HARTFORD FINANCIAL SERVICES GROUP INC/DE
Form 10-Q
October 25, 2018

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ______________
Commission file number 001-13958

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	13-3317783
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Hartford Plaza, Hartford, Connecticut 06155
(Address of principal executive offices) (Zip Code)
(860) 547-5000
(Registrant's telephone number, including area code)

Indicate by check mark:	Yes	No
• whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.	ý	¨
• whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).	ý	¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨ Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

- whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ ý

As of October 23, 2018, there were outstanding 358,734,819 shares of Common Stock, $0.01 par value per share, of the registrant.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018
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[a]The information required by this item is set forth in the Enterprise Risk Management section of Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations and is incorporated herein by reference.

Forward-Looking Statements

Certain of the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as “anticipates,” “intends,” “plans,” “seeks,” “believes,” “estimates,” “expects,” “projects,” and similar references to future per Forward-looking statements are based on management's current expectations and assumptions regarding future economic, competitive, legislative and other developments and their potential effect upon The Hartford Financial Services Group, Inc. and its subsidiaries (collectively, the "Company" or "The Hartford"). Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Actual results could differ materially from expectations, depending on the evolution of various factors, including the risks and uncertainties identified below, as well as factors described in such forward-looking statements; Part II, Item 1A, Risk Factors of this Quarterly Report on Form 10-Q; Part II, Item 1A, Risk Factors in The Hartford's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018; Part I, Item 1A, Risk Factors in The Hartford’s 2017 Form 10-K Annual Report; and our other filings with the Securities and Exchange Commission ("SEC").

- Risks Related to Economic, Political and Global Market Conditions:

challenges related to the Company’s current operating environment, including global political, economic and market conditions, and the effect of financial market disruptions, economic downturns, changes in trade regulation including tariffs and other barriers or other potentially adverse macroeconomic developments on the demand for our products and returns in our investment portfolios;

financial risk related to the continued reinvestment of our investment portfolios;

market risks associated with our business, including changes in credit spreads, equity prices, interest rates, inflation rate, market volatility and foreign exchange rates;

the impact on our investment portfolio if our investment portfolio is concentrated in any particular segment of the economy;

- Insurance Industry and Product-Related Risks:

the possibility of unfavorable loss development, including with respect to long-tailed exposures;

the possibility of a pandemic, earthquake, or other natural or man-made disaster that may adversely affect our businesses;

weather and other natural physical events, including the severity and frequency of storms, hail, winter storms, hurricanes and tropical storms, as well as climate change and its potential impact on weather patterns;

the possible occurrence of terrorist attacks and the Company’s inability to contain its exposure as a result of, among other factors, the inability to exclude coverage for terrorist attacks from workers' compensation policies and limitations on reinsurance coverage from the federal government under applicable laws;

the Company’s ability to effectively price its property and casualty policies, including its ability to obtain regulatory consents to pricing actions or to non-renewal or withdrawal of certain product lines;

actions by competitors that may be larger or have greater financial resources than we do;

technology changes, such as usage-based methods of determining premiums, advancement in automotive safety features, the development of autonomous vehicles, and platforms that facilitate ride sharing, which may alter demand for the Company's products, impact the frequency or severity of losses, and/or impact the way the Company markets, distributes and underwrites its products;

the Company’s ability to market, distribute and provide insurance products and investment advisory services through current and future distribution channels and advisory firms;

the uncertain effects of emerging claim and coverage issues;

- Financial Strength, Credit and Counterparty Risks:

risks to our business, financial position, prospects and results associated with negative rating actions or downgrades in the Company's financial strength and credit ratings or negative rating actions or downgrades relating to our investments;

the impact on our statutory capital of various factors, including many that are outside the Company's control, which can in turn affect our credit and financial strength ratings, cost of capital, regulatory compliance and other aspects of our business and results;

losses due to nonperformance or defaults by others, including credit risk with counterparties associated with investments, derivatives, premiums receivable, reinsurance recoverables and indemnifications provided by third parties in connection with previous dispositions;

the potential for losses due to our reinsurers' unwillingness or inability to meet their obligations under reinsurance contracts and the availability, pricing and adequacy of reinsurance to protect the Company against losses;

regulatory limitations on the ability of the Company and certain of its subsidiaries to declare and pay dividends;

- Risks Relating to Estimates, Assumptions and Valuations;

risk associated with the use of analytical models in making decisions in key areas such as underwriting, capital management, hedging, reserving, and catastrophe risk management;
the potential for differing interpretations of the methodologies, estimations and assumptions that underlie the Company’s fair value estimates for its investments and the evaluation of other-than-temporary impairments on available-for-sale securities;
the potential for further impairments of our goodwill or the potential for changes in valuation allowances against deferred tax assets;
the significant uncertainties that limit our ability to estimate the ultimate reserves necessary for asbestos and environmental claims;

- Strategic and Operational Risks:

the Company’s ability to maintain the availability of its systems and safeguard the security of its data in the event of a disaster, cyber or other information security incident or other unanticipated event;
failure to complete our proposed acquisition of The Navigators Group, Inc. may cause volatility in our securities;
the risks, challenges and uncertainties associated with our capital management plan, expense reduction initiatives and other actions, which may include acquisitions, divestitures or restructurings;
the potential for difficulties arising from outsourcing and similar third-party relationships;
the Company’s ability to protect its intellectual property and defend against claims of infringement;

- Regulatory and Legal Risks:

the cost and other potential effects of increased regulatory and legislative developments, including those that could adversely impact the demand for the Company’s products, operating costs and required capital levels;
unfavorable judicial or legislative developments;
the impact of changes in federal or state tax laws;
regulatory requirements that could delay, deter or prevent a takeover attempt that shareholders might consider in their best interests;
the impact of potential changes in accounting principles and related financial reporting requirements.

Any forward-looking statement made by the Company in this document speaks only as of the date of the filing of this Form 10-Q. Factors or events that could cause the Company’s actual results to differ may emerge from time to time, and it is not possible for the Company to predict all of them. The Company undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise.

Part I - Item 1. Financial Statements

Item 1. Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
The Hartford Financial Services Group, Inc.
Hartford, Connecticut

Results of Review of Interim Financial Information

We have reviewed the accompanying condensed consolidated balance sheet of The Hartford Financial Services Group, Inc. and subsidiaries (the "Company") as of September 30, 2018, the related condensed consolidated statements of operations and comprehensive income (loss) for the three-month and nine-month periods ended September 30, 2018 and 2017, and the condensed consolidated statements of changes in stockholders' equity and cash flows for the nine-month periods ended September 30, 2018 and 2017, and the related notes (collectively referred to as the "interim financial information"). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 23, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

This interim financial information is the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/ DELOITTE & TOUCHE LLP
Hartford, Connecticut
October 25, 2018

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Operations

(In millions, except for per share data)	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
	(Unaudited)			
Revenues				
Earned premiums	$3,987	$3,447	$11,872	$10,340
Fee income	344	291	994	855
Net investment income	444	404	1,323	1,209
Net realized capital gains (losses):				
Total other-than-temporary impairment ("OTTI") losses	(4)	(4)	(6)	(11)
OTTI losses recognized in other comprehensive income (“OCI”)	3	3	5	7
Net OTTI losses recognized in earnings	(1)	(1)	(1)	(4)
Other net realized capital gains	39	27	61	109
Total net realized capital gains	38	26	60	105
Other revenues	29	24	73	66
Total revenues	4,842	4,192	14,322	12,575
Benefits, losses and expenses				
Benefits, losses and loss adjustment expenses	2,786	2,638	8,219	7,482
Amortization of deferred policy acquisition costs ("DAC")	348	341	1,034	1,030
Insurance operating costs and other expenses	1,091	952	3,195	3,521
Loss on extinguishment of debt	—	—	6	—
Interest expense	69	79	228	238
Amortization of other intangible assets	18	1	54	3
Total benefits, losses and expenses	4,312	4,011	12,736	12,274
Income from continuing operations before income taxes	530	181	1,586	301
Income tax expense	103	36	297	5
Income from continuing operations, net of tax	427	145	1,289	296
Income from discontinued operations, net of tax	5	89	322	276
Net income	$432	$234	$1,611	$572
Income from continuing operations, net of tax, per common share				
Basic	$1.19	$0.40	$3.60	$0.81
Diluted	$1.17	$0.40	$3.54	$0.79
Net income per common share				
Basic	$1.20	$0.65	$4.50	$1.56
Diluted	$1.19	$0.64	$4.42	$1.54
Cash dividends declared per common share	$0.30	$0.23	$0.80	$0.69

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.

Condensed Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2018	2017	2018	2017
	(Unaudited)			
Net income	$432	$234	$1,611	$572
Other comprehensive income (loss):				
Changes in net unrealized gain on securities	(171)	85	(2,164)	564
Changes in OTTI losses recognized in other comprehensive income	(1)	(1)	(1)	(1)
Changes in net gain on cash flow hedging instruments	(5)	(14)	(37)	(33)
Changes in foreign currency translation adjustments	1	14	(4)	21
Changes in pension and other postretirement plan adjustments	10	7	29	371
OCI, net of tax	(166)	91	(2,177)	922
Comprehensive income (loss)	$266	$325	$(566)	$1,494

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Balance Sheets

(In millions, except for share and per share data)	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Investments:		
Fixed maturities, available-for-sale, at fair value (amortized cost of $36,094 and $35,612)	$36,166	$ 36,964
Fixed maturities, at fair value using the fair value option	24	41
Equity securities, at fair value	1,035	—
Equity securities, available-for-sale, at fair value (cost of $0 and $907)	—	1,012
Mortgage loans (net of allowances for loan losses of $1 and $1)	3,559	3,175
Limited partnerships and other alternative investments	1,712	1,588
Other investments	98	96
Short-term investments	3,540	2,270
Total investments	46,134	45,146
Cash	102	180
Premiums receivable and agents' balances, net	4,025	3,910
Reinsurance recoverables, net	3,931	4,061
Deferred policy acquisition costs	670	650
Deferred income taxes, net	1,244	1,164
Goodwill	1,290	1,290
Property and equipment, net	997	1,034
Other intangible assets, net	651	659
Other assets	2,393	2,230
Assets held for sale	—	164,936
Total assets	$61,437	$ 225,260
Liabilities		
Unpaid losses and loss adjustment expenses	$32,297	$ 32,287
Reserve for future policy benefits	656	713
Other policyholder funds and benefits payable	775	816
Unearned premiums	5,388	5,322
Short-term debt	413	320
Long-term debt	4,263	4,678
Other liabilities	4,916	5,188
Liabilities held for sale	—	162,442
Total liabilities	$48,708	$ 211,766
Commitments and Contingencies (Note 13)		
Stockholders' Equity		
Common stock, $0.01 par value — 1,500,000,000 shares authorized, 384,923,222 shares issued at September 30, 2018 and December 31, 2017	$4	$ 4
Additional paid-in capital	4,385	4,379
Retained earnings	10,973	9,642
Treasury stock, at cost — 26,247,219 and 28,088,186 shares	(1,114)	(1,194)
Accumulated other comprehensive income (loss), net of tax	(1,519)	663
Total stockholders' equity	$12,729	$ 13,494
Total liabilities and stockholders' equity	$61,437	$ 225,260

See Notes to Condensed Consolidated Financial Statements.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Changes in Stockholders' Equity

	Nine Months Ended September 30,	
(In millions, except for share data)	2018	2017
	(Unaudited)	
Common Stock	$4	$4
Additional Paid-in Capital		
Additional Paid-in Capital, beginning of period	4,379	5,247
Issuance of shares under incentive and stock compensation plans	(92)	(68)
Stock-based compensation plans expense	105	77
Issuance of shares for warrant exercise	(7)	(65)
Additional Paid-in Capital, end of period	4,385	5,191
Retained Earnings		
Retained Earnings, beginning of period	9,642	13,114
Cumulative effect of accounting changes, net of tax	5	—
Adjusted balance, beginning of period	9,647	13,114
Net income	1,611	572
Dividends declared on common stock	(285)	(252)
Retained Earnings, end of period	10,973	13,434
Treasury Stock, at cost		
Treasury Stock, at cost, beginning of period	(1,194)	(1,125)
Treasury stock acquired	—	(975)
Issuance of shares under incentive and stock compensation plans	109	90
Net shares acquired related to employee incentive and stock compensation plans	(36)	(36)
Issuance of shares for warrant exercise	7	65
Treasury Stock, at cost, end of period	(1,114)	(1,981)
Accumulated Other Comprehensive Income (Loss), net of tax		
Accumulated Other Comprehensive Income (Loss), net of tax, beginning of period	663	(337)
Cumulative effect of accounting changes, net of tax	(5)	—
Adjusted balance, beginning of period	658	(337)
Total other comprehensive income (loss)	(2,177)	922
Accumulated Other Comprehensive Income (Loss), net of tax, end of period	(1,519)	585
Total Stockholders’ Equity	$12,729	$17,233
Common Shares Outstanding		
Common Shares Outstanding, beginning of period (in thousands)	356,835	373,949
Treasury stock acquired	—	(19,281)
Issuance of shares under incentive and stock compensation plans	2,373	2,078
Return of shares under incentive and stock compensation plans to treasury stock	(694)	(718)
Issuance of shares for warrant exercise	162	1,512
Common Shares Outstanding, at end of period	358,676	357,540

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Cash Flows

(In millions)	Nine Months Ended September 30, 2018	2017
Operating Activities	(Unaudited)	
Net income	$1,611	$572
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized capital gains	(7)	(52)
Amortization of deferred policy acquisition costs	1,092	1,088
Additions to deferred policy acquisition costs	(1,057)	(1,039)
Depreciation and amortization	359	300
Loss on extinguishment of debt	6	—
Gain on sale	(202)	—
Pension settlement	—	747
Other operating activities, net	346	328
Change in assets and liabilities:		
Decrease in reinsurance recoverables	111	43
Decrease (increase) in accrued and deferred income taxes	(74)	64
Increase (decrease) in unpaid losses and loss adjustment expenses, reserve for future policy benefits, and unearned premiums	(119)	845
Net change in other assets and other liabilities	(224)	(1,372)
Net cash provided by operating activities	1,842	1,524
Investing Activities		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	20,069	21,371
Fixed maturities, fair value option	21	140
Equity securities, at fair value	1,171	—
Equity securities, available-for-sale	—	599
Mortgage loans	314	558
Partnerships	377	190
Proceeds from repurchase agreements program	(11)	—
Payments for the purchase of:		
Fixed maturities, available-for-sale	(18,679)	(22,021)
Equity securities, at fair value	(1,084)	—
Equity securities, available-for-sale	—	(517)
Mortgage loans	(667)	(943)
Partnerships	(408)	(344)
Repayments of repurchase agreements program	42	—
Net payments for derivatives	(228)	(98)
Net additions of property and equipment	(70)	(129)
Net payments for short-term investments	(2,720)	(523)
Other investing activities, net	(4)	10
Proceeds from business sold, net of cash transferred	1,115	222
Net cash used for investing activities	(762)	(1,485)
Financing Activities		
Deposits and other additions to investment and universal life-type contracts	1,814	3,628
Withdrawals and other deductions from investment and universal life-type contracts	(9,210)	(10,623)

Net transfers from separate accounts related to investment and universal life-type contracts	6,949	6,080
Repayments at maturity or settlement of consumer notes	(2)	(12)
Net increase (decrease) in securities loaned or sold under agreements to repurchase	(646)	1,434
Repayment of debt	(826)	(416)
Proceeds from the issuance of debt	490	500
Net issuance (return) of shares under incentive and stock compensation plans	10	(16)
Treasury stock acquired	—	(975)
Dividends paid on common stock	(270)	(258)
Net cash used for financing activities	(1,691)	(658)
Foreign exchange rate effect on cash	(4)	70
Net decrease in cash, including cash classified as assets held for sale	(615)	(549)
Less: Net decrease in cash classified as assets held for sale	(537)	(315)
Net (decrease) in cash	(78)	(234)
Cash – beginning of period	180	328
Cash – end of period	$ 102	$ 94
Supplemental Disclosure of Cash Flow Information		
Income tax received (paid)	$ (1)	$ 3
Interest paid	$ 197	$ 205

See Notes to Condensed Consolidated Financial Statements

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in millions, except for per share data, unless otherwise stated)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The Hartford Financial Services Group, Inc. is a holding company for insurance and financial services subsidiaries that provide property and casualty insurance, group life and disability products and mutual funds and exchange-traded products to individual and business customers in the United States (collectively, “The Hartford”, the “Company”, “we” or “our”).

On August 22, 2018, the Company announced it entered into a definitive agreement to acquire all outstanding common shares of The Navigators Group, Inc. ("Navigators Group"), a global specialty underwriter, for $70 a share, or $2.1 billion in cash. The transaction is expected to close in the first half of 2019, subject to approval by Navigators Group's shareholders and other customary closing conditions, including receipt of regulatory approvals.

On May 31, 2018, Hartford Holdings, Inc., a wholly owned subsidiary of the Company, completed the sale of the issued and outstanding equity of Hartford Life, Inc. (“HLI”), a holding company for its life and annuity operating subsidiaries. For further discussion of this transaction, see Note 18 - Business Dispositions and Discontinued Operations of Notes to Condensed Consolidated Financial Statements.

On November 1, 2017, Hartford Life and Accident Insurance Company ("HLA"), a wholly owned subsidiary of the Company, completed the acquisition of Aetna's U.S. group life and disability business through a reinsurance transaction. For further discussion of this transaction, see Note 2 - Business Acquisitions of Notes to Condensed Consolidated Financial Statements.

On May 10, 2017, the Company completed the sale of its United Kingdom ("U.K.") property and casualty run-off subsidiaries.

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information, which differ materially from the accounting practices prescribed by various insurance regulatory authorities. These Condensed Consolidated Financial Statements and Notes should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's 2017 Form 10-K Annual Report. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the full year.

The accompanying Condensed Consolidated Financial Statements and Notes are unaudited. These financial statements reflect all adjustments (generally consisting only of normal accruals) which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The Company's significant accounting policies are summarized in Note 1 - Basis of Presentation and Significant Accounting Policies of Notes to Consolidated Financial Statements included in the Company's 2017 Form 10-K Annual Report.

Consolidation

The Condensed Consolidated Financial Statements include the

accounts of The Hartford Financial Services Group, Inc., and entities in which the Company directly or indirectly has a controlling financial interest. Entities in which the Company has significant influence over the operating and financing decisions but does not control are reported using the equity method. All intercompany transactions and balances between The Hartford and its subsidiaries and affiliates that are not held for sale have been eliminated.

Discontinued Operations

The results of operations of a component of the Company are reported in discontinued operations when certain criteria are met as of the date of disposal, or earlier if classified as held-for-sale. When a component is identified for discontinued operations reporting, amounts for prior periods are retrospectively reclassified as discontinued operations. Components are identified as discontinued operations if they are a major part of an entity's operations and financial results such as a separate major line of business or a separate major geographical area of operations.

Use of Estimates

The preparation of financial statements, in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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 property and casualty and group long-term disability insurance product reserves, net of reinsurance; evaluation of goodwill for impairment; valuation of investments and derivative instruments; valuation allowance on deferred tax assets; and contingencies relating to corporate litigation and regulatory matters.

Reclassifications

Certain reclassifications have been made to prior year financial information to conform to the current year presentation. In particular:

- Distribution costs within the Mutual Funds segment that were previously netted against fee income are presented gross in insurance operating costs and other expenses.

Adoption of New Accounting Standards

Reclassification of Effect of Tax Rate Change from AOCI to Retained Earnings

On January 1, 2018, the Company adopted the FASB's new guidance for the effect on deferred tax assets and liabilities related to items recorded in accumulated other comprehensive income ("AOCI") resulting from the Tax Cuts and Jobs Act of 2017

("Tax Reform") enacted on December 22, 2017. Tax Reform reduced the federal tax rate applied to the Company's deferred tax balances from 35% to 21% on enactment. Under U.S. GAAP, the Company recorded the total effect of the change in enacted tax rates on deferred tax balances as a charge to income tax expense within net income during the fourth quarter of 2017, including the change in deferred tax balances related to components of AOCI. The new accounting guidance permitted the Company to reclassify the "stranded" tax effects out of AOCI and into retained earnings that resulted from recording the tax effects of unrealized investment gains, unrecognized actuarial losses on pension and other postretirement benefit plans, and cumulative translation adjustments at a 35% tax rate because the 14 point reduction in tax rate was recognized in net income instead of other comprehensive income. On adoption, the Company recorded a reclassification of $88 from AOCI to retained earnings. As a result of the reclassification, in the first quarter of 2018, the Company reduced the estimated loss on sale recorded in income from discontinued operations by $193, net of tax, for the increase in AOCI related to the assets held for sale. The reduction in the loss on sale resulted in a corresponding increase in assets held for sale and AOCI as of January 1, 2018 and the AOCI associated with assets held for sale was removed from the balance sheet when the sale closed on May 31, 2018. Additionally, as of January 1, 2018, the Company reclassified $105 of stranded tax effects related to continuing operations which reduced AOCI and increased retained earnings.

Financial Instruments- Recognition and Measurement

On January 1, 2018, the Company adopted updated guidance issued by the FASB for the recognition and measurement of financial instruments through a cumulative effect adjustment to the opening balances of retained earnings and AOCI. The new guidance requires investments in equity securities to be measured at fair value with any changes in valuation reported in net income except for investments that are consolidated or are accounted for under the equity method of accounting. The new guidance also requires a deferred tax asset resulting from net unrealized losses on available-for-sale fixed maturities that are

recognized in AOCI to be evaluated for recoverability in combination with the Company's other deferred tax assets. Under prior guidance, the Company reported equity securities, available for sale ("AFS"), at fair value with changes in fair value reported in other comprehensive income. As of January 1, 2018, the Company reclassified from AOCI to retained earnings net unrealized gains of $83, after tax, related to equity securities having a fair value of $1.0 billion. In addition, $10 of net unrealized gains net of shadow DAC related to discontinued operations were reclassified from AOCI to retained earnings of the life and annuity run-off business held for sale, which increased the estimated loss on sale in 2018 by the same amount. Beginning in 2018, the Company reports equity securities at fair value with changes in fair value reported in net realized capital gains and losses.

Revenue Recognition

On January 1, 2018, the Company adopted the FASB's updated guidance for recognizing revenue from contracts with customers, which excludes insurance contracts and financial instruments. Revenue subject to the guidance is recognized when, or as, goods or services are transferred to customers in an amount that reflects the consideration that an entity is expected to receive in exchange for those goods or services. For all but certain revenues associated with our Mutual Funds business, the updated guidance is consistent with previous guidance for the Company's transactions and did not have an effect on the Company's financial position, cash flows or net income. The updated guidance also updated criteria for determining when the Company acts as a principal or an agent. The Company determined that it is the principal for some of its mutual fund distribution service contracts and, upon adoption, reclassified distribution costs of $48 and $140 for the three and nine months ended September 30, 2017, respectively, that were previously netted against fee income to insurance operating costs and other expenses.

Information about the nature, amount, timing of recognition and cash flows for the Company's revenues subject to the updated guidance follows.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
1. Basis of Presentation and Significant Accounting Policies (continued)

Revenue from Non-Insurance Contracts with Customers

		Three months ended September 30,		Nine months ended September 30,	
	Revenue Line Item	2018	2017	2018	2017
Commercial Lines					
Installment billing fees	Fee income	$9	$9	$26	$28
Personal Lines					
Installment billing fees	Fee income	10	11	30	33
Insurance servicing revenues	Other revenues	24	24	66	66
Group Benefits					
Administrative services	Fee income	43	19	131	57
Mutual Funds					
Advisor, distribution and other management fees	Fee income	245	229	722	660
Other fees	Fee income	21	22	63	75
Corporate					
Investment management and other fees	Fee income	15	1	21	2
Transition service revenues	Other revenues	6	—	8	—
Total revenues subject to updated guidance		$373	$315	$1,067	$921

Installment fees are charged on property and casualty insurance contracts for billing the insurance customer in installments over the policy term. These fees are recognized in fee income as earned on collection.
Insurance servicing revenues within Personal Lines consist of up-front commissions earned for collecting premiums and processing claims on insurance policies for which The Hartford does not assume underwriting risk, predominantly related to the National Flood Insurance Plan program. These insurance servicing revenues are recognized over the period of the flood program's policy terms.
Group Benefits products earn fee income from employers for the administration of underwriting, implementation and claims processing for employer self-funded plans and for leave management services. Fees are recognized as services are provided and collected monthly.
The Company provides investment management, administrative and distribution services to mutual funds and exchange-traded products. The Company assesses investment advisory, distribution and other asset management fees primarily based on the average daily net asset values from mutual funds and exchange-traded products, which are recorded in the period in which the services are provided and collected monthly. Fluctuations in domestic and international markets and related investment performance, volume and mix of sales and redemptions of mutual funds or exchange-traded products, and other changes to the composition of assets under management are all factors that ultimately have a direct effect on fee income earned.
Mutual Funds other fees primarily include transfer agent fees, generally assessed as a charge per account, and are recognized as fee income in the period in which the services are provided with payments collected monthly.

Corporate investment management and other fees are primarily for managing third party invested assets, including management of the invested assets of the Talcott Resolution life and annuity run-off business sold in the second quarter of 2018 ("Talcott Resolution"). These fees, calculated based on the average quarterly net asset values, are recorded in the period in which the services are provided and are collected quarterly. Fluctuations in markets and interest rates and other changes to the composition of assets under management are all factors that ultimately have a direct effect on fee income earned.

Corporate transition service revenues consist of operational services provided to The Hartford's former life and annuity run-off business that will be provided for a period up to 24 months from the May 31, 2018 sale date. The transition service revenues are recognized as other revenues in the period in which the services are provided with payments collected monthly.

Future Adoption of New Accounting Standards

Hedging Activities

The FASB issued updated guidance on hedge accounting. See Note 1 - Basis of Presentation and Significant Accounting Policies of Notes to Consolidated Financial Statements included in the Company's 2017 Form 10-K Annual Report for more information on the future adoption of the new hedging activities accounting standard. The Company will adopt the updated guidance January 1, 2019, as required, although earlier adoption is permitted. The adoption is not expected to have a material effect on the Company's financial position, cash flows or net income.

Leases

In accordance with the FASB's update to its new lease accounting standard, the Company will adopt the new guidance as of the January 1, 2019 effective date with no change to comparative periods. See Note 1 - Basis of Presentation and Significant Accounting Policies of Notes to Consolidated Financial Statements included in the Company's 2017 Form 10-K Annual Report for more information on the future adoption of the new lease accounting standard. We do not expect a material impact to the consolidated financial statements; however, it is expected that assets and liabilities will increase based on the present value of remaining lease payments for leases in place at the adoption date.

Reserve for Future Policy Benefits

The FASB issued new guidance on accounting for long-duration insurance contracts. The Company's long-duration insurance contracts include paid-up life insurance and whole-life insurance policies resulting from conversion from group life policies and run-off structured settlement and terminal funding agreement liabilities. Under existing guidance, a reserve for future policy benefits is calculated as the present value of future benefits and related expenses less the present value of any future premiums using assumptions "locked in" at the time the policies were issued, including discount rate, lapse rate, mortality, and expense assumptions. Under existing guidance, assumptions are only updated if there is an expected premium deficiency. The new guidance will require that underlying cash flow assumptions (such as for lapse rate, mortality and expenses) be reviewed and updated at least annually in the same quarter each year. The new guidance also requires that the discount rate assumption be updated each quarter and be based on an upper-medium grade (low-credit-risk) fixed-income investment yield. The change in the reserve estimate as a result of updating cash flow assumptions will be recognized in net income. The change in the reserve estimate as a result of updating the discount rate assumption will be recognized in other comprehensive income. Because reserves will be based on updated assumptions and no longer locked in at contract inception, there will no longer be a test for premium deficiency. The new guidance will be effective January 1, 2021, and will be applied to balances in place as of the earliest period presented. Early adoption is permitted. The Company has not yet determined the method or timing for adoption or estimated the effect on the Company's financial statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
2. Business Acquisitions

Aetna Group Insurance
On November 1, 2017, The Hartford acquired Aetna's U.S. group life and disability business through a reinsurance transaction for total consideration of $1.452 billion and recorded provisional estimates of the fair value of the assets acquired and liabilities assumed. In September 2018, The Hartford and Aetna agreed on the final assets acquired and liabilities assumed as of the acquisition date and The Hartford finalized its provisional

estimates with a final cash settlement in October. As a result, in the third quarter of 2018, The Hartford recorded additional assets and liabilities at fair value of $80 and $80, respectively, with no change in goodwill. The following table presents the preliminary allocation of the purchase price to the assets acquired and liabilities assumed as of the acquisition date, the measurement period adjustments recorded, and the final purchase price allocation.

Fair Value of Assets Acquired and Liabilities Assumed at the Acquisition Date

	Preliminary Value as of November 1, 2017 (as previously reported as of December 31, 2017)	Measurement Period Adjustments	As Adjusted Value as of November 1, 2017
Assets			
Cash and invested assets [1]	$ 3,360	$ 45	$ 3,405
Premiums receivable	96	7	103
Deferred income taxes, net	56	13	69
Other intangible assets	629	—	629
Property and equipment	68	—	68
Reinsurance recoverables	—	31	31
Other assets	16	(16)	—
Total Assets Acquired	4,225	80	4,305
Liabilities			
Unpaid losses and loss adjustment expenses	2,833	71	2,904
Reserve for future policy benefits payable	346	1	347
Other policyholder funds and benefits payable	245	1	246
Unearned premiums	3	1	4
Other liabilities	69	6	75
Total Liabilities Assumed	3,496	80	3,576
Net identifiable assets acquired	729	—	729
Goodwill [2]	723	—	723
Net Assets Acquired	$ 1,452	$ —	$ 1,452

[1] Includes $45 of cash received from Aetna in October 2018 in settlement of the final balance sheet and reported as a receivable in other assets in the Condensed Consolidated Balance Sheet as of September 30, 2018.
[2] Approximately $610 is deductible for income tax purposes.

The effect of measurement period adjustments on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 was immaterial and was determined as if the accounting had been completed as of the acquisition date.

The following table presents supplemental pro forma amounts of revenue and net income for the Company for the three and nine months ended September 30, 2017, as though the business was acquired on January 1, 2016.

Pro Forma Results

	Three months ended September 30, 2017 [1]	Nine months ended September 30, 2017 [1]
Total Revenue	$ 4,777	$ 14,309
Net Income	$ 249	$ 619

[1]Pro forma adjustments include the revenue and earnings of the Aetna U.S. group life and disability business as well as amortization of identifiable intangible assets acquired and the fair value adjustment to acquired insurance reserves. Pro forma adjustments do not include retrospective adjustments to defer and amortize acquisition costs as would be recorded under the Company’s accounting policy.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Earnings Per Common Share

Computation of Basic and Diluted Earnings per Common Share

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions, except for per share data)	2018	2017	2018	2017
Earnings				
Income from continuing operations, net of tax	$427	$145	$1,289	$296
Income from discontinued operations, net of tax	5	89	322	276
Net income	$432	$234	$1,611	$572
Shares				
Weighted average common shares outstanding, basic	358.6	360.2	358.1	365.9
Dilutive effect of stock compensation plans	3.6	4.5	4.0	4.1
Dilutive effect of warrants	1.9	2.3	2.0	2.6
Weighted average common shares outstanding and dilutive potential common shares	364.1	367.0	364.1	372.6
Net income per common share				
Basic				
Income from continuing operations, net of tax	$1.19	$0.40	$3.60	$0.81
Income from discontinued operations, net of tax	$0.01	$0.25	$0.90	$0.75
Net income per common share	$1.20	$0.65	$4.50	$1.56
Diluted				
Income from continuing operations, net of tax	$1.17	$0.40	$3.54	$0.79
Income from discontinued operations, net of tax	$0.02	$0.24	$0.88	$0.75
Net income per common share	$1.19	$0.64	$4.42	$1.54

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Segment Information

The Company currently conducts business principally in five reporting segments including Commercial Lines, Personal Lines, Property & Casualty Other Operations, Group Benefits and Mutual Funds, as well as a Corporate category. The Company includes in the Corporate category investment management fees and expenses related to managing third party business, including management of the invested assets of the Talcott Resolution life and annuity run-off business sold in the second quarter of 2018, discontinued operations related to the sale of Talcott Resolution, reserves for run-off structured settlement and terminal funding agreement liabilities, capital raising activities (including debt financing and related interest expense), purchase accounting adjustments related to goodwill and other expenses not allocated to the reporting segments. In addition, Corporate includes a 9.7% ownership interest in the limited partnership that acquired Talcott Resolution. For further discussion of continued involvement with Talcott Resolution, see Note 18 - Business Dispositions and Discontinued Operations of Notes to Condensed Consolidated Financial Statements.

The Company's revenues are generated primarily in the United States ("U.S."). Any foreign sourced revenue is immaterial.

Net Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Commercial Lines	$289	$90	$959	$579
Personal Lines	51	8	146	65
Property & Casualty Other Operations	9	18	31	62
Group Benefits	77	71	227	185
Mutual Funds	41	26	112	73
Corporate	(35)	21	136	(392)
Net income	$432	$234	$1,611	$572

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
4. Segment Information (continued)

Revenues

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Earned premiums and fee income				
Commercial Lines				
Workers' compensation	$845	$828	$2,495	$2,461
Liability	170	150	480	450
Package business	343	325	1,013	965
Automobile	157	155	454	477
Professional liability	65	63	190	183
Bond	60	59	179	172
Property	154	152	456	451
Total Commercial Lines	1,794	1,732	5,267	5,159
Personal Lines				
Automobile	598	653	1,809	1,975
Homeowners	261	279	785	843
Total Personal Lines [1]	859	932	2,594	2,818
Group Benefits				
Group disability	684	386	2,051	1,146
Group life	652	383	1,968	1,176
Other	60	53	179	159
Total Group Benefits	1,396	822	4,198	2,481
Mutual Funds				
Mutual fund and Exchange-Traded Products ("ETP") [2]	242	225	710	657
Talcott Resolution life and annuity separate accounts [3]	25	26	76	78
Total Mutual Funds	267	251	786	735
Corporate	15	1	21	2
Total earned premiums and fee income	4,331	3,738	12,866	11,195
Net investment income	444	404	1,323	1,209
Net realized capital gains	38	26	60	105
Other revenues	29	24	73	66
Total revenues	$4,842	$4,192	$14,322	$12,575

[1] For the three months ended September 30, 2018 and 2017, AARP members accounted for earned premiums of $758 and $801, respectively. For the nine months ended September 30, 2018 and 2017, AARP members accounted for earned premiums of $2.3 billion and $2.4 billion, respectively.

[2] Excludes distribution costs of $48 and $140 for the three and nine months ended September 30, 2017, respectively, that were previously netted against fee income and are now presented gross in insurance operating costs and other expenses.

[3] Relates to Talcott Resolution life and annuity business sold in May, 2018 that is still managed by the Company's Mutual Funds segment.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Fair Value Measurements

The Company carries certain financial assets and liabilities at estimated fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants. Our fair value framework includes a hierarchy that gives the highest priority to the use of quoted prices in active markets, followed by the use of market observable inputs, followed by the use of unobservable inputs. The fair value hierarchy levels are as follows:

Level 1	Fair values based primarily on unadjusted quoted prices for identical assets or liabilities, in active markets that the Company has the ability to access at the measurement date.
Level 2	Fair values primarily based on observable inputs, other than quoted prices included in Level 1, or based on prices for similar assets and liabilities.
Level 3	Fair values derived when one or more of the significant inputs are unobservable (including assumptions about risk). With little or no observable market, the determination of fair values uses considerable judgment and represents the Company’s best estimate of an amount that could be realized in a market exchange for the asset or liability. Also included are securities that are traded within illiquid markets and/or priced by independent brokers.

The Company will classify the financial asset or liability by level based upon the lowest level input that is significant to the determination of the fair value. In most cases, both observable inputs (e.g., changes in interest rates) and unobservable inputs (e.g., changes in risk assumptions) are used to determine fair values that the Company has classified within Level 3.

Assets and (Liabilities) Carried at Fair Value by Hierarchy Level as of September 30, 2018

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Fixed maturities, AFS				
Asset-backed-securities ("ABS")	$1,191	$ —	$ 1,137	$ 54
Collateralized loan obligations ("CLOs")	1,326	—	1,030	296
Commercial mortgage-backed securities ("CMBS")	3,657	—	3,635	22
Corporate	13,492	—	12,941	551
Foreign government/government agencies	952	—	949	3
Municipal	10,602	—	10,593	9
Residential mortgage-backed securities ("RMBS")	3,118	—	2,184	934
U.S. Treasuries	1,828	695	1,133	—
Total fixed maturities	36,166	695	33,602	1,869
Fixed maturities, FVO	24	—	24	—
Equity securities, at fair value	1,035	905	52	78
Derivative assets				
Credit derivatives	14	—	14	—
Equity derivatives	1	—	—	1
Foreign exchange derivatives	(1)	—	(1)	—
Total derivative assets [1]	14	—	13	1
Short-term investments	3,540	980	2,560	—
Total assets accounted for at fair value on a recurring basis	$40,779	$ 2,580	$ 36,251	$ 1,948

Liabilities accounted for at fair value on a recurring basis				
Derivative liabilities				
Foreign exchange derivatives	(10)	—	(10)	—
Interest rate derivatives	(51)	—	(53)	2
Total derivative liabilities [2]	(61)	—	(63)	2
Contingent consideration [3]	(32)	—	—	(32)
Total liabilities accounted for at fair value on a recurring basis	$ (93)	$ —	$ (63)	$ (30)

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Fair Value Measurements (continued)

Assets and (Liabilities) Carried at Fair Value by Hierarchy Level as of December 31, 2017

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Fixed maturities, AFS				
Asset-backed-securities ("ABS")	$1,126	$ —	$ 1,107	$ 19
Collateralized loan obligations ("CLOs")	1,260	—	1,165	95
Commercial mortgage-backed securities ("CMBS")	3,336	—	3,267	69
Corporate	12,804	—	12,284	520
Foreign government/government agencies	1,110	—	1,108	2
Municipal	12,485	—	12,468	17
Residential mortgage-backed securities ("RMBS")	3,044	—	1,814	1,230
U.S. Treasuries	1,799	333	1,466	—
Total fixed maturities	36,964	333	34,679	1,952
Fixed maturities, FVO	41	—	41	—
Equity securities, AFS	1,012	887	49	76
Derivative assets				
Credit derivatives	9	—	9	—
Equity derivatives	1	—	—	1
Foreign exchange derivatives	(1)	—	(1)	—
Interest rate derivatives	1	—	1	—
Total derivative assets [1]	10	—	9	1
Short-term investments	2,270	1,098	1,172	—
Total assets accounted for at fair value on a recurring basis	$40,297	$ 2,318	$ 35,950	$ 2,029
Liabilities accounted for at fair value on a recurring basis				
Derivative liabilities				
Credit derivatives	(3)	—	(3)	—
Foreign exchange derivatives	(13)	—	(13)	—
Interest rate derivatives	(84)	—	(85)	1
Total derivative liabilities [2]	(100)	—	(101)	1
Contingent consideration [3]	(29)	—	—	(29)
Total liabilities accounted for at fair value on a recurring basis	$(129)	$ —	$ (101)	$ (28)

[1] Includes derivative instruments in a net positive fair value position after consideration of the accrued interest and impact of collateral posting requirements which may be imposed by agreements and applicable law. See footnote 2 to this table for derivative liabilities.
[2] Includes derivative instruments in a net negative fair value position (derivative liability) after consideration of the accrued interest and impact of collateral posting requirements which may be imposed by agreements and applicable law.
[3] For additional information see the Contingent Consideration section below.

Fixed Maturities, Equity Securities, Short-term Investments, and Derivatives
Valuation Techniques

The Company generally determines fair values using valuation techniques that use prices, rates, and other relevant information evident from market transactions involving identical or similar instruments. Valuation techniques also include, where appropriate, estimates of future cash flows that are converted into a single discounted amount using current market expectations. The Company uses a "waterfall" approach

comprised of the following pricing sources and techniques, which are listed in priority order:

- Quoted prices, unadjusted, for identical assets or liabilities in active markets, which are classified as Level 1.
- Prices from third-party pricing services, which primarily utilize a combination of techniques. These services utilize recently reported trades of identical, similar, or benchmark securities making adjustments for market observable inputs available through the reporting date. If there are no recently reported trades, they may use a discounted cash flow technique to develop a price using expected cash flows based upon the anticipated future performance of the underlying collateral discounted at an estimated market rate. Both

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techniques develop prices that consider the time value of future cash flows and provide a margin for risk, including liquidity and credit risk. Most prices provided by third-party pricing services are classified as Level 2 because the inputs used in pricing the securities are observable. However, some securities that are less liquid or trade less actively are classified as Level 3. Additionally, certain long-dated securities, such as municipal securities and bank loans, include benchmark interest rate or credit spread assumptions that are not observable in the marketplace and are thus classified as Level 3.

- Internal matrix pricing, which is a valuation process internally developed for private placement securities for which the Company is unable to obtain a price from a third-party pricing service. Internal pricing matrices determine credit spreads that, when combined with risk-free rates, are applied to contractual cash flows to develop a price. The Company develops credit spreads using market based data for public securities adjusted for credit spread differentials between public and private securities, which are obtained from a survey of multiple private placement brokers. The market-based reference credit spread considers the issuer’s financial strength and term to maturity, using an independent public security index and trade information, while the credit spread differential considers the non-public nature of the security. Securities priced using internal matrix pricing are classified as Level 2 because the inputs are observable or can be corroborated with observable data.
- Independent broker quotes, which are typically non-binding, use inputs that can be difficult to corroborate with observable market based data. Brokers may use present value techniques using assumptions specific to the security types, or they may use recent transactions of similar securities. Due to the lack of transparency in the process that brokers use to develop prices, valuations that are based on independent broker quotes are classified as Level 3.

The fair value of derivative instruments is determined primarily using a discounted cash flow model or option model technique and incorporate counterparty credit risk. In some cases, quoted market prices for exchange-traded and OTC-cleared derivatives may be used and in other cases independent broker quotes may be used. The pricing valuation models primarily use inputs that are observable in the market or can be corroborated by observable market data. The valuation of certain derivatives may include significant inputs that are unobservable, such as volatility levels, and reflect the Company’s view of what other market participants would use when pricing such instruments.

Valuation Controls

The fair value process for investments is monitored by the Valuation Committee, which is a cross-functional group of senior management within the Company that meets at least quarterly. The purpose of the committee is to oversee the pricing policy and procedures, as well as to approve changes to valuation methodologies and pricing sources. Controls and procedures used to assess third-party pricing services are reviewed by the Valuation Committee, including the results of annual due-diligence reviews.

There are also two working groups under the Valuation Committee: a Securities Fair Value Working Group (“Secu