438 | 339 |
| Embedded derivative - GLWB | 6,833 | 644 | 7,749 | 960 |
| Embedded derivative - FIA | 4,372 | 659 | 3,889 | 633 |
| Embedded derivative - IUL | 459 | 269 | 357 | 201 |
| Interest rate futures | 729 | 4 | 415 | 3 |
| Equity futures | 42 | 1 | 190 | 5 |
| Currency futures | 158 | 2 | 264 | 4 |
| Equity options | 7,044 | 771 | 5,499 | 835 |
| Other | 448 | 87 | 303 | 56 |
| | <u>\$ 25,189</u> | <u>\$ 2,737</u> | <u>\$ 23,578</u> | <u>\$ 3,061</u> |

7. OFFSETTING OF ASSETS AND LIABILITIES

Certain of the Company's derivative instruments are subject to enforceable master netting arrangements that provide for the net settlement of all derivative contracts between the Company and a counterparty in the event of default or upon the occurrence of certain termination events. Collateral support agreements associated with each master netting arrangement provide that the Company will receive or pledge financial collateral in the event either minimum thresholds, or in certain cases ratings levels, have been reached. Additionally, certain of the Company's repurchase agreements provide for net settlement on termination of the agreement. Refer to Note 14, *Debt and Other Obligations* for details of the Company's repurchase agreement programs.

Collateral received includes both cash and non-cash collateral. Cash collateral received by the Company is recorded on the consolidated balance sheet as "cash", with a corresponding amount recorded in "other liabilities" to represent the Company's obligation to return the collateral. Non-cash collateral received by the Company is not recognized on the consolidated balance sheet unless the Company exercises its right to sell or re-pledge the underlying asset. As of December 31, 2021 and December 31, 2020, there was no fair value of non-cash collateral received.

The tables below present the derivative instruments by assets and liabilities for the Company as of December 31, 2021:

| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Balance Sheet | Net Amounts of Assets Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | Net Amount |
|---|--|---|--|---|------------------------|---------------|
| | | | | Financial Instruments | Collateral Received | |
| (Dollars In Millions) | | | | | | |
| Offsetting of Derivative Assets | | | | | | |
| Derivatives: | | | | | | |
| Free-Standing derivatives | \$ 1,152 | \$ — | \$ 1,152 | \$ 806 | \$ 178 | \$ 168 |
| Total derivatives, subject to a master netting arrangement or similar arrangement | 1,152 | — | 1,152 | 806 | 178 | 168 |
| Derivatives not subject to a master netting arrangement or similar arrangement | | | | | | |
| Embedded derivative - Modco reinsurance treaties | 62 | — | 62 | — | — | 62 |
| Embedded derivative - GLWB | 169 | — | 169 | — | — | 169 |
| Embedded derivative - FIA | 12 | — | 12 | — | — | 12 |
| Total derivatives, not subject to a master netting arrangement or similar arrangement | 243 | — | 243 | — | — | 243 |
| Total derivatives | 1,395 | — | 1,395 | 806 | 178 | 411 |
| Total Assets | \$ 1,395 | \$ — | \$ 1,395 | \$ 806 | \$ 178 | \$ 411 |

| | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Balance Sheet | Net Amounts of Liabilities Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | Net Amount |
|---|---|---|---|---|----------------------|-----------------|
| | | | | Financial Instruments | Collateral Posted | |
| (Dollars In Millions) | | | | | | |
| Offsetting of Derivative Liabilities | | | | | | |
| Derivatives: | | | | | | |
| Free-Standing derivatives | \$ 830 | \$ — | \$ 830 | \$ 806 | \$ 22 | \$ 2 |
| Total derivatives, subject to a master netting arrangement or similar arrangement | 830 | — | 830 | 806 | 22 | 2 |
| Derivatives not subject to a master netting arrangement or similar arrangement | | | | | | |
| Embedded derivative - Modco reinsurance treaties | 248 | — | 248 | — | — | 248 |
| Embedded derivative - GLWB | 644 | — | 644 | — | — | 644 |
| Embedded derivative - FIA | 659 | — | 659 | — | — | 659 |
| Embedded derivative - IUL | 269 | — | 269 | — | — | 269 |
| Other | 87 | — | 87 | — | — | 87 |
| Total derivatives, not subject to a master netting arrangement or similar arrangement | 1,907 | — | 1,907 | — | — | 1,907 |
| Total derivatives | 2,737 | — | 2,737 | 806 | 22 | 1,909 |
| Repurchase agreements ⁽¹⁾ | 1,393 | — | 1,393 | — | — | 1,393 |
| Total Liabilities | \$ 4,130 | \$ — | \$ 4,130 | \$ 806 | \$ 22 | \$ 3,302 |

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

The tables below present the derivative instruments by assets and liabilities for the Company as of December 31, 2020:

| | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Balance Sheet | Net Amounts of Assets Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | Net Amount |
|---|------------------------------------|---|--|---|---------------------|---------------|
| | | | | Financial Instruments | Collateral Received | |
| (Dollars In Millions) | | | | | | |
| Offsetting of Derivative Assets | | | | | | |
| Derivatives: | | | | | | |
| Free-Standing derivatives | \$ 1,337 | \$ — | \$ 1,337 | \$ 864 | \$ 290 | \$ 183 |
| Total derivatives, subject to a master netting arrangement or similar arrangement | 1,337 | — | 1,337 | 864 | 290 | 183 |
| Derivatives not subject to a master netting arrangement or similar arrangement | | | | | | |
| Embedded derivative - Modco reinsurance treaties | 101 | — | 101 | — | — | 101 |
| Embedded derivative - GLWB | 138 | — | 138 | — | — | 138 |
| Other | 6 | — | 6 | — | — | 6 |
| Total derivatives, not subject to a master netting arrangement or similar arrangement | 245 | — | 245 | — | — | 245 |
| Total derivatives | 1,582 | — | 1,582 | 864 | 290 | 428 |
| Total Assets | \$ 1,582 | \$ — | \$ 1,582 | \$ 864 | \$ 290 | \$ 428 |

| | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Balance Sheet | Net Amounts of Liabilities Presented in the Balance Sheet | Gross Amounts Not Offset in the Balance Sheet | | Net Amount |
|---|---|---|---|---|-------------------|-----------------|
| | | | | Financial Instruments | Collateral Posted | |
| (Dollars In Millions) | | | | | | |
| Offsetting of Derivative Liabilities | | | | | | |
| Derivatives: | | | | | | |
| Free-Standing derivatives | \$ 871 | \$ — | \$ 871 | \$ 865 | \$ 4 | \$ 2 |
| Total derivatives, subject to a master netting arrangement or similar arrangement | 871 | — | 871 | 865 | 4 | 2 |
| Derivatives not subject to a master netting arrangement or similar arrangement | | | | | | |
| Embedded derivative - Modco reinsurance treaties | 339 | — | 339 | — | — | 339 |
| Embedded derivative - GLWB | 960 | — | 960 | — | — | 960 |
| Embedded derivative - FIA | 633 | — | 633 | — | — | 633 |
| Embedded derivative - IUL | 201 | — | 201 | — | — | 201 |
| Other | 57 | — | 57 | — | — | 57 |
| Total derivatives, not subject to a master netting arrangement or similar arrangement | 2,190 | — | 2,190 | — | — | 2,190 |
| Total derivatives | 3,061 | — | 3,061 | 865 | 4 | 2,192 |
| Repurchase agreements ⁽¹⁾ | 437 | — | 437 | — | — | 437 |
| Total Liabilities | \$ 3,498 | \$ — | \$ 3,498 | \$ 865 | \$ 4 | \$ 2,629 |

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

8. COMMERCIAL MORTGAGE LOANS

The Company invests a portion of its investment portfolio in commercial mortgage loans. As of December 31, 2021, the Company's commercial mortgage loan holdings were \$11.0 billion, or \$10.9 billion net of allowance for credit losses. As of December 31, 2020, the Company's commercial mortgage loan holdings were \$10.2 billion, or \$10.0 billion net of allowance for credit losses. The Company specializes in making commercial mortgage loans on credit-oriented commercial properties. The Company's underwriting procedures relative to its commercial mortgage loan portfolio are based, in the Company's view, on a conservative and disciplined approach. The Company concentrates on a small number of commercial real estate asset types

associated with the necessities of life (grocery anchored and credit tenant retail, industrial, multi-family, senior living, and credit tenant and medical office). The Company believes that these asset types tend to weather economic downturns better than other commercial asset classes in which it has chosen not to participate. The Company believes this disciplined approach has helped to maintain a relatively low delinquency and foreclosure rate throughout its history. The majority of the Company's commercial mortgage loan portfolio was underwritten by the Company. From time to time, the Company may acquire commercial mortgage loans in conjunction with an acquisition.

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

| <u>Type</u> | <u>Percentage of Commercial Mortgage Loans</u> | |
|------------------|--|----------------|
| | <u>2021</u> | <u>2020</u> |
| Retail | 30.3 % | 34.9 % |
| Office buildings | 13.8 | 15.1 |
| Apartments | 17.2 | 12.7 |
| Warehouses | 16.5 | 16.0 |
| Senior housing | 17.0 | 16.2 |
| Other | 5.2 | 5.1 |
| | <u>100.0 %</u> | <u>100.0 %</u> |

The Company specializes in making commercial mortgage loans on credit-oriented commercial properties. No single tenant's exposure represents more than 0.9% of the commercial mortgage loan portfolio.

The following states represent the primary locations of the Company's commercial mortgage loans as of December 31:

| <u>Percentage of Commercial Mortgage Loans</u> | | | |
|--|---------------|----------------|---------------|
| <u>State</u> | <u>2021</u> | <u>State</u> | <u>2020</u> |
| California | 10.1 % | California | 11.3 % |
| Texas | 7.3 | Texas | 7.3 |
| Florida | 7.2 | Alabama | 6.7 |
| Alabama | 6.3 | Florida | 6.2 |
| North Carolina | 5.6 | Georgia | 5.3 |
| Ohio | 4.6 | North Carolina | 4.9 |
| Michigan | 4.6 | Ohio | 4.7 |
| Georgia | 4.2 | Michigan | 4.4 |
| Utah | 4.0 | Utah | 4.2 |
| Tennessee | 3.5 | Tennessee | 3.5 |
| | <u>57.4 %</u> | | <u>58.5 %</u> |

During the year ended December 31, 2021, the Company funded approximately \$2.0 billion of new commercial mortgage loans, with an average commercial mortgage loan size of \$11 million. The average size commercial mortgage loan in the portfolio as of December 31, 2021, was \$6 million and the weighted-average interest rate was 4.1%. The largest single commercial mortgage loan at December 31, 2021 was \$78 million.

During the year ended December 31, 2020, the Company funded \$1.4 billion of new commercial mortgage loans, with an average loan size of \$8 million. The average size commercial mortgage loan in the portfolio as of December 31, 2020, was \$6 million and the weighted-average interest rate was 4.3%. The largest single commercial mortgage loan at December 31, 2020 was \$78 million.

Certain of the commercial mortgage loans have call options that occur within the next eight years. However, if interest rates were to significantly increase, the Company may be unable to exercise the call options on its existing commercial mortgage loans commensurate with the significantly increased market rates. Assuming the commercial mortgage loans are called at their next call dates, \$116 million would become due in 2022, \$379 million in 2023 through 2027, and \$6 million in 2028 through 2029.

The Company offers a type of commercial mortgage loan under which the Company will permit a loan-to-value ratio of up to 85% in exchange for a participating interest in the cash flows from the underlying real estate. As of December 31, 2021 and 2020, \$600 million and \$806 million, respectively, of the Company's total commercial mortgage loans principal balance have this participation feature. Cash flows received as a result of this participation feature are recorded as interest income. During the years ended December 31, 2021 and 2020, the Company recognized \$54 million and \$26 million of participation commercial mortgage loan income, respectively.

As of December 31, 2021, the Company did not have any commercial mortgage loans that were nonperforming, restructured, or foreclosed and converted to real estate properties. As of December 31, 2020, \$3 million of invested assets consisted of commercial mortgage loans that were nonperforming, restructured or foreclosed and converted to real estate properties. The Company does not expect these investments to adversely affect its liquidity or ability to maintain proper matching of assets and liabilities. For all commercial mortgage loans, the impact of troubled debt restructurings is reflected in our investment balance and in the allowance for commercial mortgage loan credit losses.

During the years ended December 31, 2021 and 2020, the Company recognized one and four troubled debt restructurings transactions, respectively, as a result of granting concessions to borrowers which included loan terms unavailable from other lenders. These concessions were the result of agreements between the creditor and the debtor. The Company did not identify any commercial mortgage loans whose principal was permanently impaired during the year ended December 31, 2021 and identified one loan that was permanently impaired during the year ended December 31, 2020.

The Company provides certain relief under the Coronavirus Aid Relief, and Economic Security Act ("the CARES Act") under its COVID-19 Commercial Mortgage Loan Program (the "Loan Modification Program"). During the year ended December 31, 2021, the Company modified 23 commercial mortgage loans under the Loan Modification Program, representing \$475 million in unpaid principal balance. As of December 31, 2021, since the inception of the CARES Act there were 268 total commercial mortgage loans modified under the Loan Modification Program, representing \$2 billion in unpaid principal balance. At December 31, 2021, \$1.9 billion of these loans have resumed regular principal and interest payments in accordance with the terms of the modification agreements and the Company expects the remaining \$69 million commercial mortgage loans to resume scheduled payments in accordance with the agreed upon terms. The modifications under this program include agreements to defer principal payments only and/or to defer principal and interest payments for a specified period of time. None of these modifications were considered troubled debt restructurings.

As of December 31, 2021 and 2020, the amortized cost basis of the Company's commercial mortgage loan receivables by origination year, net of the allowance, for credit losses is as follows:

| Term Loans Amortized Cost Basis by Origination Year | | | | | | | |
|---|----------|----------|----------|----------|----------|----------|-----------|
| | 2021 | 2020 | 2019 | 2018 | 2017 | Prior | Total |
| (Dollars In Millions) | | | | | | | |
| As of December 31, 2021 | | | | | | | |
| Commercial mortgage loans: | | | | | | | |
| Performing | \$ 2,063 | \$ 1,439 | \$ 2,034 | \$ 1,404 | \$ 1,224 | \$ 2,802 | \$ 10,966 |
| Non-performing | — | — | — | — | — | — | — |
| Amortized cost | 2,063 | 1,439 | 2,034 | 1,404 | 1,224 | 2,802 | 10,966 |
| Allowance for credit losses | (12) | (10) | (21) | (18) | (12) | (30) | (103) |
| Total commercial mortgage loans | \$ 2,051 | \$ 1,429 | \$ 2,013 | \$ 1,386 | \$ 1,212 | \$ 2,772 | \$ 10,863 |

| Term Loans Amortized Cost Basis by Origination Year | | | | | | | |
|---|----------|----------|----------|----------|--------|----------|-----------|
| | 2020 | 2019 | 2018 | 2017 | 2016 | Prior | Total |
| (Dollars In Millions) | | | | | | | |
| As of December 31, 2020 | | | | | | | |
| Commercial mortgage loans: | | | | | | | |
| Performing | \$ 1,463 | \$ 2,442 | \$ 1,577 | \$ 1,344 | \$ 943 | \$ 2,458 | \$ 10,227 |
| Non-performing | — | — | — | — | — | 1 | 1 |
| Amortized cost | 1,463 | 2,442 | 1,577 | 1,344 | 943 | 2,459 | 10,228 |
| Allowance for credit losses | (21) | (46) | (55) | (37) | (25) | (38) | (222) |
| Total commercial mortgage loans | \$ 1,442 | \$ 2,396 | \$ 1,522 | \$ 1,307 | \$ 918 | \$ 2,421 | \$ 10,006 |

The following tables provide a comparative view of the key credit quality indicators of the loan-to-value and Debt Service Coverage Ratio ("DSCR") as of December 31, 2021 and 2020:

| | As of December 31, 2021 | | | As of December 31, 2020 | | |
|-------------------------------------|-------------------------|------------|---------------------|-------------------------|------------|---------------------|
| | Amortized Cost | % of Total | DSCR ⁽²⁾ | Amortized Cost | % of total | DSCR ⁽²⁾ |
| (Dollars In Millions) | | | | | | |
| Loan-to-value:⁽¹⁾ | | | | | | |
| Greater than 75% | \$ 285 | 3.0 % | 1.32 | \$ 399 | 4 % | 1.29 |
| 50% - 75% | 7,241 | 66.0 % | 1.59 | 6,557 | 64 % | 1.61 |
| Less than 50% | 3,440 | 31.0 % | 2.04 | 3,272 | 32 % | 2.01 |
| Total commercial mortgage loans | \$ 10,966 | 100.0 % | | \$ 10,228 | 100 % | |

(1) The loan-to-value ratio compares the current unpaid principal of the loan to the estimated fair value of the underlying property collateralizing the loan. Our weighted average loan-to-value ratio was 54% at both December 31, 2021 and December 31, 2020.

(2) The debt service coverage ratio compares a property's net operating income to its debt service payments, including principal and interest. Our weighted average debt service coverage ratio for December 31, 2021 and December 31, 2020 was 1.72x and 1.72x, respectively.

The following provides a summary of the rollforward of the allowance for credit losses for funded commercial mortgage loans and unfunded commercial mortgage loan commitments for the periods included.

| | For The Year Ended December 31, | |
|---|---------------------------------|---------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Allowance for Funded Commercial Mortgage Loan Credit Losses | | |
| Beginning balance | \$ 222 | \$ 5 |
| Cumulative effect adjustment | — | 80 |
| Charge offs | — | — |
| Recoveries | (7) | (3) |
| Provision | (112) | 140 |
| Ending balance | <u>\$ 103</u> | <u>\$ 222</u> |
| Allowance for Unfunded Commercial Mortgage Loan Commitments Credit Losses | | |
| Beginning balance | \$ 22 | \$ — |
| Cumulative effect adjustment | — | 10 |
| Charge offs | — | — |
| Recoveries | — | — |
| Provision | (17) | 12 |
| Ending balance | <u>\$ 5</u> | <u>\$ 22</u> |

As of December 31, 2021, the Company had one commercial mortgage loan of \$28 million that was 30-59 days delinquent. As of December 31, 2020, the Company had one commercial mortgage loan of \$1 million that was 60-89 days delinquent.

The Company's commercial mortgage loan portfolio consists of commercial mortgage loans that are collateralized by real estate. Due to the collateralized nature of the commercial mortgage loans, any assessment of impairment and ultimate loss given a default on the commercial mortgage loans is based upon a consideration of the estimated fair value of the real estate.

The Company limits accrued interest income on commercial mortgage loans to ninety days of interest. For loans in nonaccrual status, interest income is recognized on a cash basis. For the year ended December 31, 2021, the Company did not have any of accrued interest was excluded from the amortized cost basis pursuant to the Company's nonaccrual policy.

As of December 31, 2021, the Company did not have any commercial mortgage loans in nonaccrual status. As of December 31, 2020, the Company had one commercial mortgage loan in nonaccrual status with no related allowance recorded. The recorded investment, unpaid principal balance, and average recorded investment was \$1 million.

9. DEFERRED POLICY ACQUISITION COSTS AND VALUE OF BUSINESS ACQUIRED

Deferred Policy Acquisition Costs

The balances and changes in DAC are as follows:

| | As of December 31, | |
|--|-----------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Balance, beginning of period | \$ 1,628 | \$ 1,477 |
| Capitalization of commissions, sales, and issue expenses | 572 | 461 |
| Amortization | (203) | (164) |
| Change due to unrealized gains and losses | 104 | (152) |
| Implementation of ASU 2016-13 | — | 5 |
| Balance, end of period | <u>\$ 2,101</u> | <u>\$ 1,627</u> |

Value of Business Acquired

The balances and changes in VOBA are as follows:

| | As of December 31, | |
|---|-----------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Balance, beginning of period | \$ 1,801 | \$ 2,040 |
| Acquisitions | 16 | — |
| Amortization | (117) | (45) |
| Change due to unrealized gains and losses | 80 | (192) |
| Other | 25 | (2) |
| Balance, end of period | <u>\$ 1,805</u> | <u>\$ 1,801</u> |

Based on the balance recorded as of December 31, 2021, the expected amortization of VOBA for the next five years is as follows:

| Years | Expected Amortization |
|-------|--------------------------|
| | (Dollars In Millions) |
| 2022 | \$ 121 |
| 2023 | 123 |
| 2024 | 123 |
| 2025 | 116 |
| 2026 | 99 |

10. GOODWILL

The changes in the carrying value of goodwill by segment are as follows:

| | Retail Life and Annuity | Acquisitions | Stable Value Products | Asset Protection | Total Consolidated |
|---------------------------------|-------------------------|--------------|-----------------------|------------------|--------------------|
| | (Dollars In Millions) | | | | |
| Balance as of December 31, 2019 | \$ 559 | \$ 24 | \$ 114 | \$ 129 | \$ 826 |
| Balance as of December 31, 2020 | 559 | 24 | 114 | 129 | 826 |
| Acquisition | — | — | — | 126 | 126 |
| Impairment | (200) | — | — | — | (200) |
| Balance as of December 31, 2021 | \$ 359 | \$ 24 | \$ 114 | \$ 255 | \$ 752 |

In connection with its annual goodwill impairment testing, the Company elected to perform a quantitative assessment of goodwill associated with the reporting units within the Retail Life and Annuity segment, in which the fair value of each reporting unit was compared to that reporting unit's carrying amount, including goodwill. To estimate the fair value of the reporting units, the Company utilized the income (i.e. discounted cash flow) valuation approach. This quantitative assessment indicated that an impairment existed as of December 31, 2021 within the Retirement reporting unit primarily due to the impact of interest rates and a longer period of sustained equity volatility on the weighted-average cost of capital used to discount the reporting units cash flows. Guidance in ASC 350-20, *Intangibles-Goodwill and Other*, requires that an impairment loss be recognized in the amount that the carrying amount of a reporting unit exceeds its fair value. As a result, the Company recorded a non-cash impairment charge of \$200 million.

The Company also performed its annual qualitative evaluation of goodwill with respect to its other reporting units based on the circumstances that existed as of October 1, 2021 and determined that there was no indication that the goodwill was associated with the other reporting units more likely than not impaired and therefore no adjustment to impair goodwill was necessary. The Company has assessed whether events have occurred subsequent to October 1, 2021 that would impact the Company's conclusions and no such events were identified.

11. CERTAIN NONTRADITIONAL LONG-DURATION CONTRACTS

The Company issues variable universal life and VA products through its separate accounts for which investment income and investment gains and losses accrue directly to, and investment risk is borne by, the contract holder. The Company also offers, for our VA products, certain GMDB riders. The most significant of these guarantees involve 1) return of the highest anniversary date account value, or 2) return of the greater of the highest anniversary date account value or the last anniversary date account value compounded at 5% interest or 3) return of premium. The GLWB rider provides the contract holder with protection against certain adverse market impacts on the amount they can withdraw and is classified as an embedded derivative and is carried at fair value on the Company's balance sheet. The VA separate account balances subject to GLWB were \$9.2 billion and \$8.9 billion as of December 31, 2021 and 2020, respectively. For more information regarding the valuation of and income impact of GLWB, please refer to Note 2, *Summary of Significant Accounting Policies*, Note 5, *Fair Value of Financial Instruments*, and Note 6, *Derivative Financial Instruments*.

The GMDB reserve is calculated by applying a benefit ratio, equal to the present value of total expected GMDB claims divided by the present value of total expected contract assessments, to cumulative contract assessments. This amount is then adjusted by the amount of cumulative GMDB claims paid and accrued interest. Assumptions used in the calculation of the GMDB reserve were as follows: mean investment performance of 6.73%, age-based mortality from the Ruark 2015 ALB table adjusted for company and industry experience, lapse rates determined by a dynamic formula, and an average discount rate of 4.85%. Changes in the GMDB reserve are included in benefits and settlement expenses in the accompanying consolidated statements of income.

The VA separate account balances subject to GMDB were \$14.6 billion and \$14.8 billion as of December 31, 2021 and 2020, respectively. The total GMDB amount payable based on VA account balances as of December 31, 2021 and 2020, was \$85 million and \$126 million with a GMDB reserve of \$38 million and \$43 million, respectively. The average attained age of contract holders as of December 31, 2021 and 2020 for the Company was 73 and 72.

These amounts exclude certain VA business which has been 100% reinsured to Commonwealth Annuity and Life Insurance Company (formerly known as Allmerica Financial Life Insurance and Annuity Company) ("CALIC"), under a Modco agreement. The guaranteed amount payable associated with the annuities reinsured to CALIC was \$6 million and \$6

million, as of December 31, 2021 and 2020, respectively. The average attained age of contract holders as of December 31, 2021 and 2020, was 69 and 69.

Activity relating to GMDB reserves (excluding those 100% ceded under the Modco agreement) is as follows:

| | For The Year Ended December 31, | |
|-------------------------------|---------------------------------|-------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Beginning balance | \$ 43 | \$ 46 |
| Incurred guarantee benefits | — | 2 |
| Less: Paid guarantee benefits | 5 | 5 |
| Ending balance | \$ 38 | \$ 43 |

Account balances of variable annuities with guarantees invested in VA separate accounts are as follows:

| | As of December 31, | |
|--------------------|-----------------------|-----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Equity funds | \$ 9,732 | \$ 10,425 |
| Fixed income funds | 5,236 | 4,631 |
| Total | \$ 14,968 | \$ 15,056 |

Certain of the Company's fixed annuities and universal life products have a sales inducement in the form of a retroactive interest credit ("RIC"). In addition, certain annuity contracts provide a sales inducement in the form of a bonus interest credit. The Company maintains a reserve for all interest credits earned to date. The Company defers the expense associated with the RIC and bonus interest credits each period and amortizes these costs in a manner similar to that used for DAC.

Activity in the Company's deferred sales inducement asset, recorded on the balance sheet in other assets was as follows:

| | For The Year Ended December 31, | |
|-------------------------------------|---------------------------------|-------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Deferred asset, beginning of period | \$ 41 | \$ 43 |
| Amounts deferred | 3 | 2 |
| Amortization | (7) | (4) |
| Deferred asset, end of period | \$ 37 | \$ 41 |

12. MONY CLOSED BLOCK OF BUSINESS

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

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

The excess of Closed Block liabilities over Closed Block assets (adjusted to exclude the impact of related amounts in AOCI) at the acquisition date of October 1, 2013, represented the estimated maximum future post-tax earnings from the Closed Block that would be recognized in income from continuing operations over the period the policies and contracts in the Closed Block remain in force. In connection with the acquisition of MONY, the Company developed an actuarial calculation of the expected timing of MONY's Closed Block's earnings as of October 1, 2013. Pursuant to the acquisition of the Company by Dai-ichi Life on February 1, 2015, this actuarial calculation of the expected timing of MONY's Closed Block earnings was recalculated and reset on that date along with the establishment of a policyholder dividend obligation as of such date.

If the actual cumulative earnings from the Closed Block are greater than the expected cumulative earnings, only the expected earnings will be recognized in the Company's net income. Actual cumulative earnings in excess of expected cumulative earnings at any point in time are recorded as a policyholder dividend obligation because they will ultimately be paid to Closed Block policyholders as an additional policyholder dividend unless offset by future performance that is less favorable than originally expected. If a policyholder dividend obligation has been previously established and the actual Closed Block earnings in a subsequent period are less than the expected earnings for that period, the policyholder dividend obligation would be reduced (but not below zero). If, over the period the policies and contracts in the Closed Block remain in force, the actual cumulative earnings of the Closed Block are less than the expected cumulative earnings, only actual earnings would be recognized in income from continuing operations. If the Closed Block has insufficient funds to make guaranteed policy benefit payments, such payments will be made from assets outside the Closed Block.

Many expenses related to Closed Block operations, including amortization of VOBA, are charged to operations outside of the Closed Block; accordingly, net revenues of the Closed Block do not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside of the Closed Block are, therefore, disproportionate to the business outside of the Closed Block.

Summarized financial information for the Closed Block is as follows:

| | As of December 31, | |
|---|-----------------------|----------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Closed block liabilities | | |
| Future policy benefits, policyholders' account balances and other policyholder liabilities | \$ 5,277 | \$ 5,406 |
| Policyholder dividend obligation | 401 | 580 |
| Other liabilities | 10 | 7 |
| Total closed block liabilities | 5,688 | 5,993 |
| Closed block assets | | |
| Fixed maturities, available-for-sale, at fair value | 4,633 | 4,903 |
| Commercial mortgage loans on real estate | 68 | 68 |
| Policy loans | 557 | 596 |
| Cash and other invested assets | 73 | 46 |
| Other assets | 83 | 91 |
| Total closed block assets | 5,414 | 5,704 |
| Excess of reported closed block liabilities over closed block assets | 274 | 289 |
| Portion of above representing accumulated other comprehensive income: | | |
| Net unrealized investments gains (losses) net of policyholder dividend obligation: \$323 and \$493; and net of income tax: \$(68) and \$(104) | — | — |
| Future earnings to be recognized from closed block assets and closed block liabilities | \$ 274 | \$ 289 |

Reconciliation of the policyholder dividend obligation is as follows:

| | For The Year Ended December 31, | |
|---|---------------------------------|--------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Policyholder dividend obligation, beginning balance | \$ 580 | \$ 279 |
| Applicable to net revenue | (9) | (25) |
| Change in net unrealized investment gains allocated to policyholder dividend obligation | (170) | 326 |
| Policyholder dividend obligation, ending balance | \$ 401 | \$ 580 |

Closed Block revenues and expenses were as follows:

| | For The Year Ended December 31, | |
|---|---------------------------------|--------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Revenues | | |
| Premiums and other income | \$ 144 | \$ 154 |
| Net investment income | 189 | 202 |
| Net investment gains | 28 | (2) |
| Total revenues | 361 | 354 |
| Benefits and other deductions | | |
| Benefits and settlement expenses | 342 | 332 |
| Other operating expenses | 1 | 2 |
| Total benefits and other deductions | 343 | 334 |
| Net revenues before income taxes | 18 | 20 |
| Income tax expense | 5 | 4 |
| Net revenues | \$ 13 | \$ 16 |

13. REINSURANCE

The Company reinsures certain of its risks with (cedes), and assumes risks from, other insurers under yearly renewable term, coinsurance, and modified coinsurance agreements. Under yearly renewable term agreements, the Company reinsures only the mortality risk, while under coinsurance the Company reinsures a proportionate share of all risks arising under the reinsured policy. Under coinsurance, the reinsurer receives a proportionate share of the premiums less commissions and is liable for a corresponding share of all benefit payments. Modified coinsurance is accounted for in a manner similar to coinsurance except that the liability for future policy benefits is held by the ceding company, and settlements are made on a net basis between the companies.

Reinsurance ceded arrangements do not discharge the Company as the primary insurer. Ceded balances would represent a liability of the Company in the event the reinsurers were unable to meet their obligations to us under the terms of the reinsurance agreements. The Company monitors the concentration of credit risk the Company has with any reinsurer, as well as the financial condition of its reinsurers. As of December 31, 2021, the Company had reinsured approximately 22% of the face value of its life insurance in-force. The Company has reinsured approximately 10% of the face value of its life insurance in-force with the following three reinsurers:

- Security Life of Denver Insurance Co. (currently administered by Hannover Re)
- Swiss Re Life & Health America Inc.
- The Lincoln National Life Insurance Co. (currently administered by Swiss Re Life & Health America Inc.)

The Company has not experienced any credit losses for the years ended December 31, 2021 and 2020 related to these reinsurers. The Company has set limits on the amount of insurance retained on the life of any one person. The amount of insurance retained by the Company on any one life on traditional life insurance was \$500,000 in years prior to mid-2005. In 2005, this retention amount was increased to \$1,000,000 for certain policies, and during 2008 it was increased to \$2,000,000 for certain policies. During 2016, the retention amount was increased to \$5,000,000.

Reinsurance premiums, commissions, expense reimbursements, benefits, and reserves related to reinsured long-duration contracts are accounted for over the life of the underlying reinsured contracts using assumptions consistent with those used to account for the underlying contracts. The cost of reinsurance related to short-duration contracts is accounted for over the reinsurance contract period. Amounts recoverable from reinsurers, for both short-and long-duration reinsurance arrangements, are estimated in a manner consistent with the claim liabilities and policy benefits associated with reinsured policies.

The following table presents total net life insurance in-force:

| | As of December 31, | |
|--------------------------------------|-----------------------|------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Direct life insurance in-force | \$ 829,253 | \$ 785,197 |
| Amounts assumed from other companies | 191,110 | 206,050 |
| Amounts ceded to other companies | (222,865) | (244,588) |
| Net life insurance in-force | \$ 797,498 | \$ 746,659 |
| Percentage of amount assumed to net | 24 % | 28 % |

The following table reflects the effect of reinsurance on life, accident/health, and property and liability insurance premiums written and earned:

| | Gross Amount | Ceded to Other Companies | Assumed from Other Companies | Net Amount |
|----------------------------------|-----------------------|--------------------------------|---------------------------------------|-------------------------|
| | (Dollars In Millions) | | | |
| For The Year Ended | | | | |
| December 31, 2021: | | | | |
| Premiums and policy fees: | | | | |
| Life insurance | \$ 2,843 | \$ (1,113) | \$ 1,036 | \$ 2,766 ⁽¹⁾ |
| Accident/health insurance | 32 | (19) | 28 | 41 |
| Property and liability insurance | 401 | (257) | 8 | 152 |
| Total | <u>\$ 3,276</u> | <u>\$ (1,389)</u> | <u>\$ 1,072</u> | <u>\$ 2,959</u> |
| December 31, 2020: | | | | |
| Premiums and policy fees: | | | | |
| Life insurance | \$ 2,661 | \$ (827) | \$ 935 | \$ 2,769 ⁽¹⁾ |
| Accident/health insurance | 37 | (23) | 90 | 104 |
| Property and liability insurance | 307 | (198) | 2 | 111 |
| Total | <u>\$ 3,005</u> | <u>\$ (1,048)</u> | <u>\$ 1,027</u> | <u>\$ 2,984</u> |

(1) Includes annuity policy fees of \$199 million and \$163 million for the years ended December 31, 2021 and 2020, respectively.

As of December 31, 2021 and 2020, policy and claim reserves relating to insurance ceded of \$4.2 billion and \$4.3 billion, respectively, are included in reinsurance receivables. Should any of the reinsurers be unable to meet its obligation at the time of the claim, the Company would be obligated to pay such claims. As of December 31, 2021 and 2020, the Company had paid \$157 million and \$135 million, respectively, of ceded benefits which are recoverable from reinsurers. In addition, as of December 31, 2021 and 2020, the Company had receivables of \$64 million and \$64 million, respectively, related to insurance assumed.

The Company's third party reinsurance receivables amounted to \$4.2 billion and \$4.2 billion as of December 31, 2021 and 2020, respectively. These amounts include ceded reserve balances and ceded benefit payments. The ceded benefit payments are recoverable from reinsurers. The following table sets forth the receivables attributable to our more significant reinsurance partners:

| | As of December 31, | | | |
|---|------------------------|------------------|------------------------|------------------|
| | 2021 | | 2020 | |
| | Reinsurance Receivable | A.M. Best Rating | Reinsurance Receivable | A.M. Best Rating |
| | (Dollars In Millions) | | | |
| Security Life of Denver Insurance Company | \$ 500.5 | A- | \$ 548.5 | NR |
| Swiss Re Life & Health America, Inc. | 480.1 | A+ | 489.6 | A+ |
| Lincoln National Life Insurance Co. | 337.3 | A+ | 370.7 | A+ |
| Somerset Re | 335.1 | A- | 259.9 | A- |
| Transamerica Life Insurance Co. | 226.4 | A | 240.3 | A |
| RGA Reinsurance Company | 204.6 | A+ | 210.5 | A+ |
| American United Life Insurance Company | 187.6 | A+ | 199.1 | A+ |
| Centre Reinsurance (Bermuda) Ltd | 149.3 | A | 167.3 | NR |
| Employers Reassurance Corporation | 139.4 | B+ | 162.0 | NR |
| The Canada Life Assurance Company | 123.2 | A+ | 134.0 | A+ |

The Company's reinsurance contracts typically do not have a fixed term. In general, the reinsurers' ability to terminate coverage for existing cessions is limited to such circumstances as material breach of contract or non-payment of premiums by the ceding company. The reinsurance contracts generally contain provisions intended to provide the ceding company with the ability to cede future business on a basis consistent with historical terms. However, either party may terminate any of the contracts with respect to future business upon appropriate notice to the other party.

Generally, the reinsurance contracts do not limit the overall amount of the loss that can be incurred by the reinsurer. The amount of liabilities ceded under contracts that provide for the payment of experience refunds is immaterial.

14. DEBT AND OTHER OBLIGATIONS

Debt and Subordinated Debt Securities

Debt and subordinated debt securities are summarized as follows:

| | As of December 31, | | | |
|---|--------------------------|------------------|--------------------------|------------------|
| | 2021 | | 2020 | |
| | Outstanding Principal | Carrying Amounts | Outstanding Principal | Carrying Amounts |
| | (Dollars In Millions) | | | |
| Debt (year of issue): | | | | |
| Credit Facility | \$ 275 | \$ 275 | \$ 190 | \$ 190 |
| Capital lease obligation | — | — | 1 | 1 |
| Term Loan Credit Agreement | 600 | 600 | 600 | 600 |
| 8.45% Senior Notes (2009), due 2039 | 181 | 266 | 181 | 269 |
| 4.30% Senior Notes (2018), due 2028 | 400 | 397 | 400 | 396 |
| 3.40% Senior Notes (2019), due 2030 | 400 | 397 | 400 | 397 |
| | <u>\$ 1,856</u> | <u>\$ 1,935</u> | <u>\$ 1,772</u> | <u>\$ 1,853</u> |
| Subordinated debt (year of issue): | | | | |
| 5.35% Subordinated Debentures (2017), due 2052 | \$ 500 | \$ 496 | \$ 500 | \$ 496 |
| 3.55% Subordinated Funding Obligations (2018), due 2038 | 55 | 55 | 55 | 55 |
| 3.55% Subordinated Funding Obligations (2018), due 2038 | 55 | 55 | 55 | 55 |
| | <u>\$ 610</u> | <u>\$ 606</u> | <u>\$ 610</u> | <u>\$ 606</u> |

Under a revolving line of credit arrangement (the “Credit Facility”), the Company has the ability to borrow on an unsecured basis up to an aggregate principal amount of \$1.0 billion. The Company has the right in certain circumstances to request that the commitment under the Credit Facility be increased up to a maximum principal amount of \$1.5 billion. Balances outstanding under the Credit Facility accrue interest at a rate equal to, at the option of the Borrowers, (i) LIBOR plus a spread based on the ratings of the Company’s Senior Debt, or (ii) the sum of (A) a rate equal to the highest of (x) the Administrative Agent’s Prime rate, (y) 0.50% above the Funds rate, or (z) the one-month LIBOR plus 1.00% and (B) a spread based on the ratings of the Company’s Senior Debt. The Credit Facility also provided for a facility fee at a rate that varies with the ratings of the Company’s Senior Debt and that is calculated on the aggregate amount of commitments under the Credit Facility, whether used or unused. The annual facility fee rate is 0.125% of the aggregate principal amount. The Credit Facility provides that the Company is liable for the full amount of any obligations for borrowings or letters of credit, including those of PLICO, under the Credit Facility. The maturity date of the Credit Facility is May 3, 2023. As of December 31, 2021, the Company was in compliance with its debt covenant requirements.

Secured Financing Transactions

Repurchase Program Borrowings

While the Company anticipates that the cash flows of its operating subsidiaries will be sufficient to meet its investment commitments and operating cash needs in a normal credit market environment, the Company recognizes that investment commitments scheduled to be funded may, from time to time, exceed the funds then available. Therefore, the Company has established repurchase agreement programs for certain of its insurance subsidiaries to provide liquidity when needed. The Company expects that the rate received on its investments will equal or exceed its borrowing rate. Under this program, the Company may, from time to time, sell an investment security at a specific price and agree to repurchase that security at another specified price at a later date. These borrowings are typically for a term less than 90 days. The market value of securities to be repurchased is monitored and collateral levels are adjusted where appropriate to protect the counterparty against credit exposure. Cash received is invested in fixed maturity securities, and the agreements provided for net settlement in the event of default or on termination of the agreements. As of December 31, 2021, the fair value of securities pledged under the repurchase program was \$1,503 million and the repurchase obligation of \$1,393 million was included in the Company’s consolidated balance sheets (at an average borrowing rate of 13 basis points). During the year ended December 31, 2021, the maximum balance outstanding at any one point in time related to these programs was \$1,799 million. The average daily balance was \$775 million (at an average borrowing rate of 13 basis points, respectively) during the year ended December 31, 2021. As of December 31, 2020, the fair value of securities pledged under the repurchase program was \$452 million and the repurchase obligation of \$437 million was included in the Company’s consolidated balance sheets (at an average borrowing rate of 15 basis points). During the year ended December 31, 2020, the maximum balance outstanding at any one point in time related to these programs was \$825 million. The average daily balance was \$143 million (at an average borrowing rate of 33 basis points) during the year ended December 31, 2020.

Securities Lending

The Company participates in securities lending, primarily as an investment yield enhancement, whereby securities that are held as investments are loaned out to third parties for short periods of time. The Company requires collateral at least equal to 102% of the fair value of the loaned securities to be separately maintained. The loaned securities’ fair value is monitored on a daily basis and collateral is adjusted accordingly. The Company maintains ownership of the securities at all times and is entitled to receive from the borrower any payments for interest received on such securities during the loan term. Securities lending transactions are accounted for as secured borrowings. As of December 31, 2021 and 2020, securities with a fair value of \$174 million and \$57 million were loaned under this program. As collateral for the loaned securities, the Company receives cash, which is primarily reinvested in short-term repurchase agreements, which are also collateralized by U.S. Government or U.S. Government Agency securities, and government money market funds. These investments are recorded in “short-term investments” with a corresponding liability recorded in “secured financing liabilities” to account for its obligation to return the collateral. As of December 31, 2021 and 2020, the fair value of the collateral related to this program was \$179 million and \$59 million, and the Company has an obligation to return \$179 million and \$59 million of collateral to the securities borrowers.

The following table provides the fair value of collateral pledged for repurchase agreements, grouped by asset class, as of December 31, 2021 and 2020:

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

| | Remaining Contractual Maturity of the Agreements | | | | |
|--|--|---------------|--------------|----------------------|-----------------|
| | As of December 31, 2021 | | | | |
| | (Dollars In Millions) | | | | |
| | Overnight and Continuous | Up to 30 days | 30 - 90 days | Greater Than 90 days | Total |
| Repurchase agreements and repurchase-to-maturity transactions | | | | | |
| U.S. Treasury and agency securities | \$ 1,070 | \$ — | \$ — | \$ — | \$ 1,070 |
| Corporate securities | 69 | — | — | — | 69 |
| Commercial mortgage loans | 364 | — | — | — | 364 |
| Total repurchase agreements and repurchase-to-maturity transactions | 1,503 | — | — | — | 1,503 |
| Securities lending transactions | | | | | |
| Fixed maturity securities | 171 | — | — | — | 171 |
| Equity securities | 1 | — | — | — | 1 |
| Redeemable preferred stocks | 2 | — | — | — | 2 |
| Total securities lending transactions | 174 | — | — | — | 174 |
| Total securities | \$ 1,677 | \$ — | \$ — | \$ — | \$ 1,677 |

| | Remaining Contractual Maturity of the Agreements | | | | |
|--|--|---------------|--------------|----------------------|---------------|
| | As of December 31, 2020 | | | | |
| | (Dollars In Millions) | | | | |
| | Overnight and Continuous | Up to 30 days | 30 - 90 days | Greater Than 90 days | Total |
| Repurchase agreements and repurchase-to-maturity transactions | | | | | |
| U.S. Treasury and agency securities | \$ 366 | \$ 86 | \$ — | \$ — | \$ 452 |
| Commercial mortgage loans | — | — | — | — | — |
| Total repurchase agreements and repurchase-to-maturity transactions | 366 | 86 | — | — | 452 |
| Securities lending transactions | | | | | |
| Corporate securities | 49 | — | — | — | 49 |
| Equity securities | 7 | — | — | — | 7 |
| Redeemable preferred stocks | 1 | — | — | — | 1 |
| Total securities lending transactions | 57 | — | — | — | 57 |
| Total securities | \$ 423 | \$ 86 | \$ — | \$ — | \$ 509 |

Interest Expense

Interest expense is summarized as follows:

| | For The Year Ended December 31, | |
|--|---------------------------------|---------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Debt, subordinated debt, and subordinated funding obligations | \$ 86 | \$ 87 |
| Non-recourse funding obligations, other obligations, and repurchase agreements | 11 | 75 |
| Total interest expense | \$ 97 | \$ 162 |

Golden Gate Captive Insurance Company

On October 1, 2020, Golden Gate Captive Insurance Company (“Golden Gate”), a Vermont special purpose financial insurance company and a wholly owned subsidiary of PLICO, entered into a transaction with a term of 20 years, that may be extended to a maximum of 25 years, to finance up to \$5 billion of “XXX” and “AXXX” reserves related to the term life insurance business and universal life insurance with secondary guarantee business that is reinsured to Golden Gate by PLICO and West Coast Life Insurance Company, an indirect wholly owned subsidiary, pursuant to an Excess of Loss Reinsurance Agreement (the “XOL Agreement”) with Hannover Life Reassurance Company of America (Bermuda) Ltd., The Canada Life Assurance Company (Barbados Branch) and RGA Reinsurance Company (Barbados) Ltd. (collectively, the “Retrocessionaires”). The transaction is “non-recourse” to the Company, WCL, and PLICO, meaning that none of these companies are liable to reimburse the Retrocessionaires for any XOL payments required to be made. As of December 31, 2021, the XOL Asset backing the difference in statutory and economic reserve liabilities was \$4.267 billion.

15. COMMITMENTS AND CONTINGENCIES

The Company has entered into indemnity agreements with each of its current directors other than those that are employees of Dai-ichi Life that provide, among other things and subject to certain limitations, a contractual right to indemnification to the fullest extent permissible under the law. The Company has agreements with certain of its officers providing up to \$10 million in indemnification. These obligations are in addition to the customary obligation to indemnify officers and directors contained in the Company’s governance documents.

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

The Company had rental expense of \$10 million and \$9 million for the years ended December 31, 2021 and 2020, respectively. The following is a schedule by year of future minimum rental payments required under these leases:

| <u>Year</u> | <u>Amount</u> |
|-------------|------------------------------|
| | <u>(Dollars In Millions)</u> |
| 2022 | \$ 8 |
| 2023 | 5 |
| 2024 | 5 |
| 2025 | 3 |
| 2026 | 2 |
| Thereafter | 17 |

As of December 31, 2021 and 2020, the Company had outstanding commercial mortgage loan commitments of \$994 million at an average rate of 3.58% and \$801 million at an average rate of 3.91%, respectively.

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

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

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

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

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

PLICO is currently defending two putative class actions (*Beverly Allen v. Protective Life Insurance Company*, Civil Action No. 1:20-cv-00530-JLT (E.D. Cal. filed Apr. 14, 2020), and *Janice Schmidt v. Protective Life Insurance Company, et al.*, Civil Action No. 1:21-cv-01784-SAB (E.D. Cal. filed Dec. 17, 2021) in which the plaintiffs claim that defendants' alleged failure to comply with certain California statutes which address contractual grace periods and lapse notice requirements for certain life insurance policies requires that these policies remain in force. The plaintiffs seek unspecified monetary damages and injunctive relief. No class has been certified in either putative class action. In August 2021, the California Supreme Court determined in *McHugh v. Protective Life Insurance Company*, Case No. D072863, that the statutory requirements apply to life insurance policies issued before the statutes' effective date and remanded the case back to the Court of Appeal to review the jury's original verdict in favor of Protective. In continuing to defend these matters, PLICO maintains various defenses to the merits of the plaintiffs' claims and to class certification. However, the Company cannot predict the outcome of or reasonably estimate the possible loss or range of loss that might result from this litigation.

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

A proposed Rehabilitation Plan ("Original Rehabilitation Plan") was filed by the Receiver on June 30, 2020. The Original Rehabilitation Plan presents the following two options to each cedent: 1) remain in business with SRUS and be governed by the Rehabilitation Plan, or 2) recapture business ceded to SRUS. Due to SRUS's financial status, neither option would pay 100% of the Company's outstanding claims. The Original Rehabilitation Plan would impose certain financial terms and conditions on the cedents based on the election made, the type of business ceded, the manner in which the business is collateralized, and the amount of losses sustained by the cedent. On October 9, 2020, the Receiver filed a proposed order setting forth a schedule to present the Original Rehabilitation Plan for Court approval, which order contemplated possible modifications to the Rehabilitation Plan to be filed with the Court by March 16, 2021. The Court approved the order. On March 16, 2021, the Receiver filed a draft Amended Rehabilitation Plan ("Amended Plan"). The majority of the substance and form of the original Rehabilitation Plan, including its two option structure described above, remained in place.

For much of 2020 and into early 2021, a group of interested parties collectively requested certain information and financial data from the Receiver that would allow them to more fully evaluate first the Original Rehabilitation Plan and then the Amended Plan. This group also had a number of conversations with counsel for the Receiver regarding concerns over the Plan. On July 26, 2021, the Receiver shared with interested parties an outline of a Modified Plan, along with a liquidation analysis. While there are significant changes proposed in the Modified Plan (as compared to the Original Rehabilitation Plan and the

Amended Plan), much of the economic substance (including not paying claims in full) of the Original Rehabilitation Plan and the Amended Rehabilitation Plan are likely to be included in the Modified Plan.

The Court has yet to rule further or to re-establish a schedule for pre-confirmation procedures or a hearing on confirmation.

The Company continues to monitor SRUS and the actions of the Receiver through discussions with legal counsel and review of publicly available information. An allowance for credit losses related to SRUS is included in the overall reinsurance allowance for credit losses. As of December 31, 2021, management does not believe that the ultimate outcome of the rehabilitation process will have a material impact on our financial position or results of operations.

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

16. EMPLOYEE BENEFIT PLANS

The Company sponsors a Qualified Pension Plan and a Nonqualified Excess Pension Plan (“Pension Benefits”). The Qualified Pension Plan covers substantially all of its employees. Benefits are based on years of service and the employee’s compensation. The Nonqualified Excess Pension Plan is an unfunded nonqualified plan that provides defined pension benefits in excess of limits imposed on the Qualified Pension Plan by federal tax law.

In addition to pension benefits, the Company offers life insurance benefits for retirees from \$10,000 up to a maximum of \$75,000 which are provided through the payment of premiums under a group life insurance policy (“Other Postretirement Benefits”). This plan is partially funded at a maximum of \$50,000 face amount of insurance.

The Company also provides limited healthcare benefits to eligible retired employees until age 65. As of December 31, 2021 and December 31, 2020, the Company’s liability related to this benefit was immaterial.

The projected benefit obligation for pension benefits as of December 31, 2021 and 2020 was \$423 million and \$435 million, of which \$372 million and \$381 million related to the Qualified Pension Plan. The fair value of the plan assets as of December 31, 2021 and 2020 was \$341 million and \$323 million, all of which related to the Qualified Pension Plan.

The projected benefit obligation of the postretirement life insurance plans as of December 31, 2021 and 2020 was \$14 million and \$14 million. The fair value of the plan assets for the postretirement life insurance plan as of December 31, 2021 and 2020 was \$4 million and \$4 million.

Estimated future benefit payments are as follows:

| Years | Qualified Pension Plan | Nonqualified Excess Pension Plan | Postretirement Life Insurance Plan |
|-----------|------------------------|----------------------------------|------------------------------------|
| | (Dollars In Millions) | | |
| 2022 | \$ 27 | \$ 5 | \$ 1 |
| 2023 | 26 | 5 | 1 |
| 2024 | 29 | 5 | 1 |
| 2025 | 28 | 8 | 1 |
| 2026 | 27 | 5 | 1 |
| 2027-2031 | 138 | 21 | 3 |

Qualified Pension Plan Funding Policy

The Company's funding policy is to contribute amounts to the Qualified Pension Plan sufficient to meet the minimum funding requirements of the Employee Retirement Income Security Act ("ERISA"). The Company may also make additional contributions to maintain a funding target attainment percentage of at least 80% and to avoid certain Pension Benefit Guaranty Corporation reporting triggers, plus such additional amounts as the Company may determine to be appropriate from time to time.

During the year ended December 31, 2021, the Company contributed \$3 million to the Qualified Pension Plan for the 2020 plan year and \$6 million for the 2021 plan year. The Company has not yet determined what amount it will fund during 2022 but estimates the amount will be between \$10 million and \$20 million which is the expected plan year contribution range needed to eliminate the PBGC variable-rate premium payable in 2022.

Assumptions

Weighted-average assumptions used to determine benefit obligations as of December 31 are as follows:

| | Qualified Pension Plan | | Nonqualified Excess Pension Plan | |
|--|------------------------|--------|----------------------------------|--------|
| | 2021 | 2020 | 2021 | 2020 |
| Discount rate | 2.95 % | 2.55 % | 2.31 % | 1.81 % |
| Rate of compensation increase ⁽¹⁾ | 3.87 % | 3.83 % | 4.06 % | 4.01 % |

(1) The rate of compensation increase assumption used to determine the benefit obligation as of December 31, 2021 and 2020 is based on separate age-graded salary increase rates broken out by compensation structure.

Weighted-average assumptions used to determine the net periodic benefit cost for the years ended December 31, 2021 and 2020 are as follows:

| | Qualified Pension Plan | | Nonqualified Excess Pension Plan | |
|--|---------------------------------|--------|----------------------------------|--------|
| | For The Year Ended December 31, | | | |
| | 2021 | 2020 | 2021 | 2020 |
| Discount rate | 2.64 % | 3.24 % | 1.83 % | 2.75 % |
| Rate of compensation increase ⁽¹⁾ | 3.83 % | 3.81 % | 4.04 % | 3.75 % |
| Expected long-term return on plan assets | 7.00 % | 7.00 % | N/A | N/A |

(1) The rate of compensation increase assumption used to determine the net periodic benefit cost for the year ended December 31, 2021 and 2020 is based on separate age-graded salary increase rates broken out by compensation structure.

For the postretirement life insurance plan, the Company's discount rate assumption used to determine the benefit obligation and the net periodic benefit cost as of December 31, 2021 and 2020, is 3.09% and 2.79%, and 2.80% and 3.39%, respectively. The Company's expected long-term rate of return assumption used to determine the net periodic benefit cost for the postretirement life insurance plan as of December 31, 2021 and 2020, is 2.25% and 2.5%. To determine an appropriate long-term rate of return assumption, the Company utilized 25 year average and annualized return results on the Barclay's short treasury index.

Plan Assets

Qualified Pension Plan

The Qualified Pension Plan target asset allocation is designed to provide an acceptable level of risk and balance between return-seeking assets and liability-hedging fixed income assets. The target allocation is 60% return-seeking and 40% liability-hedging fixed income. During 2021, the Company completed an asset and liability study of its Qualified Pension Plan and the associated investment portfolio. As a result, the Plan's investment policy statement and investment portfolio are currently being updated. The new target allocation is as follows:

| Growth Asset Class | Target |
|-------------------------------|--------|
| Cash | 2.0 % |
| Group Annuity Contract | 20.0 % |
| Liability-Driven Fixed Income | 8.0 % |
| High Yield Fixed Income | 5.0 % |
| US Equities | 36.5 % |
| International Equities | 18.5 % |
| Strategic Opportunities | 10.0 % |

The Company's investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investment guidelines consider a broad range of economic conditions. The objectives of the target allocations are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plans' actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies.

The valuation methodologies used to determine the fair values reflect market participant assumptions and are based on the application of the fair value hierarchy that prioritizes observable market inputs over unobservable inputs. The following is a description of the valuation methodologies used for assets measured at fair value.

Mutual funds are valued at the daily closing prices as reported by the fund. Mutual funds held by the Plan are open-end mutual funds that are registered with the SEC. These funds are required to publish their daily net asset value ("NAV") and to transact at that price. The mutual funds held by the Plan are deemed to be actively traded.

Units in the collective investment funds are valued at the NAV. The NAV, as provided by the Trustee, is used as a practical expedient to estimate fair value and is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV.

The Qualified Pension Plan's group deposit administration annuity contract with PLICO is recorded at contract value, which the Company believes approximates fair value. Contract value represents contributions made under the contract, plus interest at the contract rate, less funds used to purchase annuities.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Qualified Pension Plan's assets at fair value as of December 31, 2021.

| | Level 1 | Level 2 | Level 3 | Total |
|---|-----------------------|---------|---------|--------|
| | (Dollars In Millions) | | | |
| Mutual fund | \$ 11 | \$ — | \$ — | \$ 11 |
| Collective investment funds | — | 255 | — | 255 |
| Group deposit administration annuity contract | — | — | 75 | 75 |
| Total assets measured at fair value | \$ 11 | \$ 255 | \$ 75 | \$ 341 |

The following table sets forth by level, within the fair value hierarchy, the Qualified Pension Plan's assets at fair value as of December 31, 2020:

| | Level 1 | Level 2 | Level 3 | Total |
|---|-----------------------|---------|---------|--------|
| | (Dollars In Millions) | | | |
| Mutual fund | \$ 25 | \$ — | \$ — | \$ 25 |
| Collective investment funds | — | 232 | — | 232 |
| Group deposit administration annuity contract | — | — | 66 | 66 |
| Total assets measured at fair value | \$ 25 | \$ 232 | \$ 66 | \$ 323 |

For the year ended December 31, 2021, \$6 million was transferred into Level 3 from Level 2 and \$18 million was transferred into Level 2 from Level 1. For the year ended December 31, 2020, \$13 million was transferred into Level 2 from Level 3 and \$12 million was transferred into Level 2 from Level 1. These transfers were made to cover benefit payments and maintain an acceptable asset allocation as determined by the Company's investment policy statement.

The following table presents a reconciliation of the beginning and ending balances for the fair value measurement for which the Company has used significant unobservable inputs (Level 3):

| | For The Year Ended December 31, | |
|---|---------------------------------|-------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Balance, beginning of year | \$ 66 | \$ 75 |
| Interest income | 3 | 3 |
| Transfers from collective short-term investments fund | 6 | — |
| Transfers to collective short-term investments fund | — | (12) |
| Balance, end of year | \$ 75 | \$ 66 |

The following table represents the Plan's Level 3 financial instrument, the valuation technique used, and the significant unobservable input and the ranges of values for that input as of December 31, 2021:

| Instrument | Fair Value | Principal Valuation Technique | Significant Unobservable Inputs | Range of Significant Input Values |
|---|-----------------------|-------------------------------|---------------------------------|-----------------------------------|
| | (Dollars In Millions) | | | |
| Group deposit administration annuity contract | \$ 75 | Contract Value | Contract Rate | 4.89% - 4.94% |

Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported.

Postretirement Life Insurance Plan

Investments of the Company's postretirement life insurance plan are held by Wells Fargo Bank, N.A. and are invested in a money market fund.

Investments are stated at fair value and are based on the application of the fair value hierarchy that prioritizes observable market inputs over unobservable inputs. The money market funds are valued based on historical cost, which represents fair value, at year end. This method of valuation may produce a fair value calculation that may not be reflective of future fair values. Furthermore, while the Company believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value could result in a different fair value measurement at the reporting date.

The plan assets of the postretirement life insurance plan, which were all Level 1, totaled \$4 million and \$4 million as of December 31, 2021 and 2020, respectively.

Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term could materially affect the amounts reported.

17. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables summarize the changes in the accumulated balances for each component of AOCI as of December 31, 2021 and 2020.

Changes in Accumulated Other Comprehensive Income (Loss) by Component

| | Unrealized Gains and Losses on Investments ⁽²⁾ | Accumulated Gain and Loss on Derivatives | Minimum Pension Benefits Liability Adjustment | Total Accumulated Other Comprehensive Income (Loss) |
|---|---|--|---|---|
| (Dollars In Millions, Net of Tax) | | | | |
| Balance, December 31, 2019 | \$ 1,424 | \$ (8) | \$ (32) | \$ 1,384 |
| Other comprehensive income (loss) before reclassifications | 2,054 | (2) | (23) | 2,029 |
| Other comprehensive income (loss) relating to other-than-temporary impaired investments for which a portion has been recognized in operations | 24 | — | — | 24 |
| Amounts reclassified from accumulated other comprehensive income (loss) ⁽¹⁾ | 63 | 2 | 6 | 71 |
| Balance, December 31, 2020 | \$ 3,565 | \$ (8) | \$ (49) | \$ 3,508 |
| Other comprehensive income (loss) before reclassifications | (1,110) | — | 19 | (1,091) |
| Other comprehensive income (loss) on investments for which a credit loss has been recognized in operations | (1) | — | — | (1) |
| Amounts reclassified from accumulated other comprehensive income (loss) ⁽¹⁾ | (41) | 1 | 6 | (34) |
| Balance, December 31, 2021 | \$ 2,413 | \$ (7) | \$ (24) | \$ 2,382 |

(1) See Reclassification table below for details.

(2) As of December 31, 2020 and 2021, net unrealized losses reported in AOCI were offset by \$(776.9) million and \$(1.9) billion, respectively, due to the impact those net unrealized losses would have had on certain of the Company's insurance assets and liabilities if the net unrealized losses had been recognized in net income.

The following tables summarize the reclassification amounts out of AOCI for the years ended December 31, 2021 and 2020.

| Gains/(losses) in net income: | Affected Line Item in the Consolidated Statements of Income | For The Year Ended December 31, | |
|--|---|---------------------------------|---------|
| | | 2021 | 2020 |
| | | (Dollars In Millions) | |
| Derivative instruments | Benefits and settlement expenses, net of reinsurance ceded ⁽¹⁾ | \$ (1) | \$ (3) |
| | Tax (expense) benefit | — | 1 |
| | | \$ (1) | \$ (2) |
| | | | |
| Unrealized gains and losses on available-for-sale securities | Net realized gains (losses) - investments | \$ 46 | \$ 46 |
| | Net impairment losses recognized in earnings | 6 | (125) |
| | Tax (expense) or benefit | (11) | 17 |
| | | \$ 41 | \$ (62) |
| | | | |
| Pension benefits liability adjustment | Other operating expenses: | | |
| | Amortization of net actuarial gain/(loss) | \$ (8) | \$ (7) |
| | Tax (expense) or benefit | 2 | 2 |
| | | \$ (6) | \$ (5) |
| | | | |

(1) See Note 6, *Derivative Financial Instruments* for additional information

18. INCOME TAXES

The Company's effective income tax rate related to continuing operations varied from the maximum federal income tax rate as follows:

| | For The Year Ended December 31, | |
|---|---------------------------------|---------------|
| | 2021 | 2020 |
| Statutory federal income tax rate applied to pre-tax income | 21.0 % | 21.0 % |
| State income taxes | 0.4 | 3.2 |
| Investment income not subject to tax | (5.1) | (2.2) |
| Prior period adjustments | (1.5) | (0.3) |
| Goodwill impairment | 11.2 | — |
| Other | 0.1 | (0.3) |
| | <u>26.1 %</u> | <u>21.4 %</u> |

The annual provision for federal income tax in these financial statements differs from the annual amounts of income tax expense reported in the Company's income tax returns. Certain significant revenues and expenses are appropriately reported in different years with respect to the financial statements and the tax returns.

The components of the Company's income tax are as follows:

| | For The Year Ended December 31, | |
|---|---------------------------------|--------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Current income tax expense: | | |
| Federal | \$ 138 | \$ 106 |
| State | 7 | (7) |
| Total current | <u>\$ 145</u> | <u>\$ 99</u> |
| Deferred income tax expense (benefit): | | |
| Federal | \$ (42) | \$ (16) |
| State | (5) | 16 |
| Total deferred | <u>\$ (47)</u> | <u>\$ —</u> |

The components of the Company's net deferred income tax liability are as follows:

| | As of December 31, | |
|--|-----------------------|-------------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Deferred income tax assets: | | |
| Loss and credit carryforwards | \$ 67 | \$ 27 |
| Deferred compensation | 101 | 110 |
| Deferred policy acquisition costs | 59 | 144 |
| Premium on corporate debt | 26 | 27 |
| Valuation allowance | (5) | (7) |
| | <u>248</u> | <u>301</u> |
| Deferred income tax liabilities: | | |
| Premium receivables and policy liabilities | 274 | 272 |
| VOBA and other intangibles | 573 | 584 |
| Invested assets (other than unrealized gains (losses)) | 261 | 283 |
| Net unrealized gains on investments | 641 | 947 |
| Other | 30 | 47 |
| | <u>1,779</u> | <u>2,133</u> |
| Net deferred income tax liability | <u>\$ (1,531)</u> | <u>\$ (1,832)</u> |

The deferred tax assets reported above include certain deferred tax assets related to nonqualified deferred compensation and other employee benefit liabilities that were assumed by AXA and they were not acquired by the Company in connection with the acquisition of MONY. The future tax deductions stemming from these liabilities will be claimed by the Company on MONY's tax returns in its post-acquisition periods. These deferred tax assets have been estimated as of December 31, 2021 reporting date based on all available information. However, it is possible that these estimates may be adjusted in future reporting periods based on actuarial changes to the projected future payments associated with these liabilities. Any such adjustments will be recognized by the Company as an adjustment to income tax expense during the period in which they are realized.

The CARES Act, as described in Note 8, *Commercial Mortgage Loans*, includes tax provisions relevant to businesses. The income tax related impacts of the CARES Act are not material to the Company's consolidated financial statements for the year ended December 31, 2021.

In management's judgment, the gross deferred income tax asset as of December 31, 2021 will more likely than not be fully realized. The Company has recognized a valuation allowance of \$6 million and \$9 million as of December 31, 2021 and December 31, 2020, respectively, related to state-based future deductible temporary differences that it has determined are more likely than not to expire unutilized. This resulting favorable change of \$3 million, before federal income taxes, decreased state income tax expense in 2021 by the same amount.

At December 31, 2021 and 2020, the Company has non-life net operating loss carryforwards for federal income tax purposes of \$206 million and \$28 million, respectively, which are available to offset future non-life group federal taxable income (and life group taxable income with limitations) and begin to expire in 2030. In addition, included in the deferred income tax assets above are \$29 million in state net operating loss carryforwards attributable to certain jurisdictions, which are available to offset future tax in the respective state jurisdictions, expiring between 2022 and 2041.

As of December 31, 2021 and 2020, some of the Company's fixed maturities were reported at an unrealized loss, although the net amount is an unrealized gain as of December 31, 2021. If the Company were to realize a tax-basis net capital loss for a year, then such loss could not be deducted against that year's other taxable income. However, such a loss could be carried back and forward against any prior year or future year tax-basis net capital gains. Therefore, the Company has relied upon a prudent and feasible tax-planning strategy regarding its fixed maturities that were reported at an unrealized loss. The Company has the ability and the intent to either hold such fixed maturities to maturity, thereby avoiding a realized loss, or to generate an offsetting realized gain from unrealized gain fixed maturities if such unrealized loss fixed maturities are sold at a loss prior to maturity.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | As of December 31, | |
|---|-----------------------|------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Balance, beginning of period | \$ 2 | \$ 2 |
| Additions for tax positions of the current year | — | — |
| Additions for tax positions of prior years | — | — |
| Reductions of tax positions of prior years: | | |
| Changes in judgment | — | — |
| Settlements during the period | — | — |
| Lapses of applicable statute of limitations | (2) | — |
| Balance, end of period | \$ — | \$ 2 |

Included in the end of period balances above, there were no unrecognized tax benefits for which the ultimate deductibility is certain but for which there is uncertainty about the timing of such deductions. Other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective income tax rate but would accelerate to an earlier period the payment of cash to the taxing authority. The total amount of unrecognized tax benefits, if recognized, that would affect the effective income tax rate is none and approximately \$2 million for the years ended December 31, 2021 and 2020, respectively.

Any accrued interest related to the unrecognized tax benefits and other accrued income taxes have been included in income tax expense. These amounts were an immaterial benefit and a \$1 million benefit for the years ended December 31, 2021 and 2020, respectively. The Company has an immaterial amount of accrued interest associated with unrecognized tax benefits as of December 31, 2021 and 2020.

The lapse of the 2017 statute of limitation is the reason for the reductions in the unrecognized tax benefits shown in the above chart. In general, the Company is no longer subject to income tax examinations by taxing authorities for tax years that began before 2018.

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

19. SUPPLEMENTAL CASH FLOW INFORMATION

The following table sets forth supplemental cash flow information:

| | For The Year Ended December 31, | |
|--|---------------------------------|--------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Cash paid / (received) during the year: | | |
| Interest on debt | \$ 99 | \$ 253 |
| Income taxes | 220 | 94 |

Total cash interest paid on debt for the year ended December 31, 2021, was \$99 million. Of this amount, \$57 million related to interest on debt, \$31 million related to interest on subordinated debt and subordinated funding obligations, \$1 million on repurchase agreements, and \$11 million related to XOL agreements and other obligations.

20. RELATED PARTY TRANSACTIONS

Certain corporations with which the Company's directors were affiliated paid us premiums and policy fees or other amounts for various types of insurance and investment products, interest on bonds we own and commissions on securities underwriting in which our affiliates participated. Such amounts were immaterial for December 31, 2021 and December 31, 2020. The Company paid commissions, interest on debt and investment products, and fees to these same corporations that were immaterial for the year ended December 31, 2021 and did not make any payments for the year ended December 31, 2020.

The Company has joint venture interests in real estate for which the Company holds the underlying real estate's loan. During 2021 and 2020, the Company received \$7 million and \$5 million, respectively, in commercial mortgage loan payments corresponding to the joint venture interest.

The Company holds certain commercial mortgage loans to which its parent, Dai-ichi Life owns a participating interest. During the year ended December 31, 2021 and 2020, the Company did not sell any commercial mortgage loans interests to Dai-ichi Life. As of December 31, 2021 and 2020, the Company while acting as the servicing agent for the participating interest, collected and remitted \$9 million and \$6 million in commercial mortgage loan payments.

During the periods ending December 31, 2021 and December 31, 2020, the Company paid a management fee to Dai-ichi Life of \$13 million and \$12 million for certain services provided to the Company, respectively.

The Company has guaranteed PLICO's obligations for borrowings or letters of credit under the revolving line of credit arrangement to which the Company is also a party. The Company has also issued guarantees, entered into support agreements and/or assumed a duty to indemnify its indirect wholly owned captive insurance companies in certain respects.

The Company has agreements with certain of its subsidiaries under which it supplies investment, legal and data processing services on a fee basis and provides other managerial and administrative services on a shared cost basis. Such other managerial and administrative services include but are not limited to accounting, financial reporting, compliance services, reinsurance administration, tax reporting, reserve computation, and projections.

21. STATUTORY REPORTING PRACTICES AND OTHER REGULATORY MATTERS

The Company's insurance subsidiaries prepare statutory financial statements for regulatory purposes in accordance with accounting practices prescribed by the NAIC and the applicable state insurance department laws and regulations. These financial statements vary materially from GAAP. Statutory accounting practices include publications of the NAIC, state laws, regulations, general administrative rules as well as certain permitted accounting practices granted by the respective state insurance department. Generally, the most significant differences are that statutory financial statements do not reflect 1) deferred acquisition costs and VOBA, 2) benefit liabilities that are calculated using Company estimates of expected mortality, interest, and withdrawals, 3) deferred income taxes that are not subject to statutory limits, 4) recognition of realized gains and losses on the sale of securities in the period they are sold, and 5) fixed maturities recorded at fair values, but instead at amortized cost.

Statutory net income for PLICO was \$426 million and \$692 million for the years ended December 31, 2021 and 2020, respectively. Statutory capital and surplus for PLICO was \$5.3 billion and \$5.4 billion as of December 31, 2021 and 2020, respectively.

The Company's insurance subsidiaries are subject to various state statutory and regulatory restrictions on the insurance subsidiaries' ability to pay dividends to Protective Life Corporation. In general, dividends up to specified levels are considered ordinary and may be paid without prior approval of the insurance commissions of the state of domicile. Dividends in larger amounts are considered extraordinary and are subject to affirmative prior approval by such commissioner. The maximum amount that would qualify as ordinary dividends to the Company from our insurance subsidiaries, and which would consequently be free from restriction and available for the payment of dividends to the Company's shareowner in 2022 is \$539 million. This results in \$9.8 billion of the net assets of PLC's insurance subsidiaries being restricted from transfer to PLC without prior approval from the respective state insurance departments.

State insurance regulators and the National Association of Insurance Commissioners ("NAIC") have adopted risk-based capital ("RBC") requirements for life insurance companies to evaluate the adequacy of statutory capital and surplus in relation to investment and insurance risks. The requirements provide a means of measuring the minimum amount of statutory surplus appropriate for an insurance company to support its overall business operations based on its size and risk profile. A company's risk-based statutory surplus is calculated by applying factors and performing calculations relating to various asset, premium, claim, expense, and reserve items. Regulators can then measure the adequacy of a company's statutory surplus by comparing it to RBC. The Company manages its capital consumption by using the ratio of its total adjusted capital, as defined by the insurance regulators, to the Company's action level RBC (known as the RBC ratio), also defined by insurance regulators. As of December 31, 2021 and 2020, the Company's insurance subsidiaries all exceeded the minimum RBC requirements.

Additionally, the Company has certain assets that are on deposit with state regulatory authorities and restricted from use. As of December 31, 2021, the Company's insurance subsidiaries had on deposit with regulatory authorities, fixed maturity and short-term investments with a fair value of \$43 million.

The states of domicile of the Company's insurance subsidiaries have adopted prescribed accounting practices that differ from the required accounting outlined in NAIC Statutory Accounting Principles ("SAP"). The insurance subsidiaries also have certain accounting practices permitted by the states of domicile that differ from those found in NAIC SAP.

Certain prescribed practices impact the statutory surplus of PLICO, the Company's primary operating subsidiary. These practices include the non-admission of goodwill as an asset for statutory reporting.

The favorable (unfavorable) effects of PLICO's statutory surplus, compared to NAIC statutory surplus, from the use of this prescribed practice was as follows:

| | As of December 31, | |
|---------------------------|-----------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Non-admission of goodwill | \$ (66) | \$ (105) |
| Total, net | \$ (66) | \$ (105) |

The Company also has certain permitted practices which are applied at the subsidiary level and do not have a direct impact on the statutory surplus of PLICO. These practices include permission to follow the actuarial guidelines of the domiciliary state of the ceding insurer for certain captive reinsurers, accounting for the XOL Asset Value, and a reserve difference related to a captive insurance company.

The favorable (unfavorable) effects on the statutory surplus of the Company's insurance subsidiaries, compared to NAIC statutory surplus, from the use of these permitted practices were as follows:

| | As of December 31, | |
|---|-----------------------|-----------------|
| | 2021 | 2020 |
| | (Dollars In Millions) | |
| Accounting for XOL Asset Value as an admitted asset | \$ 4,267 | \$ 4,579 |
| Reserving based on state specific actuarial practices | 101 | 94 |
| Reserving difference related to a captive insurance company | — | (218) |
| Total, net | \$ 4,368 | \$ 4,455 |

22. SUBSEQUENT EVENTS

On February 23, 2022, the Company declared a dividend of \$239 million to the Company's sole shareowner to be paid on or before March 31, 2022.

The Company has evaluated the effects of events subsequent to December 31, 2021, and through March 1, 2022, the date at which our consolidated financial statements were available to be issued. All accounting and disclosure requirements related to subsequent events are included in our consolidated financial statements.