

PROTECTIVE LIFE CORP

Form 10-Q

August 08, 2008

[Table of Contents](#)

## UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION**





## **FORM 10-Q**

**x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended June 30, 2008**

**or**

**o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from                      to**

**Commission File Number 001-11339**

## **Protective Life Corporation**

Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**95-2492236**

(IRS Employer Identification No.)

**2801 Highway 280 South**

**Birmingham, Alabama 35223**

(Address of principal executive offices and zip code)

**(205) 268-1000**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐  
(Do not check if a smaller reporting company)

Smaller reporting company ☐

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

Number of shares of Common Stock, \$0.50 par value, outstanding as of August 6, 2008: **69,881,676**

**Table of Contents**

**PROTECTIVE LIFE CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR QUARTER ENDED JUNE 30, 2008**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I: Financial Information</b>	
Item 1.	Financial Statements (unaudited):
	<u>Consolidated Condensed Statements of Income for the Three and Six Months Ended June 30, 2008 and 2007</u>
	3
	<u>Consolidated Condensed Balance Sheets as of June 30, 2008 and December 31, 2007</u>
	4
	<u>Consolidated Condensed Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007</u>
	5
	<u>Notes to Consolidated Condensed Financial Statements</u>
	6
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>
	26
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
	83
<u>Item 4.</u>	<u>Controls and Procedures</u>
	83
<b><u>PART II: Other Information</u></b>	
<u>Item 1A.</u>	<u>Risk Factors</u>
	83
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>
	83
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>
	84
<u>Item 6.</u>	<u>Exhibits</u>
	84
<u>Signature</u>	85

Table of Contents**PROTECTIVE LIFE CORPORATION****CONSOLIDATED CONDENSED STATEMENTS OF INCOME**

(Unaudited)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(Dollars In Thousands, Except Per Share Amounts)</b>			
<b>Revenues</b>				
Premiums and policy fees	\$ 678,873	\$ 691,165	\$ 1,341,277	\$ 1,348,182
Reinsurance ceded	(423,774)	(422,766)	(794,846)	(793,763)
Net of reinsurance ceded	255,099	268,399	546,431	554,419
Net investment income	438,941	410,436	847,406	826,118
Realized investment (losses) gains:				
Derivative financial instruments	65,087	76,281	63,430	73,990
All other investments	(112,411)	(66,609)	(140,456)	(53,315)
Other income	47,983	57,452	93,492	131,244
Total revenues	694,699	745,959	1,410,303	1,532,456
<b>Benefits and expenses</b>				
Benefits and settlement expenses, net of reinsurance ceded:				
(three months: 2008 - \$403,096; 2007 - \$469,449)				
six months: 2008 - \$774,829; 2007 - \$762,347)	470,344	458,949	965,020	926,734
Amortization of deferred policy acquisition costs and value of business acquired	71,450	78,036	139,820	154,416
Other operating expenses, net of reinsurance ceded:				
(three months: 2008 - \$56,290; 2007 - \$72,368)				
six months: 2008 - \$108,668; 2007 - \$137,671)	95,426	107,533	194,395	216,537
Total benefits and expenses	637,220	644,518	1,299,235	1,297,687
<b>Income before income tax</b>	57,479	101,441	111,068	234,769
Income tax expense	19,295	36,336	37,002	79,081
<b>Net income</b>	\$ 38,184	\$ 65,105	\$ 74,066	\$ 155,688
Net income per share - basic	\$ 0.54	\$ 0.92	\$ 1.04	\$ 2.19
Net income per share - diluted	\$ 0.53	\$ 0.91	\$ 1.04	\$ 2.18
Cash dividends paid per share	\$ 0.235	\$ 0.225	\$ 0.46	\$ 0.44
Average share outstanding - basic	71,116,961	71,074,976	71,098,832	71,046,489
Average share outstanding - diluted	71,442,599	71,490,467	71,448,211	71,488,786

See Notes to Consolidated Condensed Financial Statements

Table of Contents

**PROTECTIVE LIFE CORPORATION**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**

(Unaudited)

	June 30, 2008	December 31, 2007
	(Dollars In Thousands)	
<b>Assets</b>		
Investments:		
Fixed maturities, at fair market value (amortized cost: 2008 - \$24,948,834; 2007 - \$23,448,784)	\$ 24,097,693	\$ 23,389,069
Equity securities, at fair market value (cost: 2008 - \$381,883; 2007 - \$112,406)	357,672	117,037
Mortgage loans	3,523,121	3,284,326
Investment real estate, net of accumulated depreciation (2008 - \$369; 2007 - \$283)	7,834	8,026
Policy loans	805,105	818,280
Other long-term investments	222,770	185,892
Short-term investments	839,973	1,236,443
Total investments	29,854,168	29,039,073
Cash	107,367	146,152
Accrued investment income	294,908	291,734
Accounts and premiums receivable, net of allowance for uncollectible amounts (2008 - \$2,605; 2007 - \$3,587)	139,123	87,883
Reinsurance receivables	5,203,089	5,089,100
Deferred policy acquisition costs and value of business acquired	3,629,243	3,400,493
Goodwill	116,307	117,366
Property and equipment, net of accumulated depreciation (2008 - \$114,066; 2007 - \$111,213)	40,924	42,795
Other assets	163,752	144,296
Income tax receivable	120,248	165,741
Assets related to separate accounts		
Variable annuity	2,641,203	2,910,606
Variable universal life	325,745	350,802
<b>Total Assets</b>	<b>\$ 42,636,077</b>	<b>\$ 41,786,041</b>
<b>Liabilities</b>		
Policy liabilities and accruals	\$ 17,994,864	\$ 17,429,307
Stable value product account balances	5,442,022	5,046,463
Annuity account balances	8,886,520	8,708,383
Other policyholders' funds	405,653	307,950
Securities sold under repurchase agreements	360,000	
Other liabilities	1,321,202	1,204,018
Deferred income taxes	317,531	512,156
Non-recourse funding obligations	1,375,000	1,375,000
Liabilities related to variable interest entities	400,000	400,000
Long-term debt	559,852	559,852
Subordinated debt securities	524,743	524,743
Liabilities related to separate accounts		
Variable annuity	2,641,203	2,910,606
Variable universal life	325,745	350,802
<b>Total liabilities</b>	<b>40,554,335</b>	<b>39,329,280</b>
<b>Commitments and contingent liabilities - Note 3</b>		
<b>Shareowners' equity</b>		
Preferred Stock; \$1 par value, shares authorized: 4,000,000; Issued: None		

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Common Stock, \$.50 par value, shares authorized: 2008 and 2007 - 160,000,000 shares issued: 2008 and 2007 - 73,251,960	36,626	36,626
Additional paid-in-capital	447,914	444,765
Treasury stock, at cost (2008 - 3,387,442 shares; 2007 - 3,102,898 shares)	(27,334)	(11,140)
Unallocated stock in Employee Stock Ownership Plan (2008 - 143,461 shares ; 2007 - 251,231 shares)	(474)	(852)
Retained earnings (includes FAS157 cumulative effect adjustment - \$1,470)	2,111,232	2,067,891
Accumulated other comprehensive income (loss):		
Net unrealized (losses) gains on investments, net of income tax: (2008 - \$(252,670); 2007 - \$(26,675))	(458,426)	(45,339)
Accumulated gain (loss) - hedging, net of income tax: (2008 - \$(3,025); 2007 - \$(6,185))	(5,461)	(12,222)
Postretirement benefits liability adjustment, net of income tax: (2008 - \$(11,158); 2007 - \$(11,622))	(22,335)	(22,968)
Total shareowners equity	2,081,742	2,456,761
<b>Total liabilities and shareowners equity</b>	<b>\$ 42,636,077</b>	<b>\$ 41,786,041</b>

See Notes to Consolidated Condensed Financial Statements

Table of Contents

## PROTECTIVE LIFE CORPORATION

## CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	2008	2007
	(Dollars In Thousands)	
<b>Cash flows from operating activities</b>		
Net income	\$ 74,066	\$ 155,688
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment losses (gains)	77,026	(20,675)
Amortization of deferred policy acquisition costs and value of business acquired	139,820	154,416
Capitalization of deferred policy acquisition costs	(190,145)	(247,015)
Depreciation expense	5,487	5,649
Deferred income tax	48,949	47,335
Accrued income tax	44,969	66,403
Interest credited to universal life and investment products	510,718	494,214
Policy fees assessed on universal life and investment products	(276,200)	(276,383)
Change in reinsurance receivables	(113,989)	(263,516)
Change in accrued investment income and other receivables	(54,414)	(12,062)
Change in policy liabilities and other policyholders' funds of traditional life and health products	219,571	166,875
Trading securities:		
Maturities and principal reductions of investments	285,594	202,938
Sale of investments	615,725	1,043,473
Cost of investments acquired	(736,632)	(1,381,788)
Other net change in trading securities	(105)	59,067
Change in other liabilities	287,026	185,561
Other, net	(84,930)	(34,610)
<b>Net cash provided by operating activities</b>	<b>852,536</b>	<b>345,570</b>
<b>Cash flows from investing activities</b>		
Investments available for sale:		
Maturities and principal reductions of investments	1,028,935	719,465
Sale of investments	1,665,517	1,435,080
Cost of investments acquired	(4,766,802)	(2,438,738)
Mortgage loans:		
New borrowings	(443,432)	(470,517)
Repayments	204,337	230,988
Change in investment real estate, net	181	33,990
Change in policy loans, net	13,175	20,115
Change in other long-term investments, net	10,747	(686)
Change in short-term investments, net	325,263	484,607
Purchase of property and equipment	(3,685)	(11,238)
Sales of property and equipment	787	4,094
<b>Net cash (used in) provided by investing activities</b>	<b>(1,964,977)</b>	<b>7,160</b>
<b>Cash flows from financing activities</b>		
Borrowings under line of credit arrangements and long-term debt		69,000
Principal payments on line of credit arrangement and long-term debt		(103,280)
Net proceeds from securities sold under repurchase agreements	360,000	295,051
Payments on liabilities related to variable interest entities		(20,395)
Issuance of non-recourse funding obligations		175,000

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Dividends to share owners	(32,196)	(30,817)
Investments product deposits and change in universal life deposits	2,730,191	1,310,001
Investment product withdrawals	(1,939,231)	(1,747,821)
Excess tax benefits on stock based compensation		1,653
Other financing activities, net	(45,108)	(9,509)
<b>Net cash provided by (used in) financing activities</b>	<b>1,073,656</b>	<b>(61,117)</b>
<b>Change in cash</b>	<b>(38,785)</b>	<b>291,613</b>
<b>Cash at beginning of period</b>	<b>146,152</b>	<b>69,516</b>
<b>Cash at end of period</b>	<b>\$ 107,367</b>	<b>\$ 361,129</b>

See Notes to Consolidated Condensed Financial Statements

Table of Contents

**PROTECTIVE LIFE CORPORATION**

**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

**1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying unaudited consolidated condensed financial statements of Protective Life Corporation and subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the disclosures required by U.S. GAAP for complete financial statements. In the opinion of management, the accompanying financial statements reflect all adjustments (consisting only of normal recurring items) necessary for a fair statement of the results for the interim periods presented. Operating results for the three and six month periods ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The year-end consolidated condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**Accounting Pronouncements Recently Adopted**

**Financial Accounting Standards Board ( FASB ) Statement No. 157, *Fair Value Measurement* ( SFAS No. 157 ).** In September 2006, the FASB issued SFAS No. 157. On January 1, 2008, the Company adopted this Statement, which defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The adoption of SFAS No. 157 did not have a material impact on the Company's consolidated financial statements. Additionally, on January 1, 2008, the Company elected the partial adoption of SFAS No. 157 under the provisions of FASB Staff Position ( FSP ) FAS 157-2, which amends SFAS No. 157 to allow an entity to delay the application of this Statement until periods beginning January 1, 2009 for certain non-financial assets and liabilities. Under the provisions of this FSP, the Company will delay the application of SFAS No. 157 for fair value measurements used in the impairment testing of goodwill and indefinite-lived intangible assets and eligible non-financial assets and liabilities included within a business combination. In January 2008, FASB also issued proposed FSP FAS 157-c that would amend SFAS No. 157 to clarify the principles on fair value measurement of liabilities. Management is monitoring the status of this proposed FSP for any impact on the Company's consolidated financial statements.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. The Company utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs. For more information, see Note 10, *Fair Value of Financial Instruments*.

**FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS No. 159 ).** In February 2007, the FASB issued SFAS No. 159. This Statement provides entities the option to measure certain financial assets and financial liabilities at fair value with changes in fair value recognized in earnings each period. SFAS No. 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The Company adopted SFAS No. 159 as of January 1, 2008. The Company has elected not to apply the provisions of SFAS No. 159 to its eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS No. 159 had no effect on the Company's consolidated results of operations or financial position.

Table of Contents

**FASB Staff Position ( FSP ) FIN 39-1, *Amendment of FASB Interpretation No. 39 ( FSP FIN39-1 )***. As of January 1, 2008, the Company adopted FSP FIN39-1. This FSP amends FIN 39, *Offsetting of Amounts Related to Certain Contracts*, to allow fair value amounts recognized for collateral to be offset against fair value amounts recognized for derivative instruments that are executed with the same counterparty under certain circumstances. The FSP also requires an entity to disclose the accounting policy decision to offset, or not to offset, fair value amounts in accordance with FIN 39, as amended. The Company does not, and has not previously, offset the fair value amounts recognized for derivatives with the amounts recognized as collateral.

**Accounting Pronouncements Not Yet Adopted**

**FASB Statement No. 141(R), *Business Combinations ( SFAS No. 141(R) )***. In December of 2007, the FASB issued SFAS No. 141(R). This Statement is a revision to the original Statement and continues the movement toward a greater use of fair values in financial reporting. It changes how business acquisitions are accounted for and will impact financial statements at the acquisition date and in subsequent periods. Further, certain of the changes will introduce more volatility into earnings and thus may impact a company's acquisition strategy. SFAS No. 141(R) will also impact the annual goodwill impairment test associated with acquisitions that close both before and after the effective date of this Statement. Thus, any potential goodwill impact from an acquisition that closed prior to the effective date of the Statement will need to be assessed under the provisions of SFAS No. 141(R). This Statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

**FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements ( SFAS No. 160 )***. In December of 2007, the FASB issued SFAS No. 160. This Statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (that is, January 1, 2009, for entities with calendar year-ends). The Company does not expect this Statement to have a significant impact on its consolidated results of operations or financial position.

**FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities ( SFAS No. 161 )***. In March of 2008, the FASB issued SFAS No. 161. This Statement requires enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting Derivative Instruments and Hedging Activities ( SFAS No. 133 )*. This statement is effective for fiscal years and interim periods beginning after November 15, 2008. The Statement will be effective for the Company beginning January 1, 2009. The Company is currently evaluating the impact, if any, that SFAS No. 161 will have on its consolidated results of operations or financial position.

**FSP No. 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions* ( FAS No. 140-3 ).** In February of 2008, the FASB issued FSP No. 140-3 to provide guidance on accounting for a transfer of a financial asset and a repurchase financing, which is not directly addressed by FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ( SFAS No. 140 ). This FSP is effective for fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The FSP will be effective for the Company beginning January 1, 2009. The Company is currently evaluating the impact, if any, that this FSP will have on its consolidated results of operations or financial position.

**FSP No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FAS No. 142-3 ).** In April of 2008, the FASB issued FSP No. 142-3 to improve consistency between the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*, and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141 (revised 2007), Business Combinations, and other guidance under U.S. GAAP. This FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The FSP will be effective for the Company beginning January 1, 2009. The Company does not expect this FSP to have a significant impact on its consolidated results of operations or financial position.

**FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ).** In May of 2008, the FASB issued SFAS No. 162. This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles ( GAAP ) in the United States ( the GAAP hierarchy ). This Statement is effective sixty days following the United States Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present*

Table of Contents

*Fairly in Conformity With Generally Accepted Accounting Principles.* The Company does not expect this Statement to have a significant impact on its consolidated results of operations or financial position.

**FASB Statement No. 163, *Accounting for Financial Guarantee Insurance Contracts* ( SFAS No. 163 ).** In May of 2008, the FASB issued SFAS No. 163. This Statement requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This Statement also clarifies how FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, ( SFAS No. 60 ), applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. It also requires expanded disclosures about financial guarantee insurance contracts. This Statement does not apply to financial guarantee insurance contracts that would be within the scope of SFAS No. 133. This Statement is effective for fiscal years and interim periods beginning after December 15, 2008. The standard will be effective for the Company beginning January 1, 2009. The Company does not expect this Statement to have a significant impact on its consolidated results of operations or financial position.

**FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ).** In June of 2008, the FASB issued FSP EITF 03-6-1. This FSP addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share ( EPS ) under the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, *Earnings per Share*. The FSP will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. All prior period EPS data presented shall be adjusted retrospectively to conform to the provisions of this FSP. The Company is currently evaluating the impact of this FSP, but does not expect it to have a significant impact on its consolidated results of operations or financial position.

**Reclassifications**

Certain reclassifications have been made in the previously reported financial statements and accompanying notes to make the prior period amounts comparable to those of the current period. Such reclassifications had no effect on previously reported net income or shareowners equity.

**Significant Accounting Policies**

**Valuation of investment securities**

The fair value for fixed maturity, short term, and equity securities, is determined by management after considering and evaluating one of three primary sources of information: third party pricing services, 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 prices, or lastly, securities are priced using a pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to: reported trades, benchmark yields, issuer spreads, bids, offers, and/or estimated cash flows and rates of prepayments. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third party pricing services will normally derive the security prices through 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. Included in the pricing of asset backed securities ( ABS ), collateralized mortgage obligations ( CMOs ), and mortgage-backed securities ( MBS ) are estimates of the rate of future prepayments of principal 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.

## Table of Contents

Determining whether a decline in the current fair value of invested assets is an other-than-temporary decline in value can involve a variety of assumptions and estimates, particularly for investments that are not actively traded in established markets. For example, assessing the value of certain investments requires that we perform an analysis of expected future cash flows or rates of prepayments. Other investments, such as collateralized mortgage or bond obligations, represent selected tranches of a structured transaction, supported in the aggregate by underlying investments in a wide variety of issuers. Management considers a number of factors when determining the impairment status of individual securities. These include the economic condition of various industry segments and geographic locations and other areas of identified risks. Although it is possible for the impairment of one investment to affect other investments, we engage in ongoing risk management to safeguard against and limit any further risk to our investment portfolio. Special attention is given to correlative risks within specific industries, related parties, and business markets. We generally consider a number of factors in determining whether the impairment is other-than-temporary. These include, but are not limited to: 1) actions taken by rating agencies, 2) default by the issuer, 3) the significance of the decline in fair value, 4) the intent and ability to hold the investment until recovery, 5) the time period during which the decline has occurred, 6) an economic analysis of the issuer's industry, and 7) the financial strength, liquidity, and recoverability of the issuer. Management performs a security-by-security review each quarter in evaluating the need for any other-than-temporary impairments. Although no set formula is used in this process, the investment performance, collateral position, and continued viability of the issuer are significant measures considered.

For the six months ended June 30, 2008, the Company recorded pre-tax other-than-temporary impairments of \$80.0 million in our investments compared to less than \$0.1 million for the six months ended June 30, 2007. The impairments occurred during the three months ended June 30, 2008, and related to residential mortgage-backed securities collateralized by Alt-A mortgages. The decline in the estimated fair value of these securities resulted from factors including downgrades in rating, interest rate changes, and the current distressed credit markets. These other-than-temporary impairments resulted from our analysis of circumstances and our belief that credit events, loss severity, changes in credit enhancement, and/or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to these investments. For more information on impairments, refer to Item 2, *Management's Discussion and Analysis of Financial Condition and Results of Operations*.

## **Reinsurance**

The Company uses reinsurance extensively in certain of its segments. The following summarizes some of the key aspects of the Company's accounting policies for reinsurance:

**Reinsurance Accounting Methodology** The Company accounts for reinsurance under the provisions of FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (SFAS No. 113). The methodology for accounting for the impact of reinsurance on the Company's life insurance and annuity products is determined by whether the specific products are subject to SFAS No. 60 or FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* (SFAS No. 97).

The Company's traditional life insurance products are subject to SFAS No. 60 and the recognition of the impact of reinsurance costs on the Company's financial statements reflect the requirements of that pronouncement. Ceded premiums 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 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

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

reinsurance expense allowances is treated as an offset to direct amortization of deferred policy acquisition costs or value of business acquired ( 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.

Table of Contents

The Company's short duration insurance contracts (primarily issued through the Asset Protection segment) are also subject to SFAS No. 60 and the recognition of the impact of reinsurance costs on the Company's financial statements also reflect the requirements of that pronouncement. Reinsurance allowances include such acquisition costs as commissions and premium taxes. A ceding fee is also collected to cover other administrative costs and profits for the Company. Reinsurance allowances received 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.

The Company's universal life, variable universal life, bank-owned life insurance (BOLI), and annuity products are subject to SFAS No. 97 and the recognition of the impact of reinsurance costs on the Company's financial statements reflect the requirements of that pronouncement. Ceded premiums and policy fees on SFAS No. 97 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. Commission and expense allowances paid by the assuming companies 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 are amortized based on future expected gross profits according to SFAS No. 97. Unlike with SFAS No. 60 products, assumptions for SFAS No. 97 regarding mortality, lapses and interest are continuously reviewed and may be periodically changed. These changes will result in unlocking which change the balance in the ceded deferred amortization cost and can affect the amortization of deferred acquisition cost and VOBA. Ceded unearned revenue liabilities are also amortized based on expected gross profits. Assumptions for SFAS No. 97 products are based on the best current estimate of expected mortality, lapses and interest spread. The Company complies with AICPA Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*, which impacts the timing of direct and ceded earnings on certain blocks of the Company's SFAS No. 97 business.

**Reinsurance Allowances** - The amount and timing of reinsurance allowances (both first year and renewal allowances) are contractually determined by the applicable reinsurance contract and may or may not bear a relationship to the amount and incidence of expenses actually paid by the ceding company. Many of the Company's reinsurance treaties do, in fact, have ultimate renewal allowances that exceed the direct ultimate expenses. Additionally, allowances are intended to reimburse the ceding company for some portion of the ceding company's commissions, expenses, and taxes. As a result, first year expenses paid by the Company may be higher than first year allowances paid by the reinsurer, and reinsurance allowances may be higher in later years than renewal expenses paid by the Company.

The Company recognizes allowances according to the prescribed schedules in the reinsurance contracts, which may or may not bear a relationship to actual expenses incurred by the Company. A portion of these allowances is deferred while the non-deferrable allowances are recognized immediately as a reduction of other operating expenses. The Company's practice is to defer reinsurance allowances in excess of the ultimate allowance. This practice is consistent with the Company's practice of capitalizing direct expenses. While the recognition of reinsurance allowances is consistent with U.S. GAAP, in some cases non-deferred reinsurance allowances may exceed non-deferred direct costs, which may cause net other operating expenses to be negative.

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). The Company determines ultimate allowances as the final amount to be paid over the life of a contract after higher acquisition related expenses (whether first year or renewal) are completed. Ultimate reinsurance allowances are determined by the reinsurer and set by the individual contract of each treaty during the initial negotiation of each such contract. Ultimate reinsurance allowances and other treaty provisions are listed within each treaty and will differ between agreements since each reinsurance contract is a separately negotiated agreement. The Company uses the ultimate reinsurance allowances set by the reinsurers and contained within each treaty agreement to complete its accounting responsibilities.



Table of Contents

**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. The amortization pattern varies with changes in estimated gross profits arising from the allowances. DAC and VOBA on SFAS No. 60 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 SFAS No. 60 amortization patterns. DAC and VOBA on SFAS No. 97 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 SFAS No. 97 amortization patterns.

**Reinsurance Liabilities** - Claim liabilities and policy benefits are calculated consistently for all policies in accordance with U.S. GAAP, 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. 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 by the Company's actuarial staff 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.

**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 policy reserves. Ceded benefits and settlement expenses decrease reinsurance cost.

Amortization of deferred policy acquisition cost and VOBA reflects the amortization of capitalized reinsurance allowances. Ceded amortization decreases reinsurance cost.

Other expenses include reinsurance allowances paid by assuming companies to the Company less amounts capitalized. Non-deferred 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.

Table of Contents

**Insurance liabilities and reserves**

Establishing an adequate liability for the Company's obligations to policyholders requires the use of 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. In addition, effective January 1, 2007, the Company adopted FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140* (SFAS No. 155), related to its equity indexed annuity product. SFAS No. 155 requires that the Company determine a fair value for the liability related to this block of business at each balance sheet date, with changes in the fair value recorded through earnings. Changes in this liability may be significantly affected by interest rate fluctuations. As a result of the adoption of SFAS No. 157 at January 1, 2008, the Company made certain modifications to the method used to determine fair value for its liability related to equity indexed annuities to take into consideration factors such as policyholder behavior, the Company's credit rating and other market considerations. The impact of adopting SFAS No. 157 is discussed further in Note 10, *Fair Value of Financial Instruments*.

**Guaranteed minimum withdrawal benefits**

The Company also establishes liabilities for guaranteed minimum withdrawal benefits (GMWB) on its variable annuity products. The GMWB is valued in accordance with SFAS No. 133 which requires the liability to be marked-to-market using current implied volatilities for the equity indices. The methods used to estimate the liabilities employ assumptions, primarily about mortality and lapses, equity market and interest returns, market volatility and the Company's credit rating. The Company assumes mortality of 65% of the National Association of Insurance Commissioners 1994 Variable Annuity GMDB Mortality Table. Differences between the actual experience and the assumptions used result in variances in profit and could result in losses.

As a result of the adoption of SFAS No. 157 at January 1, 2008, the Company made certain modifications to the method used to determine fair value for its liability related embedded derivatives related to annuities with guaranteed minimum withdrawal benefits to take into consideration factors such as policyholder behavior, the Company's credit rating and other market considerations. See Note 10, *Fair Value of Financial Instruments* for more information related to the impact of adopting SFAS No. 157.

Table of Contents**2. NON-RECOURSE FUNDING OBLIGATIONS**

Non-recourse funding obligations outstanding as of June 30, 2008, listed by issuer, are reflected in the following table:

Issuer	Balance (Dollars In Thousands)	Maturity Year	Year-to-Date Weighted-Avg Interest Rate
Golden Gate Captive Insurance Company	\$ 800,000	2037	5.13%
Golden Gate II Captive Insurance Company	575,000	2052	4.03%
Total	\$ 1,375,000		

**3. COMMITMENTS AND CONTINGENT LIABILITIES**

The Company is contingently liable to obtain a \$20 million letter of credit under indemnity agreements with directors. Such agreements provide insurance protection in excess of the directors' and officers' liability insurance in force at the time up to \$20 million. Should certain events occur constituting a change in control, the Company must obtain the letter of credit upon which directors may draw for defense or settlement of any claim relating to performance of their duties as directors. The Company has similar agreements with certain of its officers providing up to \$10 million in indemnification that are not secured by the obligation to obtain a letter of credit. These obligations are in addition to the customary obligation to indemnify officers and directors contained in our bylaws.

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

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 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 Company, like other financial service companies, in the ordinary course of business, is involved in such litigation and arbitration. Although the Company cannot predict the outcome of any such litigation or arbitration, the Company does not believe that any such outcome will have a material impact on the financial condition or results of the operations of the Company.

Table of Contents**4. STOCK-BASED COMPENSATION**

Performance shares awarded during the first six months of 2008 and 2007, and their estimated fair value at grant date are as follows:

Year Awarded	Performance Shares	Estimated Fair Value (Dollars In Thousands, Except Share Amounts)	Year Awarded	Performance Shares	Estimated Fair Value
2008	75,900	\$ 2,900	2007	64,700	\$ 2,800

The criteria for payment of performance awards is based primarily upon a comparison of the Company's average return on average equity (earlier upon the death, disability, or retirement of the executive, or in certain circumstances, upon a change in control of the Company) to that of a comparison group of publicly held life and multi-line insurance companies. If the Company's results are below the median of the comparison group (25<sup>th</sup> percentile for 2008 awards), no portion of the award is earned. If the Company's results are at or above the 90<sup>th</sup> percentile, the award maximum is earned. Awards are paid in shares of the Company's Common Stock.

During the first six months of 2008, stock appreciation rights (SARs) were granted to certain officers of the Company to provide long-term incentive compensation based solely on the performance of the Company's Common Stock. The SARs are exercisable in four equal annual installments beginning one year after the date of grant (earlier upon the death, disability, or retirement of the officer, or in certain circumstances, upon a change in control of the Company) and expire after ten years or upon termination of employment. The SARs activity as well as weighted average base price for the first six months of 2008 is as follows:

	Weighted-Average Base Price	Number of SARs
Balance at December 31, 2007	\$ 31.98	1,262,704
SARs granted	38.59	327,500
SARs exercised	33.33	(29,006)
Balance at June 30, 2008	\$ 33.34	1,561,198

The SARs issued in 2008 had estimated fair values at grant date of \$2.2 million. The fair value of the 2008 SARs was estimated using a Black-Scholes option pricing model. Significant assumptions used in the model for the 2008 SARs were as follows: expected volatility ranged from 16.4% to 22.1%, the risk-free interest rate ranged from 2.7% to 3.3%, a dividend rate of 2.1%, a 4.0% forfeiture rate, and the expected exercise date ranged from 2013 to 2016. The Company will pay an amount in stock equal to the difference between the specified base price of the Company's Common Stock and the market value at the exercise date for each SAR.

Additionally during 2008, the Company issued 13,100 restricted stock units at an average fair value of \$39.07 per unit. These awards, with a total fair value of \$0.5 million, vest ten years after the date of grant.



Table of Contents**5. DEFINED BENEFIT PENSION PLAN AND UNFUNDED EXCESS BENEFITS PLAN**

Components of the net periodic benefit cost of the Company's defined benefit pension plan and unfunded excess benefits plan are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands)			
Service cost - Benefits earned during the period	\$ 2,131	\$ 2,016	\$ 5,038	\$ 4,641
Interest cost on projected benefit obligations	2,290	2,454	5,415	4,994
Expected return on plan assets	(2,542)	(2,645)	(6,011)	(5,538)
Amortization of prior service cost	49	53	115	106
Amortization of actuarial losses	739	761	1,748	1,610
Net periodic benefit cost	\$ 2,667	\$ 2,639	\$ 6,305	\$ 5,813

The Company has not yet determined the amount, if any, that it will contribute to its defined benefit pension plan during 2008. As of June 30, 2008, no contributions have been made to the defined benefit pension plan.

In addition to pension benefits, the Company provides life insurance benefits to eligible retirees and limited healthcare benefits to eligible retirees who are not yet eligible for Medicare. The cost of these plans for the six months ended June 30, 2008 and 2007 was immaterial to the Company's financial position.

Table of Contents**6. EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period, including shares issuable under various deferred compensation plans. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares and dilutive potential common shares outstanding during the period, including shares issuable under various stock-based compensation plans and stock purchase contracts.

A reconciliation of the numerators and denominators of the basic and diluted earnings per share is presented below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands, Except Per Share Amounts)			
<b>Calculation of basic earnings per share:</b>				
Net income	\$ 38,184	\$ 65,105	\$ 74,066	\$ 155,688
Average share issued and outstanding	70,113,046	70,030,154	70,106,690	70,013,392
Issuable under various deferred compensation plans	1,003,915	1,044,822	992,142	1,033,097
Weighted shares outstanding - Basic	71,116,961	71,074,976	71,098,832	71,046,489
Basic earnings per share	\$ 0.54	\$ 0.92	\$ 1.04	\$ 2.19
<b>Calculation of diluted earnings per share:</b>				
Net income	\$ 38,184	\$ 65,105	\$ 74,066	\$ 155,688
Weighted shares outstanding - Basic	71,116,961	71,074,976	71,098,832	71,046,489
Stock appreciation rights ( SARs <sup>(1)</sup> )	198,789	251,586	188,704	258,050
Issuable under various other stock-based compensation plans	126,849	163,905	160,675	184,247
Weighted shares outstanding - Diluted	71,442,599	71,490,467	71,448,211	71,488,786
Diluted earnings per share	\$ 0.53	\$ 0.91	\$ 1.04	\$ 2.18

(1) Excludes 680,920 and 331,450 SARs as of June 30, 2008 and 2007, respectively, that are antidilutive. In the event the average market price exceeds the issue price of the SARs, such right would be dilutive to the Company's earnings per share and will be included in the Company's calculation of the diluted average shares outstanding.

Table of Contents**7. COMPREHENSIVE INCOME**

The following table sets forth the Company's comprehensive income (loss) for the periods presented below:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(Dollars In Thousands)</b>			
Net income	\$ 38,184	\$ 65,105	\$ 74,066	\$ 155,688
Change in net unrealized gains on investments, net of income tax:				
(three months: 2008 - \$(90,822); 2007 - \$(94,717))				
six months: 2008 - \$(246,404); 2007 - \$(80,332))	(167,889)	(172,728)	(450,670)	(146,496)
Change in accumulated gain-hedging, net of income tax:				
(three months: 2008 - \$9,363; 2007 - \$(2,162))				
six months: 2008 - \$3,418; 2007 - \$(947))	17,468	(3,899)	6,760	(1,708)
Minimum pension liability adjustment, net of income tax:				
(three months: 2008 - \$160; 2007 - \$0)				
six months: 2008 - \$316; 2007 - \$0)	317		633	
Reclassification adjustment for investment amounts included in net income, net of income tax:				
(three months: 2008 - \$23,440; 2007 - \$(118))				
six months: 2008 - \$20,409; 2007 - \$(1,743))	43,093	(215)	37,583	(3,178)
Reclassification adjustment for hedging amounts included in net income, net of income tax:				
(three months: 2008 - \$601; 2007 - \$(136))				
six months: 2008 - \$338; 2007 - \$(101))	737	(244)	1	(181)
Comprehensive income (loss)	\$ (68,090)	\$ (111,981)	\$ (331,627)	\$ 4,125

**8. OPERATING SEGMENTS**

The Company operates several business segments each having a strategic focus. An operating segment is generally distinguished by products and/or channels of distribution. A brief description of each segment follows.

- The Life Marketing segment markets level premium term insurance ( traditional ), universal life ( UL ), variable universal life and BOLI products on a national basis primarily through networks of independent insurance agents and brokers, stockbrokers, and independent marketing organizations.

- The Acquisitions segment focuses on acquiring, converting, and servicing policies acquired from other companies. The segment's primary focus is on life insurance policies and annuity products that were sold to individuals.
- The Annuities segment manufactures, sells, and supports fixed and variable annuity products. These products are primarily sold through stockbrokers, but are also sold through financial institutions and independent agents and brokers.
- The Stable Value Products segment sells guaranteed funding agreements to special purpose entities that in turn issue notes or certificates in smaller, transferable denominations. The segment also markets fixed and floating rate funding agreements directly to the trustees of municipal bond proceeds, institutional investors, bank trust departments, and money market funds. Additionally, the segment markets guaranteed investment contracts ( GICs ) to 401(k) and other qualified retirement savings plans.
- The Asset Protection segment primarily markets extended service contracts and credit life and disability insurance to protect consumers' investments in automobiles, watercraft, and recreational vehicles. In addition, the segment markets a guaranteed asset protection product and an inventory protection product.

Table of Contents

- The Corporate and Other segment primarily consists of net investment income and expenses not attributable to the segments above (including net investment income on capital and interest on debt). This segment also includes earnings from several non-strategic lines of business (primarily cancer insurance, residual value insurance, surety insurance, and group annuities), various investment-related transactions, and the operations of several small subsidiaries.

The Company uses the same accounting policies and procedures to measure segment operating income and assets as it uses to measure consolidated net income and assets. Segment operating income is generally income before income tax excluding net realized investment gains and losses (net of the related amortization of DAC/VOBA and participating income from real estate ventures), and the cumulative effect of change in accounting principle. Periodic settlements of derivatives associated with corporate debt and certain investments and annuity products are included in realized gains and losses but are considered part of operating income because the derivatives are used to mitigate risk in items affecting consolidated and segment operating income. Segment operating income represents the basis on which the performance of the Company's business is internally assessed by management. Premiums and policy fees, other income, benefits and settlement expenses, and amortization of DAC/VOBA are attributed directly to each operating segment. Net investment income is allocated based on directly related assets required for transacting the business of that segment. Realized investment gains (losses) and other operating expenses are allocated to the segments in a manner that most appropriately reflects the operations of that segment. Investments and other assets are allocated based on statutory policy liabilities, while DAC/VOBA and goodwill are shown in the segments to which they are attributable.

There were no significant intersegment transactions.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following tables summarize financial information for the Company's segments. Asset adjustments represent the inclusion of assets related to discontinued operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands)			
<b>Revenues</b>				
Life Marketing	\$ 235,067	\$ 235,205	\$ 495,986	\$ 505,744
Acquisitions	200,942	227,448	406,577	459,152
Annuities	95,956	77,724	178,216	151,478
Stable Value Products	79,570	70,895	163,364	151,421
Asset Protection	75,343	82,218	148,276	162,241
Corporate and Other	7,821	52,469	17,884	102,420
Total revenues	\$ 694,699	\$ 745,959	\$ 1,410,303	\$ 1,532,456
<b>Segment Operating Income</b>				
Life Marketing	\$ 38,127	\$ 37,834	\$ 84,576	\$ 103,114
Acquisitions	34,514	30,814	68,090	63,063
Annuities	9,487	6,669	11,976	12,275
Stable Value Products	17,545	12,355	33,761	24,541
Asset Protection	6,664	11,522	16,516	21,606
Corporate and Other	(2,093)	(1,300)	(32,066)	477
Total segment operating income	104,244	97,894	182,853	225,076
Realized investment gains (losses) - investments <sup>(1)</sup>	(111,916)	(71,146)	(141,035)	(62,198)
Realized investment gains (losses) - derivatives <sup>(2)</sup>	65,151	74,693	69,250	71,891
Income tax expense	(19,295)	(36,336)	(37,002)	(79,081)
Net income	\$ 38,184	\$ 65,105	\$ 74,066	\$ 155,688

(1) Realized investment gains (losses) - investments	\$ (112,411)	\$ (66,609)	\$ (140,456)	\$ (53,315)
Less: participating income from real estate ventures		3,707		6,857
Less: related amortization of DAC	(495)	830	579	2,026
	\$ (111,916)	\$ (71,146)	\$ (141,035)	\$ (62,198)

(2) Realized investment gains (losses) - derivatives	\$ 65,087	\$ 76,281	\$ 63,430	\$ 73,990
Less: settlements on certain interest rate swaps	1,786	237	2,270	494
Less: derivative activity related to certain annuities	(1,850)	1,351	(8,090)	1,605
	\$ 65,151	\$ 74,693	\$ 69,250	\$ 71,891

Table of Contents

**Operating Segment Assets**  
**June 30, 2008**  
(Dollars In Thousands)

	<b>Life Marketing</b>	<b>Acquisitions</b>	<b>Annuities</b>	<b>Stable Value Products</b>
Investments and other assets	\$ 10,530,794	\$ 11,135,217	\$ 8,775,463	\$ 5,678,756
Deferred policy acquisition costs and value of business acquired	2,239,820	932,035	309,196	17,377
Goodwill	10,192	43,553		
Total assets	\$ 12,780,806	\$ 12,110,805	\$ 9,084,659	\$ 5,696,133

	<b>Asset Protection</b>	<b>Corporate and Other</b>	<b>Adjustments</b>	<b>Total Consolidated</b>
Investments and other assets	\$ 1,088,258	\$ 1,654,674	\$ 27,365	\$ 38,890,527
Deferred policy acquisition costs and value of business acquired	125,786	5,029		3,629,243
Goodwill	62,479	83		116,307
Total assets	\$ 1,276,523	\$ 1,659,786	\$ 27,365	\$ 42,636,077

**Operating Segment Assets**  
**December 31, 2007**  
(Dollars In Thousands)

	<b>Life Marketing</b>	<b>Acquisitions</b>	<b>Annuities</b>	<b>Stable Value Products</b>
Investments and other assets	\$ 9,830,156	\$ 11,218,519	\$ 7,732,288	\$ 5,035,479
Deferred policy acquisition costs and value of business acquired	2,071,508	950,174	221,516	16,359
Goodwill	10,192	44,741		
Total assets	\$ 11,911,856	\$ 12,213,434	\$ 7,953,804	\$ 5,051,838

	<b>Asset Protection</b>	<b>Corporate and Other</b>	<b>Adjustments</b>	<b>Total Consolidated</b>
Investments and other assets	\$ 1,360,218	\$ 3,063,927	\$ 27,595	\$ 38,268,182
Deferred policy acquisition costs and value of business acquired	140,568	368		3,400,493
Goodwill	62,350	83		117,366
Total assets	\$ 1,563,136	\$ 3,064,378	\$ 27,595	\$ 41,786,041

## 9. GOODWILL

During the six months ended June 30, 2008, the Company decreased its goodwill balance by approximately \$1.1 million. The decrease was due to a \$1.2 million decrease in the Acquisitions segment related to tax benefits realized during the first six months of 2008 on the portion of tax goodwill in excess of GAAP basis goodwill and a \$0.3 million decrease in the Asset Protection segment related to the sale of a small insurance subsidiary during the first quarter of 2008, partially offset by a \$0.4 million increase in the Asset Protection segment related to the purchase of a small administrative subsidiary. As of June 30, 2008, the Company had an aggregate goodwill balance of \$116.3 million.



Table of Contents

**10. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Effective January 1, 2008, the Company determined the fair value of its financial instruments based on the fair value hierarchy established in SFAS No. 157 which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

In compliance with SFAS No. 157, 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
  - 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 assumptions about the assumptions a market participant would use in pricing the asset or liability.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

As a result of the adoption of SFAS No. 157, the Company recognized the following adjustment to opening retained earnings for its Equity Indexed Annuities that were previously accounted for under SFAS No. 155:

	<b>Carrying Value Prior to Adoption January 1, 2008</b>	<b>Carrying Value After Adoption January 1, 2008 (Dollars In Thousands)</b>	<b>Transition Adjustment to Retained Earnings gain (loss)</b>
Equity-indexed annuity reserves, net	\$ 145,912	\$ 143,634	\$ 2,278
Pre-tax cumulative effect of adoption of SFAS No. 157			2,278
Change in deferred income taxes			(808)
Cumulative effect of adoption of SFAS No. 157			\$ 1,470

In addition, the Company recognized a transition adjustment for the embedded derivative liability related to annuities with guaranteed minimum withdrawal benefits. The impact of this adjustment, net of DAC amortization, reduced income before income taxes by \$0.4 million during the first quarter of 2008.

# Table of Contents

The following table presents the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of June 30, 2008:

	Level 1	Level 2	Level 3	Total
	(Dollars In Thousands)			
<b>Assets:</b>				
Fixed maturity securities - available for sale				
Mortgage and asset-backed securities	\$	\$	\$	\$
US government and authorities	57,197	22,917	2,117,728	7,842,005
State, municipalities and political subdivisions		22,348	9,025	80,114
Public utilities		1,602,500	190,164	31,373
All other corporate bonds		8,178,172	2,427,207	1,792,664
Redeemable preferred stocks		47	36	10,605,379
Convertible bonds with warrants			39	83
Total fixed maturity securities - available for sale	57,197	15,550,261	4,744,199	39
Fixed maturity securities - trading	184,670	2,984,942	576,424	20,351,657
Total fixed maturity securities	241,867	18,535,203	5,320,623	3,746,036
Equity securities	288,106		69,566	24,097,693
Other long-term investments (1)		19,060	44,422	357,672
Short-term investments	532,038	262,217	45,718	63,482
Total investments	1,062,011	18,816,480	5,480,329	839,973
Cash	107,367			25,358,820
Other assets	5,394			107,367
Assets related to separate accounts				5,394
Variable annuity	2,641,203			
Variable universal life	325,745			2,641,203
Total assets measured at fair value on a recurring basis	\$ 4,141,720	\$ 18,816,480	\$ 5,480,329	\$ 28,438,529
<b>Liabilities:</b>				
Annuity account balances (2)	\$	\$	\$	\$
Other liabilities (1)	255	34,261	6,459	146,579
Total liabilities measured at fair value on a recurring basis	\$ 255	\$ 34,261	\$ 153,038	\$ 40,975
				187,554

(1) Includes certain freestanding and embedded derivatives.

(2) Represents liabilities related to equity indexed annuities.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table presents a reconciliation, for the three months ended June 30, 2008, of the beginning and ending balances for fair value measurements for which we have used significant unobservable inputs (Level 3):

	Beginning Balance	Total Realized and Unrealized Gains (losses) Included in Earnings	Included in Other Comprehensive Income	Purchases, Issuances, and Settlements (net)	Transfers in and/or out of Level 3	Ending Balance	Total Gains (losses) included in Earnings related to Instruments still held at the Reporting Date
(Dollars In Thousands)							
<b>Assets:</b>							
Fixed maturity securities - available for sale							
Mortgage-backed and asset-backed securities	\$ 2,142,256	\$	\$ 35,301	\$ (47,895)	\$ (11,934)	\$ 2,117,728	\$
State, municipalities and political subdivisions	9,294		(266)	(3)		9,025	
Public utilities	176,532		(4,798)	18,430		190,164	
All other corporate bonds	2,318,786		(57,623)	164,054	1,990	2,427,207	
Redeemable preferred stocks	36					36	
Convertible bonds with warrants	37		1	1		39	
Total fixed maturity securities - available for sale	4,646,941		(27,385)	134,587	(9,944)	4,744,199	
Fixed maturity securities - trading	728,719	(13,572)		(26,999)	(111,724)	576,424	(12,040)
Total fixed maturity securities	5,375,660	(13,572)	(27,385)	107,588	(121,668)	5,320,623	(12,040)
Equity securities	18,046		1	51,541	(22)	69,566	
Other long-term investments (1)	8,460	35,962				44,422	35,962
Short-term investments	46,323				(605)	45,718	
Total investments	5,448,489	22,390	(27,384)	159,129	(122,295)	5,480,329	23,922
Total assets measured at fair value on a recurring basis	\$ 5,448,489	\$ 22,390	\$ (27,384)	\$ 159,129	\$ (122,295)	\$ 5,480,329	\$ 23,922
<b>Liabilities:</b>							
Annuity account balances (2)	\$ 146,017	\$ 1,557	\$	\$ (2,119)	\$	\$ 146,579	\$ 1,557
Other liabilities (1)	18,091	11,632				6,459	11,632
Total liabilities measured at fair value on a recurring basis	\$ 164,108	\$ 13,189	\$	\$ (2,119)	\$	\$ 153,038	\$ 13,189

(1) Represents certain freestanding and embedded derivatives

(2) Represents liabilities related to equity indexed annuities

Certain changes have been made to the January 1, 2008 and March 31, 2008 balances in the tables above and below from the amounts reported in the previous quarter to make the amounts comparable to those of the current quarter. These changes had no effect on the Company's consolidated condensed balance sheets or consolidated condensed statements of income and cash flows. The changes resulted in an increase to the amount of assets categorized as Level 3 by \$324.1 million and \$1.2 billion at January 1, 2008 and March 31, 2008, respectively, and a corresponding decrease that was predominately to the amount of assets in Level 2. There were immaterial changes to the amount of liabilities categorized as Level 3 at January 1, 2008 and March 31, 2008.



# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table presents a reconciliation, for the six months ended June 30, 2008, of the beginning and ending balances for fair value measurements for which we have used significant unobservable inputs (Level 3):

	Beginning Balance	Total Realized and Unrealized Gains (losses) Included in Earnings	Included in Other Comprehensive Income	Purchases, Issuances, and Settlements (net)	Transfers in and/or out of Level 3	Ending Balance	Total Gains (losses) included in Earnings related to Instruments still held at the Reporting Date
(Dollars In Thousands)							
<b>Assets:</b>							
Fixed maturity securities - available for sale							
Mortgage-backed and asset-backed securities	\$ 1,290,299	\$	\$ (153,696)	\$ 849,739	\$ 131,386	\$ 2,117,728	\$
State, municipalities and political subdivisions	9,126		(98)	(3)		9,025	
Public utilities	176,473		(4,588)	18,279		190,164	
All other corporate bonds	2,248,703		(101,303)	277,817	1,990	2,427,207	
Redeemable preferred stocks	36					36	
Convertible bonds with warrants	227		(46)	(142)		39	
Total fixed maturity securities - available for sale	3,724,864		(259,731)	1,145,690	133,376	4,744,199	
Fixed maturity securities - trading	874,380	(25,490)		(163,598)	(108,868)	576,424	(23,902)
Total fixed maturity securities	4,599,244	(25,490)	(259,731)	982,092	24,508	5,320,623	(23,902)
Equity securities	18,135		(88)	51,540	(21)	69,566	
Other long-term investments <sup>(1)</sup>	2,951	41,471				44,422	41,471
Short-term investments	66,327				(20,609)	45,718	
Total investments	4,686,657	15,981	(259,819)	1,033,632	3,878	5,480,329	17,569
Total assets measured at fair value on a recurring basis	\$ 4,686,657	\$ 15,981	\$ (259,819)	\$ 1,033,632	\$ 3,878	\$ 5,480,329	\$ 17,569
<b>Liabilities:</b>							
Annuity account balances <sup>(2)</sup>	\$ 143,634	\$ (169)	\$	\$ (2,776)	\$	\$ 146,579	\$ (169)
Other liabilities <sup>(1)</sup>	39,168	32,709				6,459	32,709
Total liabilities measured at fair value on a recurring basis	\$ 182,802	\$ 32,540	\$	\$ (2,776)	\$	\$ 153,038	\$ 32,540

(1) Represents certain freestanding and embedded derivatives

(2) Represents liabilities related to equity indexed annuities

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

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

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 equity indexed annuities accounted for under SFAS No. 155.

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 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 equity indexed annuities accounted for under SFAS No. 155.

Table of Contents

**11. INCOME TAXES**

There have been no material changes to the balance of unrecognized income tax benefits which impacted earnings for the first six months ended June 30, 2008. The IRS has completed its examination of the Company's 2004 and 2005 federal income tax returns. The Company does not expect to have any material adjustments, within the next twelve months, to its balance of unrecognized income tax benefits in any of the tax jurisdictions in which it conducts its business operations.

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with our consolidated condensed financial statements included under Part I, Item 1, *Financial Statements (Unaudited)*, of this Quarterly Report on Form 10-Q and our audited consolidated financial statements for the year ended December 31, 2007, included in our Annual Report on Form 10-K.

For a more complete understanding of our business and current period results, please read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with our latest Annual Report on Form 10-K and other filings with the United States Securities and Exchange Commission (the SEC ).

Certain reclassifications have been made in the previously reported financial statements and accompanying notes to make the prior period amounts comparable to those of the current period. Such reclassifications had no effect on previously reported net income or shareowners' equity.

**FORWARD-LOOKING STATEMENTS CAUTIONARY LANGUAGE**

This report reviews our financial condition and results of operations including our liquidity and capital resources. Historical information is presented and discussed and where appropriate, factors that may affect future financial performance are also identified and discussed. Certain statements made in this report include forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any statement that may predict, forecast, indicate or imply future results, performance or achievements instead of historical facts and may contain words like believe, expect, estimate, project, budget, forecast, anticipate, plan, will, other words, phrases, or expressions with similar meaning. Forward-looking statements involve risks and uncertainties, which may cause actual results to differ materially from the results contained in the forward-looking statements, and we cannot give assurances that such statements will prove to be correct. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

**OVERVIEW**

***Our business***

We are a holding company headquartered in Birmingham, Alabama, whose subsidiaries provide financial services through the production, distribution, and administration of insurance and investment products. Founded in 1907, Protective Life Insurance Company is our largest operating subsidiary. Unless the context otherwise requires, we, us, or our refers to the consolidated group of Protective Life Corporation and our subsidiaries.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

We operate several business segments, each having a strategic focus. An operating segment is generally distinguished by products and/or channels of distribution. We periodically evaluate our operating segments in light of the segment reporting requirements prescribed by the Financial Accounting Standards Board ( FASB ) Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* ( SFAS No. 131 ), and make adjustments to our segment reporting as needed.

Our operating segments are Life Marketing, Acquisitions, Annuities, Stable Value Products, Asset Protection, and Corporate and Other.

- ***Life Marketing*** - We market level premium term insurance ( traditional life ), universal life ( UL ), variable universal life, and bank owned life insurance ( BOLI ) products on a national basis primarily through networks of independent insurance agents and brokers, stockbrokers, and independent marketing organizations.

Table of Contents

- **Acquisitions** - We focus on acquiring, converting, and servicing policies acquired from other companies. The segment's primary focus is on life insurance policies and annuity products sold to individuals. In the ordinary course of business, the Acquisitions segment regularly considers acquisitions of blocks of policies or smaller insurance companies. The level of the segment's acquisition activity is predicated upon many factors, including available capital, operating capacity, and market dynamics. Policies acquired through the Acquisition segment are typically closed blocks of business (no new policies are being marketed). Therefore, earnings and account values are expected to decline as the result of lapses, deaths, and other terminations of coverage unless new acquisitions are made.
- **Annuities** - We manufacture, sell, and support fixed and variable annuity products. These products are primarily sold through broker-dealers, but are also sold through financial institutions and independent agents and brokers.
- **Stable Value Products** - We sell guaranteed funding agreement (GFAs) to special purpose entities that in turn issue notes or certificates in smaller, transferable denominations. The segment also markets fixed and floating rate funding agreements directly to the trustees of municipal bond proceeds, institutional investors, bank trust departments, and money market funds. Additionally, the segment markets guaranteed investment contracts (GICs) to 401(k) and other qualified retirement savings plans.
- **Asset Protection** - We primarily market extended service contracts and credit life and disability insurance to protect consumers' investments in automobiles, watercraft, and recreational vehicles. In addition, the segment markets a guaranteed asset protection (GAP) product and an inventory protection product (IPP).
- **Corporate and Other** - This segment primarily consists of net investment income and expenses not attributable to the segments above (including net investment income on capital and interest on debt). This segment also includes earnings from several non-strategic lines of business (primarily cancer insurance, residual value insurance, surety insurance, and group annuities), various investment-related transactions, and the operations of several small subsidiaries.

**Reinsurance Ceded**

For approximately 10 years prior to mid-2005, we entered into reinsurance contracts in which we ceded a significant percentage, generally 90%, of our newly written business on a first dollar quota share basis. Our traditional life insurance was ceded under coinsurance contracts and universal life insurance was ceded under yearly renewable term (YRT) contracts. During this time, we utilized coinsurance on our traditional life business to lock in mortality costs at favorable rates, while reducing the amount of capital deployed and increasing overall returns. We continue to reinsure 90% of the mortality risk, but not the account values, on our newly written universal life insurance.

During recent years, the life reinsurance market continued the process of consolidation and tightening, resulting in a higher net cost of reinsurance for much of our life insurance business. We have also been challenged by changes in the reinsurance market which have impacted management of capital, particularly in our traditional life business which is required to hold reserves pursuant to Regulation XXX. In response to these challenges, in 2005 we reduced our overall reliance on reinsurance by changing from coinsurance to YRT reinsurance arrangements for newly issued traditional life products. Additionally in 2005, for newly issued traditional life products, we increased, from \$500,000 to \$1,000,000, the amount of insurance we will retain on any one life. During 2008, we have increased our retention limit to \$2,000,000 on certain of our traditional life products. These YRT arrangements are utilized to limit our exposure to large claims, and are not a significant factor in capital management or the overall profitability of the business.

Table of Contents

In order to fund the additional statutory reserves required as a result of these changes in our reinsurance arrangements, we established a surplus notes facility under which we issued an aggregate of \$800 million of non-recourse funding obligations through December 2007. In addition, during 2007, we established a surplus notes facility relative to our universal life products. Under this facility, we issued \$575 million of non-recourse funding obligations that will be used to fund statutory reserves required by the Valuation of Life Insurance Policies Model Regulation ( Regulation XXX ), as clarified by Actuarial Guideline 38 (commonly known as XXXX ). We have received regulatory approval to issue additional series of our floating rate surplus notes up to an aggregate of \$675 million principal amount. Our maximum retention for newly issued universal life products is \$1,000,000.

During 2006, immediately after the closing of our acquisition of the Chase Insurance Group, we entered into agreements with Commonwealth Annuity and Life Insurance Company (formerly known as Allmerica Financial Life Insurance and Annuity Company) ( CALIC ) and Wilton Reassurance Company and Wilton Reinsurance Bermuda Limited (collectively, the Wilton Re Group ), whereby CALIC reinsured 100% of the variable annuity business of the Chase Insurance Group and the Wilton Re Group reinsured approximately 42% of the other insurance business of the Chase Insurance Group.

**EXECUTIVE SUMMARY**

Operating earnings decreased \$42.2 million for the first six months of 2008 compared to the first six months of 2007, primarily as a result of mark-to-market losses realized during the first quarter of 2008 on a trading portfolio, a reduction in investment income during 2008 related to our participating mortgage program, and a \$15.7 million gain recognized during the first six months of 2007 resulting from the sale of a direct marketing subsidiary.

We experienced net realized losses of \$77.0 million during the first six months of 2008, versus net realized gains of \$20.7 million in the first six months of 2007. The 2008 losses were primarily the result of \$80.0 million of other-than-temporary impairment charges related to residential mortgage-backed securities collateralized by Alt-A mortgages. The decline in the estimated fair value of these securities resulted from factors including downgrades in rating, interest rate changes, and the current distressed credit markets. These other-than-temporary impairments resulted from our analysis of circumstances and our belief that credit events, loss severity, changes in credit enhancement, and/or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to these investments.

The interest rate and credit environment continues to present a significant challenge. Historically low interest rates and market illiquidity continued to create challenges for our products that generate investment spread profits, such as fixed annuities and stable value contracts. However, active management of crediting rates on these products allowed us to mitigate spread compression effects and strong sales allowed us to take advantage of wider credit spreads on investments.

Despite tightened capital market conditions, we were able to enter into an amended and restated credit agreement in April of 2008, which increased our access to short term capacity from \$200 million to \$500 million. Additionally, during the six months ended June 30, 2008, we joined the Federal Home Loan Bank of Cincinnati ( FHLB ). FHLB advances provide an attractive funding source for short-term borrowing and the sale of funding agreements. As of June 30, 2008 we had \$250 million of short-term advances and \$375 million of funding agreement-related advances outstanding under the FHLB program.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Strong competitive pressures on pricing, particularly in our life insurance business, continued to present a challenge from a new sales perspective. However, our continued focus on delivering value to consumers and broadening our base of distribution allowed for solid product sales during the quarter, as highlighted in our Annuities segment key indicators. Additionally, as a result of current market conditions and to optimize profit emergence and returns on capital, we expect to place a greater strategic emphasis on universal life sales.

Table of Contents

Current costs of reinsurance continue to present challenges from both a new product pricing and capital management perspective. In response to these challenges, during 2005 we reduced our reliance on reinsurance by changing from coinsurance to yearly renewable term reinsurance and increased the maximum amount retained on any one life from \$500,000 to \$1,000,000 on certain of our newly written traditional life products. During the first six months of 2008, we increased our retention limit to \$2,000,000 on certain newly written traditional life products.

Significant financial information related to each of our segments is included in *Results of Operations*.

**KNOWN TRENDS AND UNCERTAINTIES**

The factors which could affect our future results include, but are not limited to, general economic conditions and the following known trends and uncertainties:

*General*

- exposure to the risks of natural disasters, pandemics, malicious and terrorist acts could adversely affect our operations;
- computer viruses or network security breaches could affect our data processing systems or those of our business partners and could damage our business and adversely affect our financial condition and results of operations;
- actual experience may differ from management's assumptions and estimates and negatively affect our results;
- we may not realize our anticipated financial results from our acquisitions strategy;
- we may not be able to achieve the expected results from our recent acquisitions;
- we are dependent on the performance of others;
- our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk, which could negatively affect our business or result in losses;

*Financial environment*

- interest rate fluctuations could negatively affect our spread income or otherwise impact our business;
- our investments are subject to market and credit risks;
- equity market volatility could negatively impact our business;

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

- credit market volatility or the inability to access financing solutions could adversely impact our financial condition or results from operations;
- our ability to grow depends in large part upon the continued availability of capital;
- we could be forced to sell investments at a loss to cover policyholder withdrawals;

### *Industry*

- insurance companies are highly regulated and subject to numerous legal restrictions and regulations;
- changes to tax law or interpretations of existing tax law could adversely affect our ability to compete with non-insurance products or reduce the demand for certain insurance products;
- financial services companies are frequently the targets of litigation, including class action litigation, which could result in substantial judgments;
- publicly held companies in general and the financial services industry in particular are sometimes the target of law enforcement investigations and the focus of increased regulatory scrutiny;
- new accounting rules or changes to existing accounting rules could negatively impact us;
- reinsurance introduces variability in our statements of income;
- our reinsurers could fail to meet assumed obligations, increase rates or be subject to adverse developments that could affect us;
- policy claims fluctuate from period to period resulting in earnings volatility;

Table of Contents

*Competition*

- operating in a mature, highly competitive industry could limit our ability to gain or maintain our position in the industry and negatively affect profitability;
- our ability to maintain competitive unit costs is dependent upon the level of new sales and persistency of existing business; and
- a ratings downgrade could adversely affect our ability to compete.

**CRITICAL ACCOUNTING POLICIES**



Our accounting policies inherently require the use of judgments relating to a variety of assumptions and estimates, in particular expectations of current and future mortality, morbidity, persistency, expenses, and interest rates. Because of the inherent uncertainty when using the assumptions and estimates, the effect of certain accounting policies under different conditions or assumptions could be materially different from those reported in the consolidated financial statements. A discussion of various critical accounting policies is presented below. For a more complete listing of our critical accounting policies, refer to our Annual Report on Form 10-K for the year ended December 31, 2007.

***Evaluation of Other-Than-Temporary Impairments*** - One of the significant estimates related to available-for-sale securities is the evaluation of investments for other-than-temporary impairments. If a decline in the fair value of an available-for-sale security is judged to be other-than-temporary, a charge is recorded in net realized investment losses equal to the difference between the fair value and cost or amortized cost basis of the security. The fair value of the other-than-temporarily impaired investment becomes its new cost basis. For fixed maturities, we accrete the new cost basis to par or to the estimated future value over the expected remaining life of the security by adjusting the security's yields.

Determining whether a decline in the current fair value of invested assets is an other-than-temporary decline in value can involve a variety of assumptions and estimates, particularly for investments that are not actively traded in established markets. For example, assessing the value of certain investments requires that we perform an analysis of expected future cash flows or rates of prepayments. Other investments, such as collateralized mortgage or bond obligations, represent selected tranches of a structured transaction, supported in the aggregate by underlying investments in a wide variety of issuers. Management considers a number of factors when determining the impairment status of individual securities. These include the economic condition of various industry segments and geographic locations and other areas of identified risks. Although it is possible for the impairment of one investment to affect other investments, we engage in ongoing risk management to safeguard against and limit any further risk to our investment portfolio. Special attention is given to correlative risks within specific industries, related parties, and business markets.

For certain securitized financial assets with contractual cash flows including asset-backed securities (ABS), Emerging Issues Task Force (EITF) Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continued to Be Held by a Transferor in Securitized Financial Assets* (EITF Issue No. 99-20), requires us to periodically update our best estimate of cash flows over the life of the security. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral. Projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral. In addition, we consider our intent and ability to retain a temporarily depressed security until recovery.

Table of Contents

Securities not subject to EITF Issue No. 99-20 that are in an unrealized loss position, are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors. We generally consider a number of factors in determining whether the impairment is other than temporary. These include, but are not limited to: 1) actions taken by rating agencies, 2) default by the issuer, 3) the significance of the decline, 4) the intent and ability to hold the investment until recovery, 5) the time period during which the decline has occurred, 6) an economic analysis of the issuer's industry, and 7) the financial strength, liquidity, and recoverability of the issuer. Management performs a security-by-security review each quarter in evaluating the need for any other-than-temporary impairments. Although no set formula is used in this process, the investment performance, collateral position, and continued viability of the issuer are significant measures that we consider. Based on our analysis, during the three months ended June 30, 2008, we concluded that approximately \$80.0 million of pretax unrealized losses were other-than-temporarily impaired related to residential mortgage-backed securities collateralized by Alt-A mortgages, resulting in a charge to net realized investment losses.

**Reinsurance** - For each of our reinsurance contracts, we must determine if the contract provides indemnification against loss or liability relating to insurance risk, in accordance with applicable accounting standards. We must review all contractual features, particularly those that may limit the amount of insurance risk to which we are subject or features that delay the timely reimbursement of claims. If we determine that the possibility of a significant loss from insurance risk will occur only under remote circumstances, we record the contract under a deposit method of accounting with the net amount payable/receivable reflected in other reinsurance assets or liabilities on our consolidated balance sheets. Fees earned on the contracts are reflected as other revenues, as opposed to premiums, on our consolidated statements of income.

The balance of the reinsurance is due from a diverse group of reinsurers. The collectability of reinsurance is largely a function of the solvency of the individual reinsurers. We perform periodic credit reviews on our reinsurers, focusing on, among other things, financial capacity, stability, trends and commitment to the reinsurance business. We also require assets in trust, letters of credit or other acceptable collateral to support balances due from reinsurers not authorized to transact business in the applicable jurisdictions. Despite these measures, a reinsurer's insolvency, inability or unwillingness to make payments under the terms of a reinsurance contract, could have a material adverse effect on our results of operations and financial condition. As of June 30, 2008 our third-party reinsurance receivables amounted to \$5.2 billion. These amounts include ceded reserve balances and ceded benefit payments.

We account for reinsurance as required by FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (SFAS No. 113). In addition to SFAS No. 113, we rely on FASB Statement No. 60 *Accounting and Reporting by Insurance Enterprises* (SFAS No. 60) and FASB Statement No. 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* (SFAS No. 97) as applicable. In accordance with those pronouncements, costs for reinsurance are amortized as a level percentage of premiums for SFAS No. 60 products and a level percentage of estimated gross profits for SFAS No. 97 products. Accordingly, ceded reserve and deferred acquisition cost balances are established using methodologies consistent with those used in establishing direct policyholder reserves and deferred acquisition costs. Establishing these balances requires the use of various assumptions including investment returns, mortality, persistency, and expenses. The assumptions made for establishing ceded reserves and ceded deferred acquisition costs are consistent with those used for establishing direct policyholder reserves and deferred acquisition costs.

Table of Contents

Assumptions are also made regarding future reinsurance premium rates and allowance rates. Assumptions made for mortality, persistency, and expenses are consistent with those used for establishing direct policyholder reserves and deferred acquisition costs. Assumptions made for future reinsurance premium and allowance rates are consistent with rates provided for in our various reinsurance agreements. For certain of our reinsurance agreements, premium and allowance rates may be changed by reinsurers on a prospective basis, assuming certain contractual conditions are met (primarily that rates are changed for all companies with which the reinsurer has similar agreements). We do not anticipate any changes to these rates and, therefore, have assumed continuation of these non-guaranteed rates. To the extent that future rates are modified, these assumptions would be revised and both current and future results would be affected. For products subject to SFAS No. 60, assumptions are not changed unless projected future revenues are expected to be less than future expenses. For products subject to SFAS No. 97, assumptions are periodically updated whenever actual experience and/or expectations for the future differ from that assumed. When assumptions are updated, changes are reflected in the income statement as part of an unlocking process. For the three years ending December 31, 2007, there were no changes to reinsurance premium and allowance rates that would require an update of assumptions and subsequent unlocking of balances under SFAS No. 97.

**RESULTS OF OPERATIONS**

In the following discussion, segment operating income is defined as income before income tax excluding net realized investment gains and losses (net of the related amortization of deferred policy acquisition costs ( DAC ) and value of business acquired ( VOBA ) and participating income from real estate ventures), and the cumulative effect of change in accounting principle. Periodic settlements of derivatives associated with corporate debt and certain investments and annuity products are included in realized gains and losses but are considered part of segment operating income because the derivatives are used to mitigate risk in items affecting segment operating income. Management believes that segment operating income provides relevant and useful information to investors, as it represents the basis on which the performance of our business is internally assessed. Although the items excluded from segment operating income may be significant components in understanding and assessing our overall financial performance, management believes that segment operating income enhances an investor's understanding of our results of operations by highlighting the income (loss) attributable to the normal, recurring operations of our business. However, segment operating income should not be viewed as a substitute for accounting principles generally accepted in the United States of America ( U.S. GAAP ) net income. In addition, our segment operating income measures may not be comparable to similarly titled measures reported by other companies.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table presents a summary of results and reconciles segment operating income to consolidated net income:

	Three Months Ended June 30,				Six Months Ended June 30,					
	2008	2007	Change		2008	2007	Change			
(Dollars In Thousands)										
Segment Operating Income										
Life Marketing	\$	38,127	\$	37,834	0.8%	\$	84,576	\$	103,114	(18.0)%
Acquisitions		34,514		30,814	12.0		68,090		63,063	8.0
Annuities		9,487		6,669	42.3		11,976		12,275	(2.4)
Stable Value Products		17,545		12,355	42.0		33,761		24,541	37.6
Asset Protection		6,664		11,522	(42.2)		16,516		21,606	(23.6)
Corporate and Other		(2,093)		(1,300)	(61.0)		(32,066)		477	n/m
Total segment operating income		104,244		97,894	6.5		182,853		225,076	(18.8)
Realized investment gains (losses) - investments(1)		(111,916)		(71,146)			(141,035)		(62,198)	
Realized investment gains (losses) - derivatives(2)		65,151		74,693			69,250		71,891	
Income tax expense		(19,295)		(36,336)			(37,002)		(79,081)	
Net income	\$	38,184	\$	65,105	(41.4)	\$	74,066	\$	155,688	(52.4)

(1) Realized investment					
gains (losses) - investments	\$	(112,411)	\$	(66,609)	\$ (140,456) \$ (53,315)
Less: participating income from real estate ventures			3,707		6,857
Less: related amortization of DAC		(495)	830	579	2,026
	\$	(111,916)	\$	(71,146)	\$ (141,035) \$ (62,198)

(2) Realized investment								
gains (losses) - derivatives	\$	65,087	\$	76,281	\$	63,430	\$	73,990
Less: settlements on certain interest rate swaps		1,786		237		2,270		494
Less: derivative activity related to certain annuities		(1,850)		1,351		(8,090)		1,605
	\$	65,151	\$	74,693	\$	69,250	\$	71,891

Table of Contents

*Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007*

Net income for the three months ended June 30, 2008 reflects a \$6.4 million, or 6.5%, increase in segment operating income. The increase was primarily related to a \$5.2 million increase in operating earnings in the Stable Value segment, a \$3.7 million increase in the Acquisitions segment, and a \$2.8 million increase in the Annuities segment. These increases were partially offset by a \$4.9 million decrease in operating earnings in the Asset Protection segment. Changes in fair value related to the Corporate and Other trading portfolio and the Annuities segment increased operating earnings by \$6.0 million in the three months ended June 30, 2008.

We experienced net realized losses of \$47.3 million during the three months ended June 30, 2008, versus net realized gains of \$9.7 million for the same period of 2007. The losses realized during the three months ended June 30, 2008 were caused by \$80.0 million of other-than-temporary impairment charges related to residential mortgage-backed securities collateralized by Alt-A mortgages. These losses were partially offset by mark-to-market gains on various derivative instruments, including embedded derivatives related to reinsurance arrangements, credit default swaps and interest rate futures.

- Life Marketing segment operating income was \$38.1 million for the three months ended June 30, 2008, representing an increase of \$0.3 million, or 0.8%, from the three months ended June 30, 2007. The increase was primarily due to more favorable mortality results and lower insurance company operating expenses, which were substantially offset by lower marketing company earnings and lower investment income on universal life products due to the introduction of the AXXX securitization transaction in the third quarter of 2007 that transferred approximately \$4 million per quarter of investment income to the Corporate and Other segment.
- Acquisitions segment operating income was \$34.5 million and increased \$3.7 million, or 12.0%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase was primarily due to lower operating expenses on the Chase Insurance Group block and improved mortality results, partially offset by the expected runoff of other acquired blocks of business.
- Annuities segment operating income was \$9.5 million for the three months ended June 30, 2008, representing an increase of \$2.8 million, or 42.3%, compared to the three months ended June 30, 2007. This increase was primarily due to \$1.7 million of positive fair value changes on the equity indexed annuity product line during the three months ended June 30, 2008 and mark-to-market gains on embedded derivatives associated with the variable annuity GMWB rider. The remaining increase was primarily driven by the continued growth of the single premium deferred annuity ( SPDA ) line which accounted for a \$1.3 million increase in earnings.
- Stable Value Products segment operating income was \$17.5 million and increased \$5.2 million, or 42.0%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase resulted from a combination of higher average account balances and improved operating spreads. Lower liability costs resulted from replacing several large high-coupon maturing contracts with attractively priced funding agreements. As

a result, the operating spread increased 30 basis points to 134 basis points during the three months ended June 30, 2008, compared to an operating spread of 104 basis points during the three months ended June 30, 2007. We continually review our investment portfolio for opportunities to increase the net investment income yield in an effort to maintain or increase interest spread.

- Asset Protection segment operating income was \$6.7 million, representing a decrease of \$4.9 million, or 42.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The decrease was primarily the result of a \$2.9 million decrease in service contract income due to lower volume and higher loss ratios in certain product lines. Also contributing to the decrease was \$0.9 million of lower IPP earnings in 2008 due to the loss of a significant customer during the second quarter of 2007 and \$0.9 million of lower earnings in the GAP line due to an increase in legal expenses during the second quarter of 2008.

Table of Contents

- Corporate and Other segment operating income decreased \$0.8 million for the three months ended June 30, 2008, compared to the three months ended June 30, 2007, due primarily to \$3.4 million of lower participating income and \$2.6 million of lower prepayment fee income. These decreases were offset by mark-to-market adjustments on a \$418 million portfolio of securities designated for trading. This trading portfolio positively impacted the three months ended June 30, 2008 by approximately \$5.3 million, a \$6.0 million more favorable impact than in the three months ended June 30, 2007.

*Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007*

Net income for the six months ended June 30, 2008 reflects a \$42.2 million, or 18.8%, decrease in segment operating income. The decrease was primarily related to a \$32.5 million decrease in operating earnings in the Corporate and Other segment and an \$18.5 million decrease in the Life Marketing segment. These decreases were partially offset by a \$9.2 million increase in operating earnings in the Stable Value segment. Changes in fair value related to the Corporate and Other trading portfolio and the Annuities segment reduced operating earnings by \$20.0 million in the first six months of 2008. We experienced net realized losses of \$77.0 million during the first six months of 2008, versus realized net gains of \$20.7 million in the first six months of 2007. The losses realized during the six months ended June 30, 2008 were caused by \$80.0 million of other-than-temporary impairment charges related to residential mortgage-backed securities collateralized by Alt-A mortgages.

- Life Marketing segment operating income was \$84.6 million for the six months ended June 30, 2008, representing a decrease of \$18.5 million, or 18.0%, from the six months ended June 30, 2007. The decrease was primarily due to a \$15.7 million gain recognized during the first quarter of 2007 on the sale of the segment's direct marketing subsidiary combined with lower investment income on universal life products due to the introduction of the AXXX securitization transaction in the third quarter of 2007 that transferred approximately \$4 million per quarter of investment income to the Corporate and Other segment.
- Acquisitions segment operating income was \$68.1 million and increased \$5.0 million, or 8.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to lower operating expenses on the Chase Insurance Group block and improved mortality results, partially offset by the expected runoff of the acquired blocks of business.
- Annuities segment operating income declined \$0.3 million, or 2.4%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, which included \$4.0 million of negative fair value changes on the equity indexed annuity product and on embedded derivatives associated with the variable annuity GMWB rider. Included in the mark-to-market adjustment is a SFAS No. 157 transition adjustment loss for the embedded derivative related to the variable annuity GMWB rider of \$0.4 million before income taxes. These items were partially offset by the continued growth of the SPDA line which accounted for a \$2.9 million increase in operating income.

- Stable Value Products segment operating income was \$33.8 million and increased \$9.2 million, or 37.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase in operating earnings resulted from a combination of higher average balances, higher asset yields and lower liability costs. Lower liability costs were the result of replacing several large high-coupon maturing contracts with attractively priced funding agreements.
- Asset Protection segment operating income was \$16.5 million, representing a decrease of \$5.1 million, or 23.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Earnings from core product lines decreased \$5.3 million, or 23.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Within the segment's core product lines, credit insurance earnings increased \$0.6 million, or 82.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase in credit insurance earnings resulted primarily from a \$0.6 million gain related to the sale of a small insurance subsidiary and its related operations during the first quarter of 2008. Service contract earnings declined \$2.8 million, or 14.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The service contract line was unfavorably impacted by lower marine and auto sales and higher loss ratios in certain product lines. Earnings from other products declined \$3.1 million, or 100.6%, for the six months ended June 30, 2008 compared to the same period in 2007. The decline in other products related primarily to lower volume in the IPP line resulting from the loss of a significant customer and lower GAP earnings due to higher legal expenses in 2008.

Table of Contents

- Corporate and Other segment operating income declined \$32.5 million for the six months ended June 30, 2008, compared to the six months ended June 30, 2007, due primarily to a \$14.1 million negative impact in 2008 from the \$418 million portfolio of securities designated for trading, representing a \$14.1 million less favorable impact than in the first six months of 2007. In addition, the segment experienced lower participating mortgage income of \$10.2 million and lower prepayment fee income of \$5.8 million in the securities and mortgage investment portfolios.

Table of Contents**Life Marketing***Segment results of operations*

Segment results were as follows:

	Three Months Ended June 30,				Six Months Ended June 30,		
	2008	2007	Change		2008	2007	Change
	(Dollars In Thousands)						
REVENUES							
Gross premiums and policy fees	\$ 377,807	\$ 361,624	4.5%	\$	736,590	\$ 707,309	4.1%
Reinsurance ceded	(255,739)	(239,702)	6.7		(463,604)	(447,316)	3.6
Net premiums and policy fees	122,068	121,922	0.1		272,986	259,993	5.0
Net investment income	86,989	82,291	5.7		171,945	163,394	5.2
Other income	26,010	30,992	(16.1)		51,055	82,357	(38.0)
Total operating revenues	235,067	235,205	(0.1)		495,986	505,744	(1.9)
BENEFITS AND EXPENSES							
Benefits and settlement expenses	161,861	152,147	6.4		339,639	301,476	12.7
Amortization of deferred policy acquisition costs	27,234	25,564	6.5		54,157	54,262	(0.2 )
Other operating expenses	7,845	19,660	(60.1)		17,614	46,892	(62.4)
Total benefits and expenses	196,940	197,371	(0.2)		411,410	402,630	2.2
OPERATING INCOME	38,127	37,834	0.8		84,576	103,114	(18.0)
INCOME BEFORE INCOME TAX							
TAX	\$ 38,127	\$ 37,834	0.8	\$	84,576	\$ 103,114	(18.0)

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table summarizes key data for the Life Marketing segment:

	Three Months Ended June 30,			Change  (Dollars In Thousands)	Six Months Ended June 30,			Change		
	2008		2007		2008		2007			
Sales By Product										
Traditional	\$	26,881	\$	43,955	(38.8)%	\$	53,889	\$	77,447	(30.4)%
Universal life		12,581		18,515	(32.0)		27,244		32,712	(16.7)
Variable universal life		1,679		2,181	(23.0)		3,283		4,009	(18.1)
	\$	41,141	\$	64,651	(36.4)	\$	84,416	\$	114,168	(26.1)
Sales By Distribution Channel										
Brokerage general agents	\$	23,545	\$	41,210	(42.9)	\$	47,941	\$	71,089	(32.6)
Independent agents		9,331		10,629	(12.2)		18,183		18,957	(4.1)
Stockbrokers / banks		7,307		9,452	(22.7)		15,754		17,945	(12.2)
BOLI / other		958		3,360	(71.5)		2,538		6,177	(58.9)
	\$	41,141	\$	64,651	(36.4)	\$	84,416	\$	114,168	(26.1)
Average Life Insurance In-force(1)										
Traditional	\$	472,364,865	\$	425,847,790	10.9	\$	468,422,436	\$	418,070,072	12.0
Universal life		52,515,937		51,028,227	2.9		52,735,093		51,135,756	3.1
	\$	524,880,802	\$	476,876,017	10.1	\$	521,157,529	\$	469,205,828	11.1
Average Account Values										
Universal life	\$	5,253,016	\$	4,927,779	6.6	\$	3,137,075	\$	4,904,775	(36.0)
Variable universal life		325,049		332,251	(2.2)		333,633		324,121	2.9
	\$	5,578,065	\$	5,260,030	6.0	\$	3,470,708	\$	5,228,896	(33.6)
Traditional Life Mortality Experience(2)										
	\$	(1,291)	\$	(2,949)		\$	919	\$	2,205	
Universal Life Mortality Experience(2)										
	\$	531	\$	716		\$	763	\$	1,385	

(1) Amounts are not adjusted for reinsurance ceded.

(2) Represents the estimated pretax earnings impact resulting from mortality variances. Excludes results related to the Chase Insurance Group which was acquired in the third quarter of 2006 and excludes results related to the BOLI product line.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

### *Operating expenses detail*

Other operating expenses for the segment were as follows:

	Three Months Ended June 30,				Six Months Ended June 30,		
	2008	2007	Change		2008	2007	Change
	(Dollars In Thousands)						
<b>Insurance Companies:</b>							
First year commissions	\$ 49,739	\$ 70,347	(29.3)%	\$ 103,251	\$ 128,852	(19.9)%	
Renewal commissions	9,414	9,385	0.3	18,565	18,104	2.5	
First year ceding allowances	(5,047)	(4,829)	4.5	(10,576)	(8,844)	19.6	
Renewal ceding allowances	(59,302)	(58,847)	0.8	(113,436)	(112,595)	0.7	
General & administrative	40,897	47,699	(14.3)	81,430	92,857	(12.3)	
Taxes, licenses, and fees	7,669	8,277	(7.3)	14,732	16,173	(8.9)	
Other operating expenses incurred	43,370	72,032	(39.8)	93,966	134,547	(30.2)	
Less commissions, allowances & expenses capitalized	(59,363)	(82,023)	(27.6)	(124,230)	(152,154)	(18.4)	
Other insurance company operating expenses	(15,993)	(9,991)	60.1	(30,264)	(17,607)	71.9	
<b>Marketing Companies:</b>							
Commissions	19,754	24,606	(19.7)	39,762	49,178	(19.1)	
Other operating expenses	4,084	5,045	(19.0)	8,116	15,321	(47.0)	
Other marketing company operating expenses	23,838	29,651	(19.6)	47,878	64,499	(25.8)	
<b>Other operating expenses</b>	<b>\$ 7,845</b>	<b>\$ 19,660</b>	<b>(60.1)</b>	<b>\$ 17,614</b>	<b>\$ 46,892</b>	<b>(62.4)</b>	

### *Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007*

#### *Segment operating income*

Operating income was \$38.1 million for the three months ended June 30, 2008, representing an increase of \$0.3 million, or 0.8%, from the three months ended June 30, 2007. The increase was primarily due to more favorable mortality results and lower insurance company operating expenses, which were substantially offset by lower marketing company earnings and lower investment income on universal life products due to the introduction of the AXXX securitization transaction in the third quarter of 2007 that transferred approximately \$4 million per quarter of investment income to the Corporate and Other segment.

#### *Operating revenues*

Total revenues for the three months ended June 30, 2008 decreased \$0.1 million or 0.1%, compared to the three months ended June 30, 2007. This decrease was the result of lower other income due to the sale of a non-insurance subsidiary in late 2007 offset by higher investment income

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

due to increases in in-force volume and higher overall yields. Investment income increased in spite of the approximately \$4 million per quarter reduction of investment income related to the AXXX securitization transaction.

### *Net premiums and policy fees*

Net premiums and policy fees increased by \$0.1 million, or 0.1%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, due to the growth in both traditional and universal life insurance in-force achieved over the last several quarters combined with an increase in retention levels on certain traditional life products. Beginning in the third quarter of 2005, we reduced our reliance on reinsurance by changing from coinsurance to yearly renewable term reinsurance agreements and increased the maximum amount retained on any one life from \$500,000 to \$1,000,000 on certain of our newly written traditional life products (products written during the third quarter of 2005 and later.) In addition to increasing net premiums, this change results in higher benefits and settlement expenses, and causes greater variability in financial results due to fluctuations in mortality results. Our maximum retention level for newly issued universal life products is generally \$1,000,000. During 2008, we increased our retention limit to \$2,000,000 on certain of our traditional life products.

Table of Contents

*Net investment income*

Net investment income in the segment increased \$4.7 million, or 5.7%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase reflects the growth of the segment assets caused by growth related to traditional and universal life products, partly offset by a decrease due to the funding of statutory reserves required by Regulation XXX, as clarified by AXXX. Our AXXX securitization transaction on universal life products was effective in the third quarter of 2007. See the Recent Developments section for additional information concerning AXXX requirements.

*Other income*

Other income decreased \$5.0 million, or 16.1%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The decrease relates primarily to the sale of a non-insurance subsidiary in the fourth quarter of 2007 and lower broker-dealer revenues compared to 2007 levels.

*Benefits and settlement expenses*

Benefits and settlement expenses were \$9.7 million, or 6.4%, higher for the three months ended June 30, 2008 than for the three months ended June 30, 2007, due to growth in life insurance in-force, increased retention levels on certain newly written traditional life products and higher credited interest on UL products resulting from increases in account values. The estimated mortality impact on earnings for the three months ended June 30, 2008 related to traditional and universal life products was an unfavorable \$0.8 million, which was approximately \$1.5 million more favorable than the estimated mortality impact on earnings for the three months ended June 30, 2007.

*Amortization of DAC*

DAC amortization increased \$1.7 million or 6.5% for the three months ended June 30, 2008 compared to the three months ending June 30, 2007. Increases in amortization due to growth in the traditional block were offset by decreases in universal life and BOLI amortization, mainly due to more favorable retrospective DAC unlocking in 2008, as compared to the same period in 2007.

*Other operating expenses*

Other operating expenses decreased \$11.8 million or 60.1% for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. This decrease related to sale of a non-insurance subsidiary in the fourth quarter of 2007 and reduced administrative expenses in our insurance operations.

*Sales*

Sales for the segment decreased \$23.5 million, or 36.4%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to a decrease in traditional product sales. Lower sales levels of traditional products are primarily the result of pricing changes implemented on certain of our products at the beginning of 2008. Universal life sales declined \$5.9 million, or 32.0% for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to competitive pressures in the brokerage general agent, independent general agent and stockbroker channels. In addition, BOLI sales are subject to significant fluctuation and were \$2.4 million lower in the quarter ending June 30, 2008 compared to the quarter ending June 30, 2007.

Table of Contents

*Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007*

*Segment operating income*

Operating income was \$84.6 million for the six months ended June 30, 2008, representing a decrease of \$18.5 million, or 18.0%, from the six months ended June 30, 2007. The decrease was primarily due to a \$15.7 million gain recognized during the first quarter of 2007 on the sale of the segment's direct marketing subsidiary combined with lower investment income on universal life products due to the introduction of the AXXX securitization transaction in the third quarter of 2007 that transferred approximately \$4 million per quarter of investment income to the Corporate and Other segment.

*Operating revenues*

Excluding the \$15.7 million gain on the sale of a subsidiary which is included in other income, total revenues for the six months ended June 30, 2008 increased \$6.0 million, or 1.2%, compared to the six months ended June 30, 2007. This increase was the result of growth of life insurance in-force and growth in our traditional block leading to higher net premiums and policy fees and higher investment income due to increases in-inforce volume and higher yields, offset by reduced other income due to the sales of two non-insurance subsidiaries in 2007. Investment income increased in spite of the approximately \$4 million per quarter reduction of investment income related to the AXXX securitization transaction.

*Net premiums and policy fees*

Net premiums and policy fees increased by \$13.0 million, or 5.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, due in part to the growth in both traditional and universal life insurance in-force achieved over the last several quarters combined with an increase in retention levels on certain traditional life products.

*Net investment income*

Net investment income in the segment increased \$8.6 million, or 5.2%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase reflects the growth of the segment assets caused by growth related to traditional and universal life products, partly offset by a decrease due to the previously mentioned funding of statutory reserves required by Regulation XXX.

*Other income*

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Other income decreased \$31.3 million, or 38.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The decrease relates primarily to a \$15.7 million gain recognized on the sale of the segment's direct marketing subsidiary in the first quarter of 2007. In addition, marketing revenue was reduced after the sale of another subsidiary in the fourth quarter of 2007. Broker-dealer revenues also decreased compared to 2007 levels.

### *Benefits and settlement expenses*

Benefits and settlement expenses increased \$38.2 million, or 12.7%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, due to growth in life insurance in-force, increased retention levels on certain newly written traditional life products and higher credited interest on UL products resulting from increases in account values. The estimated mortality impact on earnings for the six months ended June 30, 2008 related to traditional and universal life products was a favorable \$1.7 million, which was approximately \$1.9 million less favorable than the estimated mortality impact on earnings for the six months ended June 30, 2007.

### *Amortization of DAC*

DAC amortization decreased \$0.1 million or 0.2% for the six months ended June 30, 2008 compared to the six months ending June 30, 2007. Increases in amortization due to growth in the traditional block were offset by decreases in universal life and BOLI amortization, mainly due to more favorable retrospective DAC unlocking in 2008, as compared to the same period in 2007.

Table of Contents

*Other operating expenses*

Other operating expenses decreased \$29.3 million or 62.4% for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. This decrease primarily relates to the impact of the sale of two marketing subsidiaries during 2007 and lower broker dealer sales compared to the six months ended June 30, 2007. The marketing companies contributed approximately \$16.6 million to the decrease in the six months ended June 30, 2008 compared to the six months ended June 30, 2007. In addition, reduced operating expenses in the insurance companies contributed to the overall decrease.

*Sales*

Sales for the segment decreased \$29.8 million, or 26.1%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to a decrease in traditional product sales. Lower sales levels of traditional products are primarily the result of pricing changes implemented on certain of our products at the beginning of 2008. Universal life sales declined \$5.5 million, or 16.7% for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to competitive pressures in the brokerage general agent, independent general agent and stockbroker channels. In addition, BOLI sales are subject to significant fluctuation and were \$3.6 million lower in the quarter ending June 30, 2008 compared to the quarter ending June 30, 2007.

*Reinsurance*

Currently, the Life Marketing segment reinsures significant amounts of its life insurance in-force. Pursuant to the underlying reinsurance contracts, reinsurers pay allowances to the segment as a percentage of both first year and renewal premiums. Reinsurance allowances represent the amount the reinsurer is willing to pay for reimbursement of acquisition costs incurred by the direct writer of the business. A portion of reinsurance allowances received is deferred as part of DAC and a portion is recognized immediately as a reduction of other operating expenses. As the non-deferred portion of allowances reduces operating expenses in the period received, these amounts represent a net increase to operating income during that period.

Reinsurance allowances do not affect the methodology used to amortize DAC or the period over which such DAC is amortized. However, they do affect the amounts recognized as DAC amortization. DAC on FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* ( SFAS No. 97 ) is amortized based on the estimated gross profits of the policies in-force. Reinsurance allowances are considered in the determination of estimated gross profits, and therefore impact SFAS No. 97 DAC amortization. Deferred reinsurance allowances on FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises* ( SFAS No. 60 ) policies are recorded as ceded DAC, which is amortized over estimated ceded premiums of the policies in force. Thus, deferred reinsurance allowances on SFAS No. 60 policies impact SFAS No. 60 DAC amortization. A more detailed discussion of the accounting for reinsurance allowances can be found in the Reinsurance section of Note 1, *Basis of Presentation and Summary of Significant Accounting Policies*.

Table of Contents*Impact of reinsurance*

Reinsurance impacted the Life Marketing segment line items as shown in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands)			
REVENUES				
Reinsurance ceded	\$ (255,739)	\$ (239,702)	\$ (463,604)	\$ (447,316)
BENEFITS AND EXPENSES				
Benefit and settlement expenses	(283,811)	(263,092)	(524,754)	(459,143)
Amortization of deferred policy acquisition costs	(11,720)	(17,891)	(20,098)	(35,692)
Other operating expenses <sup>(1)</sup>	(37,223)	(34,701)	(70,870)	(66,627)
Total benefits and expenses	(332,754)	(315,684)	(615,722)	(561,462)
NET IMPACT OF REINSURANCE				
<sup>(2)</sup>	\$ 77,015	\$ 75,982	\$ 152,118	\$ 114,146
Allowances received	\$ (64,349)	\$ (63,675)	\$ (124,012)	\$ (121,438)
Less: Amount deferred	27,126	28,974	53,142	54,811
Allowances recognized				
(ceded other operating expenses) <sup>(1)</sup>	\$ (37,223)	\$ (34,701)	\$ (70,870)	\$ (66,627)

(1) Other operating expenses ceded per the income statement are equal to reinsurance allowances recognized after capitalization.

(2) Assumes no investment income on reinsurance. Foregone investment income would substantially reduce the favorable impact of reinsurance. The Company estimates that the impact of foregone investment income would reduce the net impact of reinsurance by 85% to 95%.

The table above does not reflect the impact of reinsurance on our net investment income. By ceding business to the assuming companies, we forgo investment income on the reserves ceded. Conversely, the assuming companies will receive investment income on the reserves assumed which will increase the assuming companies' profitability on the business we cede. The net investment income impact to us and the assuming companies has not been quantified. The impact of including foregone investment income would be to substantially reduce the favorable net impact of reinsurance reflected above. We estimate that the impact of foregone investment income would be to reduce the net impact of reinsurance presented in the table above by 85% to 95%. The Life Marketing segment's reinsurance programs do not materially impact the other income line of our income statement.

As shown above, reinsurance had a favorable impact on the Life Marketing segment's operating income for the periods presented above. The impact of reinsurance is largely due to our quota share coinsurance program in place prior to mid-2005. Under that program, 90% of the segment's traditional premiums were ceded to reinsurers. Since mid-2005, a much smaller percentage of overall term premiums are ceded due to our change in reinsurance strategy on traditional business discussed previously. As a result of that change, the relative impact of reinsurance on

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

the Life Marketing segment's overall results is expected to decrease over time. While the significance of reinsurance is expected to decline over time, the overall impact of reinsurance for a given year may fluctuate due to variations in mortality and unlocking of balances under SFAS No. 97.

Table of Contents

Premiums and policy fees ceded had been rising over a number of years with increases in our in-force blocks of traditional and universal life business. Beginning in mid-2005, we changed our reinsurance approach in our traditional life product lines. Instead of generally ceding 90% of premiums on new business issued before that date, we began purchasing yearly renewable term on risks in excess of \$1 million (now increased to \$2 million). This had the effect of reducing reinsurance on new policies issued. The increase in ceded premiums above for the three and six months ended June 30, 2008 compared to the same periods in 2007, was caused primarily by growth in ceded universal life premiums and policy fees of \$10.8 million and \$20.3 million, respectively.

Ceded benefits and settlement expenses increased for the first six months of 2008 compared to the first six months of 2007 primarily due to higher death benefits ceded. Term ceded benefits increased \$13.8 million for the three months ending June 30, 2008 compared to the three months ending June 30, 2007 and \$29.2 million for the six months ending June 30, 2008 compared to the six months ending June 30, 2007 as higher death benefits ceded more than offset decreases in reserve changes ceded. Universal life ceded benefits increased \$5.7 million for the three months ending June 30, 2008 compared to the three months ending June 30, 2007 and \$36.5 million for the six months ending June 30, 2008 compared to the six months ending June 30, 2007 due to higher first quarter 2008 claims and higher change in ceded reserves associated with growth in the business throughout the year. Second quarter 2008 ceded universal life claims were lower than second quarter 2007 ceded universal life claims. Ceded universal life claims were \$17.3 million higher for the six months ending June 30, 2008 compared to the six months ending June 30, 2007. Ceded benefits and settlement expenses will fluctuate over time, largely as a function of the segment's overall variations in death benefits incurred.

Ceded amortization of deferred policy acquisitions costs decreased in 2008 compared to 2007 primarily due to unlocking in the universal life line which was substantially offset by unlocking in direct deferred acquisition costs. Ceded amortization will fluctuate over time largely as a function of changes to assumptions or fluctuations in results on direct deferred policy acquisition costs.

Ceded other operating expenses are based on allowances received from reinsurers. Total allowances received in 2008 increased from 2007 as increases associated with growth in the universal life line more than offset decreases associated with the change in our term life reinsurance strategy from 90% first dollar quota share coinsurance to use of yearly renewable term reinsurance on amounts in excess of \$1,000,000. Term allowances have decreased since mid-2005 as new YRT reinsurance replaces the 90% coinsured business.

Table of Contents**Acquisitions****Segment results of operations**

Segment results were as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
	(Dollars In Thousands)					
REVENUES						
Gross premiums and policy fees	\$ 193,516	\$ 214,465	(9.8)%	\$ 385,008	\$ 408,946	(5.9)%
Reinsurance ceded	(125,079)	(137,371)	(8.9)	(240,842)	(255,612)	(5.8)
Net premiums and policy fees	68,437	77,094	(11.2)	144,166	153,334	(6.0)
Net investment income	134,482	145,263	(7.4)	270,695	294,249	(8.0)
Other income	1,847	2,525	(26.9)	3,268	4,773	(31.5)
Total operating revenues	204,766	224,882	(8.9)	418,129	452,356	(7.6)
Realized gains (losses) - investments	(50,323)	(69,216)		(86,641)	(61,283)	
Realized gains (losses) - derivatives	46,499	71,782		75,089	68,079	
Total revenues	200,942	227,448		406,577	459,152	
BENEFITS AND EXPENSES						
Benefits and settlement expenses	142,801	158,284	(9.8)	297,221	320,188	(7.2)
Amortization of deferred policy acquisition costs and value of business acquired	20,512	19,200	6.8	39,014	39,148	(0.3)
Other operating expenses	6,939	16,584	(58.2)	13,804	29,957	(53.9)
Operating benefits and expenses	170,252	194,068	(12.3)	350,039	389,293	(10.1)
Amortization of DAC / VOBA related to realized gains (losses) - investments	(535)	777		559	1,383	
Total benefits and expenses	169,717	194,845	(12.9)	350,598	390,676	(10.3)
INCOME BEFORE INCOME TAX						
TAX	31,225	32,603	(4.2)	55,979	68,476	(18.3)
Less: realized gains (losses)	(3,824)	2,566		(11,552)	6,796	
Less: related amortization of DAC	535	(777)		(559)	(1,383)	
OPERATING INCOME	\$ 34,514	\$ 30,814	12.0	\$ 68,090	\$ 63,063	8.0

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table summarizes key data for the Acquisitions segment:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008	2007	Change	2008	2007	Change		
	(Dollars In Thousands)							
Average Life Insurance In-Force <sup>(1)</sup>								
Traditional	\$ 213,300,425	\$ 227,101,220	(6.1)%	\$ 214,263,619	\$ 228,343,004	(6.2)%		
Universal life	30,360,961	32,052,947	(5.3)	30,597,436	32,258,739	(5.1)		
	\$ 243,661,386	\$ 259,154,167	(6.0)	\$ 244,861,055	\$ 260,601,743	(6.0)		
Average Account Values								
Universal life	\$ 2,958,583	\$ 3,001,495	(1.4)	\$ 2,967,501	\$ 3,014,433	(1.6)		
Fixed annuity <sup>(2)</sup>	4,516,192	5,354,811	(15.7)	4,603,164	5,401,199	(14.8)		
Variable annuity	181,698	199,898	(9.1)	187,941	197,513	(4.8)		
	\$ 7,656,473	\$ 8,556,204	(10.5)	\$ 7,758,606	\$ 8,613,145	(9.9)		
Interest Spread - UL & Fixed Annuities								
Net investment income yield <sup>(4)</sup>	6.06%	6.19%		6.03%	6.27%			
Interest credited to policyholders	4.14	4.07		4.11	4.10			
Interest spread	1.92%	2.12%		1.92%	2.17			
Mortality Experience <sup>(3)</sup>								
	\$ 1,394	\$ 389		\$ 1,246	\$ 46			

(1) Amounts are not adjusted for reinsurance ceded.

(2) Includes general account balances held within variable annuity products and is net of reinsurance ceded.

(3) Represents the estimated pretax earnings impact resulting from mortality variance to pricing. Excludes results related to the Chase Insurance Group which was acquired in the third quarter of 2006.

(4) Includes available-for-sale and trading portfolios. Available-for-sale portfolio yields were 6.33% and 6.31%, respectively, for the three and six months ended June 30, 2008 compared to 6.24% and 6.23%, respectively, for the same periods ended June 30, 2007.

## Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007

### Segment operating income

Operating income increased \$3.7 million, or 12.0%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to lower operating expenses on the Chase Insurance Group block and improved mortality results, partially offset by the expected runoff of other acquired blocks of business.

*Revenues*

Net premiums and policy fees decreased \$8.7 million, or 11.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to the runoff of the acquired blocks. Investment income decreased \$10.8 million, or 7.4%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to a decline in annuity account values in the Chase Insurance Group block, resulting in a reduction of invested assets and lower investment income.

*Benefits and expenses*

Total benefits and expenses decreased \$25.1 million, or 12.9%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The decrease related primarily to the runoff of the acquired blocks, fluctuations in mortality, and lower operating expenses.

***Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007***

*Segment operating income*

Operating income increased \$5.0 million, or 8.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to lower operating expenses on the Chase Insurance Group block and improved mortality results, partially offset by the expected runoff of the acquired blocks of business.

Table of Contents

*Revenues*

Net premiums and policy fees decreased \$9.2 million, or 6.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to the runoff of the acquired blocks. Investment income decreased \$23.6 million, or 8.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to the runoff of the remaining acquired closed blocks and a decline in annuity account values in the Chase Insurance block.

*Benefits and expenses*

Total benefits and expenses decreased \$40.1 million, or 10.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The decrease related primarily to the runoff of the acquired closed blocks, fluctuations in mortality, and lower operating expenses.

*Reinsurance*

The Acquisitions segment currently reinsures portions of both its life and annuity in-force. The cost of reinsurance to the segment is reflected in the chart shown below. A more detailed discussion of the components of reinsurance can be found in the Reinsurance section of Note 1, *Basis of Presentation and Summary of Significant Accounting Policies*.

*Impact of reinsurance*

Reinsurance impacted the Acquisitions segment line items as shown in the following table:

**Acquisitions Segment**

**Line Item Impact of Reinsurance**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands)			
<b>REVENUES</b>				
Reinsurance ceded	\$ (125,079)	\$ (137,371)	\$ (240,842)	\$ (255,612)
<b>BENEFITS AND EXPENSES</b>				

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Benefit and settlement expenses	(95,249)	(65,009)	(204,513)	(240,127)
Amortization of deferred policy acquisition costs	(8,330)	(1,935)	(15,914)	(3,438)
Other operating expenses	(17,471)	(26,007)	(34,865)	(51,565)
Total Benefits and Expenses	(121,050)	(92,951)	(255,292)	(295,130)
<b>NET IMPACT OF REINSURANCE</b>	<b>\$ (4,029)</b>	<b>\$ (44,420)</b>	<b>\$ 14,450</b>	<b>\$ 39,518</b>

The segment's reinsurance programs do not materially impact the other income line of the income statement. In addition, net investment income generally has no direct impact on reinsurance cost. However, it should be noted that by ceding business to the assuming companies, we forgo 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. For business ceded under modified coinsurance arrangements, the amount of investment income attributable to the assuming company is included as part of the overall change in policy reserves and, as such, is reflected in benefit and settlement expenses. The net investment income impact to the Company and the assuming companies has not been quantified as it is not fully reflected in our consolidated financial statements.

The net impact of reinsurance decreased \$40.4 million, or 90.9%, and \$25.1 million, or 63.4% for the three and six months ended June 30, 2008, respectively, compared to the same periods in 2007, primarily as a result of fluctuations in ceded claims volume on the Chase Insurance Group block of business.

Table of Contents**Annuities****Segment results of operations**

Segment results were as follows:

	Three Months Ended June 30,				Six Months Ended June 30,		
	2008	2007	Change		2008	2007	Change
	(Dollars In Thousands)						
<b>REVENUES</b>							
Gross premiums and policy fees	\$ 8,449	\$ 8,633	(2.1)%	\$	16,640	\$ 16,895	(1.5)%
Reinsurance ceded							
Net premiums and policy fees	8,449	8,633	(2.1)		16,640	16,895	(1.5)
Net investment income	85,007	64,890	31.0		162,293	125,751	29.1
Realized gains (losses) - derivatives	(1,850)	1,351			(8,090)	1,605	
Other income	3,255	2,797	16.4		6,258	5,510	13.6
Total operating revenues	94,861	77,671	22.1		177,101	149,761	18.3
Realized gains (losses) - investments	1,095	53			1,115	1,717	
Total revenues	95,956	77,724	23.5		178,216	151,478	17.7
<b>BENEFITS AND EXPENSES</b>							
Benefits and settlement expenses	71,842	56,101	28.1		139,258	112,050	24.3
Amortization of deferred policy acquisition costs and value of business acquired	7,199	9,856	(27.0)		13,120	14,394	(8.9)
Other operating expenses	6,333	5,045	25.5		12,747	11,042	15.4
Operating benefits and expenses	85,374	71,002	20.2		165,125	137,486	20.1
Amortization of DAC / VOBA related to realized gains (losses) - investments	40	53			20	643	
Total benefits and expenses	85,414	71,055			165,145	138,129	
<b>INCOME BEFORE INCOME TAX</b>	10,542	6,669	58.1		13,071	13,349	(2.1)
Less: realized gains (losses)	1,095	53			1,115	1,717	
Less: related amortization of DAC	(40)	(53)			(20)	(643)	
<b>OPERATING INCOME</b>	\$ 9,487	\$ 6,669	42.3	\$	11,976	\$ 12,275	(2.4)

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The following table summarizes key data for the Annuities segment:

	Three Months Ended June 30,			Change	Six Months Ended June 30,			Change		
	2008		2007		2008		2007			
(Dollars In Thousands)										
Sales										
Fixed annuity	\$	436,788	\$	305,554	42.9%	\$	956,036	\$	541,745	76.5%
Variable annuity		115,448		123,263	(6.3)		208,240		202,245	3.0
	\$	552,236	\$	428,817	28.8	\$	1,164,276	\$	743,990	56.5
Average Account Values										
Fixed annuity <sup>(1)</sup>	\$	5,485,382	\$	4,249,579	29.1	\$	5,274,717	\$	4,142,530	27.3
Variable annuity		2,582,909		2,704,860	(4.5)		2,574,947		2,642,535	(2.6)
	\$	8,068,291	\$	6,954,439	16.0	\$	7,849,664	\$	6,785,065	15.7
Interest Spread - Fixed Annuities(2)										
Net investment income yield		6.14%		6.01%			6.10%		5.97%	
Interest credited to policyholders		5.03		5.27			5.00		5.25	
Interest spread		1.11%		0.74%			1.10%		0.72%	
		As of June 30,		Change						
		2008	2007							
GMDB - Net amount at risk(3)				\$	275,062	\$	81,748	236.5%		
GMDB - Reserves							3,308	n/m		
S&P 500® Index					1,280		1,503	(14.8)		

(1) Includes general account balances held within variable annuity products.

(2) Interest spread on average general account values.

(3) Guaranteed death benefits in excess of contract holder account balance.

## *Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007*

### *Segment operating income*

Operating income increased \$2.8 million, or 42.3%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, which included \$1.7 million of positive fair value changes on the equity indexed annuity product and on embedded derivatives associated with the variable annuity GMWB rider. The remaining increase was primarily driven by the continued growth of the single premium deferred annuity ( SPDA ) line which accounted for a \$1.3 million increase in earnings.

*Operating revenues*

Segment operating revenues increased \$17.2 million, or 22.1%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to an increase in net investment income. Average account balances grew 16.0% in the three months ended June 30, 2008, resulting in higher investment income. The additional income resulting from the larger account balances was partially reduced in the three months ended June 30, 2008 by losses on derivatives. The segment continually monitors and adjusts credited rates as appropriate in an effort to maintain and/or improve its interest spread.

*Benefits and expenses*

Operating benefits and expenses increased \$14.4 million, or 20.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. This increase was primarily the result of higher credited interest and unfavorable mortality fluctuations. Mortality was unfavorable by \$6.3 million in the three months ended June 30, 2008 compared to unfavorable mortality of \$2.7 million in the three months ended June 30, 2007, an unfavorable change of \$3.6 million. The unfavorable mortality variances primarily relate to sales of large single premium immediate annuity ( SPIA ) cases. Because this SPIA block has not reached a critical size relative to the total amount of annuities in-force, volatility in mortality results is expected.

Table of Contents

*Amortization of DAC*

The decrease in DAC amortization (not related to realized capital gains and losses) for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to the adoption of SFAS No. 157, as this standard replaced the DAC component with the fair value calculation for the equity indexed annuity product. DAC amortization also decreased significantly on the variable annuity line due to fair value losses, but was offset by higher DAC amortization in other annuity lines of business. We periodically review and update as appropriate our key assumptions including future mortality, expenses, lapses, premium persistency, investment yields and interest spreads. Changes to these assumptions result in adjustments which increase or decrease DAC amortization. The periodic review and updating of assumptions is referred to as unlocking. Retrospective DAC unlocking in the market value adjusted annuity line, although favorable in the three months ended June 30, 2008, was not as favorable as retrospective unlocking in the three months ended June 30, 2007. For the three months ended June 30, 2008, DAC amortization for the Annuities segment was reduced by \$0.6 million due to favorable retrospective DAC unlocking in the market value adjusted annuity line. Favorable retrospective DAC unlocking of \$0.3 million was recorded by the segment during the three months ended June 30, 2007.

*Sales*

Total sales increased \$123.4 million, or 28.8%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Sales of fixed annuities increased \$131.2 million, or 42.9%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase in fixed annuity sales was primarily due to strong sales in the single premium deferred annuity and market value adjusted annuity products, as well as our continued efforts to increase wholesale distribution. The continuation of new annuity sales through the Chase distribution system contributed \$185.5 million in fixed annuity sales in the three months ended June 30, 2008 compared to \$114.3 million for the three months ended June 30, 2007. Sales of variable annuities decreased \$7.8 million, or 6.3% for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. A general decline in the equity markets has increased the net amount at risk with respect to guaranteed minimum death benefits as of June 30, 2008 compared to June 30, 2007.

***Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007***

*Segment operating income*

Operating income declined \$0.3 million, or 2.4%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, which included \$4.0 million of negative fair value changes on the equity indexed annuity product and on embedded derivatives associated with the variable annuity GMWB rider. Included in the mark-to-market adjustment is a SFAS No. 157 transition adjustment loss for the embedded derivative related to the variable annuity GMWB rider of \$0.4 million before income taxes. These items were partially offset by the continued growth of the SPDA line which accounted for a \$2.9 million increase in operating income.

*Operating revenues*

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Segment operating revenues increased \$27.3 million, or 18.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to an increase in net investment income. Average account balances grew 15.7% for the six months ended June 30, 2008, resulting in higher investment income. The additional income resulting from the larger account balances was partially reduced in the first six months of 2008 by losses on derivatives.

### *Benefits and expenses*

Operating benefits and expenses increased \$27.6 million, or 20.1%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. This increase was primarily the result of higher credited interest and unfavorable mortality fluctuations. Mortality was unfavorable by \$11.1 million for the six months ended June 30, 2008 compared to unfavorable mortality of \$5.1 million for the six months ended June 30, 2007, an unfavorable change of \$6.0 million. The unfavorable mortality variances primarily relate to sales of large SPIA cases previously mentioned.

Table of Contents

*Amortization of DAC*

The decrease in DAC amortization (not related to realized capital gains and losses) for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was due to the adoption of SFAS No. 157, as this standard replaced the DAC component with the fair value calculation for the equity indexed annuity product. DAC amortization also decreased significantly on the variable annuity line due to fair value losses, but was offset by higher DAC amortization in other annuity lines of business. Retrospective DAC unlocking in the market value adjusted annuity line, although favorable for the six months ended June 30, 2008, was not as favorable as retrospective unlocking for the six months ended June 30, 2007. For the six months ended June 30, 2008, DAC amortization for the Annuities segment was reduced by \$0.9 million due to favorable retrospective DAC unlocking in the market value adjusted annuity line. Favorable retrospective DAC unlocking of \$1.5 million was recorded by the segment for the six months ended June 30, 2007.

*Sales*

Total sales increased \$420.3 million, or 56.5%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Sales of fixed annuities increased \$414.3 million, or 76.5%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase in fixed annuity sales was primarily due to strong sales in the single premium immediate annuity, single premium deferred annuity, and market value adjusted annuity products, as well as our continued efforts to increase wholesale distribution. The continuation of new annuity sales through the Chase distribution system contributed \$267.4 million in fixed annuity sales for the six months ended June 30, 2008 compared to \$184.2 million for six months ended June 30, 2007. Sales of variable annuities increased \$6.0 million, or 3.0% for the six months ended June 30, 2008 compared to the six months ended June 30, 2007.

Table of Contents**Stable Value Products***Segment results of operations*

Segment results were as follows:

	Three Months Ended June 30,				Six Months Ended June 30,		
	2008	2007	Change		2008	2007	Change
	(Dollars In Thousands)						
REVENUES							
Net investment income	\$ 77,747	\$ 71,478	8.8%	\$ 156,108	\$ 150,579	3.7%	
Realized gains (losses)	1,823	(583)		7,256	842		
Total revenues	79,570	70,895		163,364	151,421		
BENEFITS AND EXPENSES							
Benefits and settlement expenses	57,485	57,097	0.7	117,414	121,816	(3.6)	
Amortization of deferred policy acquisition costs	1,095	987	10.9	2,162	2,155	0.3	
Other operating expenses	1,622	1,039	56.1	2,771	2,067	34.1	
Total benefits and expenses	60,202	59,123	1.8	122,347	126,038	(2.9)	
INCOME BEFORE INCOME TAX							
	19,368	11,772	64.5	41,017	25,383	61.6	
Less: realized gains (losses)	1,823	(583)		7,256	842		
OPERATING INCOME	\$ 17,545	\$ 12,355	42.0	\$ 33,761	\$ 24,541	37.6	

The following table summarizes key data for the Stable Value Products segment:

	Three Months Ended June 30,				Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change	
	(Dollars In Thousands)						
Sales							
GIC	\$ 11,113	\$ 75,000	(85.2)%	\$ 85,345	\$ 77,500	10.1%	
GFA - Direct Institutional	425,000		n/m	425,000		n/m	
GFA - Registered Notes - Institutional		50,000	n/m	450,000	50,000	n/m	
GFA - Registered Notes - Retail	151,725	10,014	n/m	265,129	23,134	n/m	
	\$ 587,838	\$ 135,014	335.4	\$ 1,225,474	\$ 150,634	713.5	
Average Account Values	\$ 5,139,017	\$ 4,780,565		\$ 5,139,290	\$ 5,119,688		
Operating Spread							
Net investment income yield	5.94%	5.99%		6.02%	5.97%		
Interest credited	4.39	4.78		4.53	4.83		
Operating expenses	0.21	0.17		0.19	0.17		
Operating spread	1.34%	1.04%		1.30%	0.97%		



Table of Contents

***Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007***

*Segment operating income*

Operating income increased \$5.2 million, or 42.0%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase in operating earnings resulted from a combination of higher average balances and lower liability costs. Lower liability costs resulted from replacing several large high-coupon maturing contracts with attractively priced funding agreements. As a result, the operating spread increased 30 basis points to 134 basis points during the three months ended June 30, 2008, compared to an operating spread of 104 basis points during the three months ended June 30, 2007. We continually review our investment portfolio for opportunities to increase the net investment income yield in an effort to maintain or increase interest spread.

*Sales*

Total sales increased \$452.8 million for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase was primarily due to our re-entry into the institutional funding agreement market.

***Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007***

*Segment operating income*

Operating income increased \$9.2 million, or 37.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase in operating earnings resulted from a combination of higher average balances, higher asset yields and lower liability costs. Lower liability costs were the result of replacing several large high-coupon maturing contracts with attractively priced funding agreements.

*Sales*

Total sales increased \$1.1 billion, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase was primarily due to our re-entry into the institutional funding agreement market.

Table of Contents**Asset Protection***Segment results of operations*

Segment results were as follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
	(Dollars In Thousands)					
<b>REVENUES</b>						
Gross premiums and policy fees	\$ 91,110	\$ 97,985	(7.0)%	\$ 186,445	\$ 197,405	(5.6)%
Reinsurance ceded	(42,954)	(45,689)	(6.0)	(90,397)	(90,827)	(0.5)
Net premiums and policy fees	48,156	52,296	(7.9)	96,048	106,578	(9.9)
Net investment income	9,808	9,467	3.6	19,713	18,679	5.5
Other income	17,379	20,455	(15.0)	32,515	36,984	(12.1)
Total operating revenues	75,343	82,218	(8.4)	148,276	162,241	(8.6)
<b>BENEFITS AND EXPENSES</b>						
Benefits and settlement expenses	27,662	26,113	5.9	52,428	51,928	1.0
Amortization of deferred policy acquisition costs	15,341	21,464	(28.5)	29,673	42,167	(29.6)
Other operating expenses	25,676	23,119	11.1	49,659	46,540	6.7
Total benefits and expenses	68,679	70,696	(2.9)	131,760	140,635	(6.3)
<b>INCOME BEFORE INCOME TAX</b>						
	6,664	11,522	(42.2)	16,516	21,606	(23.6)
<b>OPERATING INCOME</b>	\$ 6,664	\$ 11,522	(42.2)	\$ 16,516	\$ 21,606	(23.6)

The following table summarizes key data for the Asset Protection segment:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
	(Dollars In Thousands)					
Sales						
Credit insurance	\$ 18,381	\$ 31,579	(41.8)%	\$ 41,171	\$ 59,661	(31.0)%
Service contracts	82,199	90,588	(9.3)	153,862	165,395	(7.0)
Other products	19,055	28,046	(32.1)	35,317	58,232	(39.4)
	\$ 119,635	\$ 150,213	(20.4)	\$ 230,350	\$ 283,288	(18.7)
Loss Ratios (1)						
Credit insurance	37.1%	30.3%		36.5%	32.4%	
Service contracts	71.0	69.0		68.0	65.6	
Other products	39.4	32.7		36.1	31.3	

(1) Incurred claims as a percentage of earned premiums



Table of Contents

***Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007***

*Segment operating income*

Operating income was \$6.7 million, representing a decrease of \$4.9 million, or 42.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The decrease was primarily the result of a \$2.9 million decrease in service contract income due to lower volume and higher loss ratios in certain product lines. Also contributing to the decrease was \$0.9 million of lower IPP earnings in 2008 due to the loss of a significant customer during the second quarter of 2007 and \$0.9 million of lower earnings in the GAP line due to an increase in legal expenses during the second quarter of 2008.

*Net premiums and policy fees*

Net premiums and policy fees decreased \$4.1 million, or 7.9%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Credit insurance premiums decreased \$8.2 million, or 54.0%, due to the sale of a small insurance subsidiary and its related operations during the first quarter of 2008 and lower auto sales. Net premiums in the service contract line increased \$2.1 million, or 8.1%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 due to an increase in in-force business. Within the other product lines, net premiums increased \$2.0 million, or 18.1%, for the three months ended June 30, 2008 compared to the prior year, due to an increase in the GAP product line related to growth over the past few years, partially offset by declines in the IPP line.

*Other income*

Other income decreased \$3.1 million, or 15.0%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, primarily due to a decline in service contract volume.

*Benefits and settlement expenses*

Benefits and settlement expenses increased \$1.5 million, or 5.9%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Credit insurance claims for the three months ended June 30, 2008 compared to the prior year decreased \$2.0 million, or 43.4%, primarily as a result of a \$1.5 million decrease related to the sale of a small insurance subsidiary and its related operations. Service contract claims increased \$2.0 million, or 11.1%, due to higher loss ratios in certain product lines and an increase in in-force business. Other products claims increased \$1.5 million, or 42.3%, primarily attributable to higher GAP claims.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

### *Amortization of DAC and Other Operating Expenses*

Amortization of DAC was \$6.1 million, or 28.5%, lower for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, mainly due to lower premium in the credit insurance lines and a \$2.6 million decrease resulting from the sale of a small insurance subsidiary and its related operations during the first quarter of 2008. Other operating expenses increased \$2.6 million, or 11.1%, for the three months ended June 30, 2008, primarily due to higher legal expenses related to the credit insurance and GAP lines compared to the three months ended June 30, 2007.

### *Sales*

Total segment sales decreased \$30.6 million, or 20.4%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The decrease in credit insurance sales are primarily the result of the sale of a small insurance subsidiary and its related operations during the first quarter of 2008 and lower auto sales. Service contract sales are lower primarily due to declines in auto and marine sales. The decline in the other products line is primarily the result of lower GAP sales, which was primarily due to price increases, tighter underwriting controls, and lower auto sales.

Table of Contents

*Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007*

*Segment operating income*

Operating income was \$16.5 million, representing a decrease of \$5.1 million, or 23.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Earnings from core product lines decreased \$5.3 million, or 23.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Within the segment's core product lines, credit insurance earnings increased \$0.6 million, or 82.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase in credit insurance earnings resulted primarily from a \$0.6 million gain related to the sale of a small insurance subsidiary and its related operations during the first quarter of 2008. Service contract earnings declined \$2.8 million, or 14.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The service contract line was unfavorably impacted by lower marine and auto sales and higher loss ratios in certain product lines. Earnings from other products declined \$3.1 million, or 100.6%, for the six months ended June 30, 2008 compared to the same period in 2007. The decline in other products related primarily to lower volume in the IPP line resulting from the loss of a significant customer and lower GAP earnings due to higher legal expenses in 2008.

*Net premiums and policy fees*

Net premiums and policy fees decreased \$10.5 million, or 9.9%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Credit insurance earned premiums decreased \$15.6 million, or 51.2%, mainly due to the sale of a small insurance subsidiary during the first quarter of 2008. Net premiums in the service contract line increased \$2.3 million, or 4.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 due to an increase in in-force business. Within the other product lines, net premiums increased \$2.8 million, or 12.7%, for the six months ended June 30, 2008 compared to the prior year, due to an increase in the GAP product line related to growth over the past few years, partially offset by declines in the IPP line.

*Other income*

Other income decreased \$4.5 million, or 12.1%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to a decline in service contract volume.

*Benefits and settlement expenses*

Benefits and settlement expenses increased \$0.5 million, or 1.0%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The credit insurance and related claims for the six months ended June 30, 2008 compared to the prior year decreased \$4.5 million, or 45.2%, as a result of lower volume and a \$2.1 million decrease related to the sale of a small insurance subsidiary and its related operations. Service contract claims increased \$2.8 million, or 8.1%, due to higher loss ratios in some product lines and an increase in in-force business. Other products claims increased \$2.2 million, or 29.9%, primarily attributable to higher GAP claims.

*Amortization of DAC and Other Operating Expenses*

Amortization of DAC decreased \$12.5 million, or 29.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, primarily due to lower premium in the credit insurance products and a \$5.6 million decrease resulting from the sale of a small insurance subsidiary and its related operations during the first quarter of 2008. Other operating expenses increased \$3.1 million, or 6.7%, for the six months ended June 30, 2008, primarily due to higher legal expenses related to the credit insurance and GAP lines compared to the six months ended June 30, 2007.

*Sales*

Total segment sales decreased \$52.9 million, or 18.7%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The decrease in credit insurance sales are primarily the result of the sale of a small insurance subsidiary and its related operations during the first quarter of 2008 and lower auto sales. Service contract sales are lower primarily due to declines in auto and marine sales. The decline in the other products line is primarily the result of lower GAP sales, which was primarily due to price increases, tighter underwriting controls, and lower auto sales.

Table of Contents**Reinsurance**

The majority of the Asset Protection segment's reinsurance activity relates to the cession of single premium credit life and credit accident and health insurance, credit property, vehicle service contracts and guaranteed asset protection insurance to producer affiliated reinsurance companies (PARC's). These arrangements are coinsurance contracts ceding the business on a first dollar quota share basis at levels ranging from 50% to 100% to limit our exposure and allow the PARC's to share in the underwriting income of the product. Reinsurance contracts do not relieve us from our obligations to our policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company or our affiliates. A more detailed discussion of the components of reinsurance can be found in the Reinsurance section of Note 1, *Basis of Presentation and Summary of Significant Accounting Policies*.

Reinsurance impacted the Asset Protection segment line items as shown in the following table:

**Asset Protection Segment****Line Item Impact of Reinsurance**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
	(Dollars In Thousands)			
<b>REVENUES</b>				
Reinsurance ceded	\$ (42,954)	\$ (45,689)	\$ (90,397)	\$ (90,827)
<b>BENEFITS AND EXPENSES</b>				
Benefit and settlement expenses	(22,580)	(23,506)	(43,325)	(45,727)
Amortization of deferred policy acquisition costs	(6,393)	(1,302)	(16,245)	(3,601)
Other operating expenses	(1,572)	(7,418)	(3,328)	(15,769)
Total Benefits and Expenses	(30,545)	(32,226)	(62,898)	(65,097)
<b>NET IMPACT OF REINSURANCE</b>	\$ (12,409)	\$ (13,463)	\$ (27,499)	\$ (25,730)

Reinsurance premiums ceded decreased \$2.7 million, or 6.0%, and \$0.4 million, or 0.5%, for the three and six months ended June 30, 2008, respectively, compared to the three and six months ended June 30, 2007. The current quarter decrease was primarily due to the discontinuation of the marketing of credit insurance products through financial institutions in 2005 in which a majority of this business was ceded to PARC's. This was somewhat offset by an increase in ceded premiums in the service contract line. The year-to-date decrease in ceded premiums was due to the discontinuation of credit business marketed through financial institutions mostly offset by the cession of a block of credit business sold through a small insurance subsidiary, prior to the sale of that company in the first quarter. Ceded unearned premium reserves and claim reserves with PARC's are generally secured by trust accounts, letters of credit or on a funds withheld basis.

Benefits and settlement expenses ceded decreased \$0.9 million, or 3.9%, and \$2.4 million, or 5.3%, for the three and six months ended June 30, 2008, respectively, compared to the three and six months ended June 30, 2007. The current quarter and year-to-date decreases are mainly due to decreases in losses ceded related to the Lender's Indemnity program in runoff and the credit business, somewhat offset by increases in the service contract line.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Amortization of DAC ceded increased \$5.1 million, or 391.0%, and \$12.6 million, or 351.1%, for the three and six months ended June 30, 2008, respectively, compared to the three and six months June 30, 2007, mainly as the result of increases in the credit insurance line.

Other operating expenses ceded decreased \$5.8 million, or 78.8%, and \$12.4 million, or 78.9%, for the three and six months ended June 30, 2008, respectively compared to the three and six months ended June 30, 2007. The fluctuation is partly attributable to the decline in credit insurance products sold through financial institutions and an overall decline in credit insurance sales.

Net investment income has no direct impact on reinsurance cost. However, it should be noted that by ceding business to the assuming companies, we forgo investment income on the reserves ceded to the assuming companies. Conversely, the assuming companies will receive investment income on the reserves assumed which

Table of Contents

will increase the assuming companies' profitability on business assumed from the Company. The net investment income impact to the Company and the assuming companies has not been quantified as it is not reflected in our consolidated financial statements.

Table of Contents**Corporate and Other****Segment results of operations**

Segment results were as follows:

	Three Months Ended June 30,			Six Months Ended June 30,			
	2008	2007	Change	2008	2007	Change	
	(Dollars In Thousands)						
REVENUES							
Gross premiums and policy fees	\$ 7,991	\$ 8,458	(5.5)%	\$ 16,594	\$ 17,627	(5.9)%	
Reinsurance ceded	(2)	(4)	(50.0)	(3)	(8)	(62.5)	
Net premiums and policy fees	7,989	8,454	(5.5)	16,591	17,619	(5.8)	
Net investment income	44,908	37,047	21.2	66,652	73,466	(9.3)	
Realized gains (losses) - investments		3,707			6,857		
Realized gains (losses) - derivatives	1,786	237	653.6	2,270	494	359.5	
Other income	(508)	683	(174.4)	396	1,620	(75.6)	
Total operating revenues	54,175	50,128	8.1	85,909	100,056	(14.1)	
Realized gains (losses) - investments	(64,652)	(674)		(61,612)	2,718		
Realized gains (losses) - derivatives	18,298	3,015		(6,413)	(354)		
Total revenues	7,821	52,469	(85.1)	17,884	102,420	(82.5)	
BENEFITS AND EXPENSES							
Benefits and settlement expenses	8,693	9,207	(5.6)	19,060	19,276	(1.1)	
Amortization of deferred policy acquisition costs	564	135	317.8	1,115	264	322.3	
Other operating expenses	47,011	42,086	11.7	97,800	80,039	22.2	
Total benefits and expenses	56,268	51,428	9.4	117,975	99,579	18.5	
(LOSS) INCOME BEFORE INCOME TAX							
	(48,447)	1,041	n/m	(100,091)	2,841	n/m	
Less: realized gains (losses) - investments	(64,652)	(674)		(61,612)	2,718		
Less: realized gains (losses) - derivatives	18,298	3,015		(6,413)	(354)		
OPERATING (LOSS) INCOME	\$ (2,093)	\$ (1,300)	(61.0)	\$ (32,066)	\$ 477	n/m	

*Three Months Ended June 30, 2008 compared to Three Months Ended June 30, 2007*

*Segment operating (loss) income*

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

The Corporate and Other segment operating income decreased \$0.8 million for the three months ended June 30, 2008, compared to the three months ended June 30, 2007, due primarily to \$3.4 million of lower participating mortgage income and \$2.6 million of lower prepayment fee income in the securities and mortgage investment portfolios. These decreases were offset by mark-to-market adjustments on a \$418 million portfolio of securities designated for trading. This trading portfolio positively impacted the three months ended June 30, 2008 by approximately \$5.3 million, a \$6.0 million more favorable impact than in the three months ended June 30, 2007.

### *Operating revenues*

Operating revenues for the Corporate and Other segment are primarily comprised of net investment income on capital and net premiums and policy fees related to several non-strategic lines of business. Net investment income for this segment increased \$7.9 million, or 21.2%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007, and net premiums and policy fees declined \$0.5 million, or 5.5%. The increase in net investment income was primarily the result of mark-to-market changes on the trading portfolio, an increase in yields on unallocated capital and additional investments related to issuances of non-recourse funding obligations, partially offset by a decline in participating mortgage income and prepayment fee income in the securities and mortgage investment portfolios.

Table of Contents

*Benefits and expenses*

Benefits and expenses increased \$4.8 million, or 9.4%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. The increase was primarily due to an increase in interest expense of \$7.8 million, or 28.5%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Of this increase in interest expense, approximately \$6.6 million relates to additional issuances of non-recourse funding obligations. This increase was partially offset by a decline in claims from discontinued lines of business.

*Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007*

*Segment operating (loss) income*

The Corporate and Other segment operating income declined \$32.5 million for the six months ended June 30, 2008, compared to the six months ended June 30, 2007, due primarily to a \$14.1 million negative impact in 2008 from the \$418 million portfolio of securities designated for trading, representing a \$14.1 million less favorable impact than in the first six months of 2007. In addition, the segment experienced lower participating mortgage income of \$10.2 million and lower prepayment fee income of \$5.8 million in the securities and mortgage investment portfolios.

*Operating revenues*

Net investment income for this segment decreased \$6.8 million, or 9.3%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, and net premiums and policy fees declined \$1.0 million, or 5.8%. The decrease in net investment income was primarily the result of mark-to-market changes on the trading portfolio, a decline in participating mortgage income and prepayment fee income in the securities and mortgage investment portfolios, partially offset by an increase in yields on unallocated capital and additional investments related to issuances of non-recourse funding obligations.

*Benefits and expenses*

Benefits and expenses increased \$18.4 million, or 18.5%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. The increase was primarily due to an increase in interest expense of \$17.9 million, or 34.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Of this increase in interest expense, approximately \$16.5 million relates to additional issuances of non-recourse funding obligations.

Table of Contents**CONSOLIDATED INVESTMENTS***Portfolio Description*

As of June 30, 2008, our investment portfolio equaled approximately \$29.9 billion. The types of assets in which we may invest are influenced by various state laws which prescribe qualified investment assets. Within the parameters of these laws, we invest in assets giving consideration to such factors as liquidity needs, investment quality, investment return, matching of assets and liabilities, and the overall composition of the investment portfolio by asset type and credit exposure.

A significant portion of our bond portfolio is invested in residential mortgage-backed securities, commercial mortgage-backed securities, and asset-backed securities. These holdings at June 30, 2008 equaled approximately \$9.1 billion. Mortgage-backed securities are constructed from pools of mortgages and may have cash flow volatility as a result of changes in the rate at which prepayments of principal occur with respect to the underlying loans. Prepayments of principal on the underlying loans can be expected to accelerate with decreases in market interest rates and diminish with increases in interest rates. In addition, we have entered into derivative contracts at times to partially offset the volatility in the market value of these securities.

**Residential mortgage-backed securities** - The tables below show a breakdown of our residential mortgage-backed securities portfolio by type and rating at June 30, 2008. As of June 30, 2008, these holdings were approximately \$6.6 billion. Planned amortization class securities ( PACs ) pay down according to a schedule. Sequentials receive payments in order until each class is paid off. Pass through securities receive principal as principal of the underlying mortgages is received.

Type	Percentage of Residential Mortgage-Backed Securities
Sequential	63.3%
PAC	14.2
Pass Through	12.7
Other	9.8
	100.0%

Rating	Percentage of Residential Mortgage-Backed Securities
AAA	98.6%
AA	0.7
A	0.1
BBB	0.1
Below investment grade	0.5
	100.0%



# Table of Contents

As of June 30, 2008, we held \$754.7 million, or 2.5% of invested assets, of securities supported by collateral classified as Alt-A. As of March 31, 2008 and December 31, 2007, we held securities with a market value of \$663.9 million and \$274.5 million, respectively, of securities supported by collateral classified as Alt-A.

As of June 30, 2008, we had residential mortgage-backed securities with a total market value of \$72.8 million, or 0.2% of total invested assets, that were supported by collateral classified as sub-prime. \$34.0 million, or 46.7%, of these securities were rated AAA. As of March 31, 2008 and December 31, 2007, we held securities with a market value of \$78.8 million and \$89.9 million, respectively, of securities supported by collateral classified as sub-prime.

The following table shows the percentage of our collateral classified as Alt-A, as of June 30, 2008, grouped by rating category:

Rating	Percentage of Alt-A Securities
AAA	92.5%
AA	2.3
BBB	0.6
Below investment grade	4.6
	100.0%

The following tables categorize the estimated fair value and unrealized gain/loss of our mortgage-backed securities collateralized by Alt-A and sub-prime mortgage loans by rating as of June 30, 2008:

## Alt-A Collateralized Holdings

Rating	Fair Value	Unrealized Gain/(Loss)
	(Dollars In Millions)	
AAA	\$ 698.4	\$ (15.0)
AA	17.4	5.9
Subtotal	\$ 715.8	\$ (9.1)
A		
BBB	4.3	(3.4)
Below investment grade	34.6	(81.2)
Total mortgage-backed securities collateralized by Alt-A mortgage loans	\$ 754.7	\$ (93.7)

## Sub-prime Collateralized Holdings

Fair Unrealized

Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Rating	Value (Dollars In Millions)		Gain/(Loss)
AAA	\$	34.0	\$ (4.6)
AA		22.4	(6.2)
Subtotal	\$	56.4	\$ (10.8)
A		14.7	(3.5)
BBB		1.0	(0.9)
Below investment grade		0.7	(0.3)
Total mortgage-backed securities collateralized by sub-prime mortgage loans	\$	72.8	\$ (15.5)

The tables above referencing our holdings collateralized by Alt-A and sub-prime mortgage loans exclude approximately \$30.8 million of securities collateralized by Alt-A mortgage loans and approximately \$11.6 million of securities collateralized by sub-prime mortgage loans, which are part of a modified coinsurance trading portfolio. The reinsurer bears the ultimate investment risk related to these securities.

Table of Contents

**Commercial mortgage-backed securities** - Our commercial mortgage-backed security ( CMBS ) portfolio consists of commercial mortgage-backed securities issued in securitization transactions. Portions of the CMBS are sponsored by the Company, in which we securitized portions of our mortgage loan portfolio. As of June 30, 2008, the CMBS holdings were approximately \$1.2 billion. Of this amount, \$821.8 million related to retained beneficial interests of commercial mortgage loan securitizations the Company completed. The following table shows the percentages of our CMBS holdings, at June 30, 2008, grouped by rating category:

Rating	Percentage of Commercial Mortgage-Backed Securities
AAA	85.5%
AA	7.5
A	3.6
BBB	1.2
Below investment grade	2.2
	100.0%

**Asset-backed securities** - Asset-backed securities ( ABS ) pay down based on cash flow received from the underlying pool of assets, such as receivables on auto loans, student loans, credit cards, etc. As of June 30, 2008, these holdings were approximately \$1.3 billion. The following table shows the percentages of our ABS holdings, at June 30, 2008, grouped by rating category:

Rating	Percentage of Asset-Backed Securities
AAA	88.7%
AA	1.1
A	7.4
BBB	2.0
Below investment grade	0.8
	100.0%

We obtained ratings of our fixed maturities from Moody's Investors Service, Inc. ( Moody's ), Standard & Poor's Corporation ( S&P ) and Fitch Ratings ( Fitch ). If a bond is not rated by Moody's, S&P, or Fitch, we use ratings from the Securities Valuation Office of the National Association of Insurance Commissioners ( NAIC ), or we rate the bond based upon a comparison of the unrated issue to rated issues of the same issuer or rated issues of other issuers with similar risk characteristics. At June 30, 2008, over 99.0% of our bonds were rated by Moody's, S&P, Fitch, and/or the NAIC.

Table of Contents**Fixed Maturity Investments**

As of June 30, 2008, our fixed maturity investment holdings were approximately \$24.1 billion. The approximate percentage distribution of our fixed maturity investments by quality rating at June 30, 2008, is as follows:

<b>Rating</b>	<b>Percentage of Fixed Maturity Investments</b>
AAA	40.9%
AA	7.3
A	18.1
BBB	28.4
Below investment grade	5.3
	100.0%

Our portfolio consists primarily of fixed maturity securities (bonds and redeemable preferred stocks) and commercial mortgage loans. Within our fixed maturity securities, we maintain portfolios classified as available for sale and trading. We generally purchase our investments with the intent to hold to maturity by purchasing investments that match future cash flow needs. However, we may sell any of our investments to maintain proper matching of assets and liabilities. Accordingly, we classified \$20.4 billion or 84.4% of our fixed maturities as available for sale as of June 30, 2008. These securities are carried at fair value on our Consolidated Balance Sheets. Changes in fair value, net of related DAC and VOBA, are charged or credited directly to shareowners' equity. Changes in fair value that are other-than-temporary are recorded as realized losses in the Consolidated Statements of Income. For more information regarding our evaluation of other-than-temporary losses, refer to *Critical Accounting Policies*.

Our trading portfolio, which accounts for \$3.7 billion or 15.6% of our fixed maturities as of June 30, 2008, consists of two major categories. First, we consolidate a special-purpose entity, in accordance with FASB Interpretation (FIN) No. 46, *Consolidation of Variable Interest Entities*, whose investments are managed by the Company. As of June 30, 2008, fixed maturities with a market value of \$421.5 million and short-term investments with a market value of \$2.0 million were classified as trading securities related to this special-purpose entity. Additionally, as of June 30, 2008, we held fixed maturities with a market value of \$3.3 billion and short-term investments with a market value of \$60.8 million, which were added as part of the Chase Insurance Group acquisition. Investment results for the Chase Insurance Group portfolios, including gains and losses from sales, are passed to the reinsurers through the contractual terms of the reinsurance arrangements. Trading securities are carried at fair value and changes in fair value are recorded in net income as they occur. Offsetting these amounts are corresponding changes in the fair value of the embedded derivative liability associated with the underlying reinsurance arrangement.

Our investments in debt and equity securities are reported at market value, and investments in mortgage loans are reported at amortized cost. As of June 30, 2008, our fixed maturity investments (bonds and redeemable preferred stocks) had a market value of \$24.1 billion, which was 3.2% below amortized cost of \$24.9 billion. We had \$3.5 billion in mortgage loans as of June 30, 2008. While our mortgage loans do not have quoted market values, as of June 30, 2008, we estimated the market value of our mortgage loans to be \$3.7 billion (using discounted cash flows from the next call date), which was 5.4% greater than the amortized cost. Most of our mortgage loans have significant prepayment fees. These assets are invested for terms approximately corresponding to anticipated future benefit payments. Thus, market fluctuations are not expected to adversely affect liquidity.



# Table of Contents

The following table shows the reported values of our invested assets:

	June 30, 2008			December 31, 2007		
			(Dollars In Thousands)			
Publicly-issued bonds	\$	19,732,349	66.1%	\$	19,588,486	67.5%
Privately issued bonds		4,365,261	14.6		3,800,505	13.1
Redeemable preferred stock		83	0.0		78	0.0
Fixed maturities		24,097,693	80.7		23,389,069	80.6
Equity securities		357,672	1.2		117,037	0.4
Mortgage loans		3,523,121	11.8		3,284,326	11.3
Investment real estate		7,834	0.0		8,026	0.0
Policy loans		805,105	2.7		818,280	2.8
Other long-term investments		222,770	0.8		185,892	0.6
Short-term investments		839,973	2.8		1,236,443	4.3
Total investments	\$	29,854,168	100.0%	\$	29,039,073	100.0%

Included in the preceding table are \$3.7 billion and \$4.0 billion of fixed maturities and \$62.8 million and \$67.0 million of short-term investments classified as trading securities as of June 30, 2008 and December 31, 2007, respectively.

Market values for private, non-traded securities are determined as follows: 1) we obtain estimates from independent pricing services and 2) we estimate market value based upon a comparison to quoted issues of the same issuer or issues of other issuers with similar terms and risk characteristics. We analyze the independent pricing services valuation methodologies and related inputs, including an assessment of the observability of market inputs. Upon obtaining this information related to market value, management makes a determination as to the appropriate valuation amount. The market value of private, non-traded securities was \$4.4 billion as of June 30, 2008, representing 14.6% of our total invested assets.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

The industry segment composition of our fixed maturity securities is presented in the following table:

	As of June 30, 2008	% Market Value (Dollars In Thousands)	As of December 31, 2007	% Market Value
Non-Agency Mortgages	\$ 5,294,920	22.0%	\$ 5,543,339	23.7%
Other Finance	2,813,013	11.7	2,114,596	9.0
Electric	2,269,446	9.4	1,971,961	8.4
Banking	2,080,696	8.6	2,123,100	9.1
Agency Mortgages	1,707,803	7.1	2,441,993	10.4
Natural Gas	1,449,756	6.0	1,185,115	5.1
Insurance	1,169,896	4.9	992,470	4.2
Energy	1,106,608	4.6	907,093	3.9
Communications	1,039,512	4.3	973,607	4.2
Basic Industrial	771,436	3.2	692,937	3.0
Brokerage	734,938	3.0	768,656	3.3
Consumer Noncyclical	722,630	3.0	668,293	2.9
Consumer Cyclical	635,285	2.6	625,923	2.7
Finance Companies	539,501	2.2	616,278	2.6
Capital Goods	485,938	2.0	437,013	1.9
Transportation	450,027	1.9	446,264	1.9
U.S. Govt Agencies	218,610	0.9	190,430	0.7
Other Industrial	182,761	0.8	157,582	0.7
U.S. Government	136,053	0.6	165,527	0.7
Technology	133,727	0.6	152,491	0.7
Real Estate	49,950	0.2	55,371	0.2
Canadian Governments	48,107	0.2	108,006	0.5
Other Utility	23,119	0.1	19,796	0.1
Municipal Agencies	18,967	0.1	25,427	0.1
Other Government Agencies	9,104	0.0		0.0
Foreign Governments	5,890	0.0	5,801	0.0
Total	\$ 24,097,693	100.0%	\$ 23,389,069	100.0%

We participate in securities lending, primarily as an investment yield enhancement, whereby securities that are held as investments are loaned to third parties for short periods of time. We require initial collateral of 102% of the market value of the loaned securities to be separately maintained. The loaned securities' market value is monitored on a daily basis. As of June 30, 2008, securities with a market value of \$328.8 million were loaned under these agreements. As collateral for the loaned securities, we receive short-term investments, which are recorded in short-term investments with a corresponding liability recorded in other liabilities to account for our obligation to return the collateral. As of June 30, 2008, the fair market value of the collateral related to these agreements equaled \$327.7 million.

Table of Contents

**Mortgage Loans**

We invest a significant portion of our investment portfolio in commercial mortgage loans. As of June 30, 2008, our mortgage loan holdings equaled approximately \$3.5 billion. We generally do not lend on speculative properties and have specialized in making loans on either credit-oriented commercial properties or credit-anchored strip shopping centers and apartments. Our underwriting procedures relative to our commercial loan portfolio are based on a conservative, disciplined approach. We concentrate our underwriting expertise on a small number of commercial real estate asset types associated with the necessities of life (retail, multi-family, professional office buildings, and warehouses). We believe these asset types tend to weather economic downturns better than other commercial asset classes in which we have chosen not to participate. We believe this disciplined approach has helped to maintain a relatively low delinquency and foreclosure rate throughout our history.

We record mortgage loans net of an allowance for credit losses. This allowance is calculated through analysis of specific loans that are believed to be at a higher risk of becoming impaired in the near future. As of June 30, 2008 and December 31, 2007, our allowance for mortgage loan credit losses was \$0.5 million and \$0.5 million, respectively.

Our mortgage lending criteria generally require that the loan-to-value ratio on each mortgage be at or less than 75% at the time of origination. Projected rental payments from credit anchors (i.e., excluding rental payments from smaller local tenants) generally exceed 70% of the property's projected operating expenses and debt service. We also offer a commercial loan product under which we 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. Approximately \$673.5 million of our mortgage loans have this participation feature.

Many of our mortgage loans have call or interest rate reset provisions between 3 and 10 years. However, if interest rates were to significantly increase, we may be unable to call the loans or increase the interest rates on our existing mortgage loans commensurate with the significantly increased market rates.

As of June 30, 2008, delinquent mortgage loans and foreclosed properties were less than 0.1% of invested assets. We do not expect these investments to adversely affect our liquidity or ability to maintain proper matching of assets and liabilities. As of June 30, 2008, \$7.4 million, or 0.2%, of the mortgage loan portfolio was nonperforming. It is our 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. If a loan becomes over 90 days delinquent, it is our general policy to initiate foreclosure proceedings unless a workout arrangement to bring the loan current is in place.

Between 1996 and 1999, we securitized \$1.4 billion of our mortgage loans. We sold the senior tranches while retaining the subordinate tranches. We continue to service the securitized mortgage loans. During 2007, we securitized an additional \$1.0 billion of our mortgage loans. We sold the highest rated tranche for approximately \$218.3 million, while retaining the remaining tranches. We continue to service the securitized mortgage loans. At June 30, 2008, we had investments related to retained beneficial interests of mortgage loan securitizations of \$821.8 million.

Table of Contents**Risk Management and Impairment Review**

We monitor the overall credit quality of our portfolio within established guidelines. The following table shows our available for sale fixed maturities by credit rating as of June 30, 2008:

<b>S&amp;P or Equivalent Designation</b>	<b>Market Value (Dollars In Thousands)</b>	<b>Percent of Market Value</b>
AAA	\$ 8,183,528	40.2%
AA	1,495,591	7.4
A	3,591,430	17.6
BBB	5,855,409	28.8
Investment grade	19,125,958	94.0
BB	797,324	3.9
B	321,809	1.6
CCC or lower	105,578	0.5
In or near default	904	0.0
Below investment grade	1,225,615	6.0
Redeemable preferred stock	83	0.0
Total	\$ 20,351,656	100.0%

Not included in the table above are \$3.7 billion of investment grade and \$46.7 million of less than investment grade fixed maturities classified as trading securities.

Limiting bond exposure to any creditor group is another way we manage credit risk. The following table summarizes our ten largest fixed maturity exposures to an individual creditor group as of June 30, 2008:

<b>Creditor</b>	<b>Market Value (Dollars In Millions)</b>
AT&T Corporation	\$ 164.7
Metlife Inc.	140.2
Toyota	137.3
Citigroup Inc.	135.8
Bank of America Corp.	131.7
JP Morgan Chase & Company	129.4
Prudential Financial	128.8
Wachovia Corp.	122.2
American International Group	122.0
Wells Fargo & Co.	116.5

Determining whether a decline in the current fair value of invested assets is an other-than-temporary decline in value can involve a variety of assumptions and estimates, particularly for investments that are not actively traded in established markets. We review our positions on a monthly basis for possible credit concerns and review our current exposure, credit enhancement, and delinquency experience. Management considers a number of factors when determining the impairment status of individual securities. These include the economic condition of various industry segments and geographic locations and other areas of identified risks. Although it is possible for the impairment of one investment to

affect other investments, we engage in ongoing risk management to safeguard against and limit any further risk to our investment portfolio. Special attention is given to correlative risks within specific industries, related parties, and business markets.

## Table of Contents

For certain securitized financial assets with contractual cash flows including ABS, EITF Issue No. 99-20 requires us to periodically update our best estimate of cash flows over the life of the security. If the fair value of a securitized financial asset is less than its cost or amortized cost and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, an other-than-temporary impairment charge is recognized. Estimating future cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the underlying collateral. Projections of expected future cash flows may change based upon new information regarding the performance of the underlying collateral. In addition, we consider our intent and ability to retain a temporarily depressed security until recovery.

Securities not subject to EITF Issue No. 99-20 that are in an unrealized loss position, are reviewed at least quarterly to determine if an other-than-temporary impairment is present based on certain quantitative and qualitative factors. We generally consider a number of factors in determining whether the impairment is other-than-temporary. These include, but are not limited to: 1) actions taken by rating agencies, 2) default by the issuer, 3) the significance of the decline, 4) the intent and ability to hold the investment until recovery, 5) the time period during which the decline has occurred, 6) an economic analysis of the issuer's industry, and 7) the financial strength, liquidity, and recoverability of the issuer. Management performs a security-by-security review each quarter in evaluating the need for any other-than-temporary impairments. Although no set formula is used in this process, the investment performance, collateral position, and continued viability of the issuer are significant measures considered. Based on our analysis, during the three months ended June 30, 2008, we concluded that approximately \$80.0 million of pretax unrealized losses were other-than-temporarily impaired related to residential mortgage-backed securities collateralized by Alt-A mortgages, resulting in a charge to net realized investment losses.

There are certain risks and uncertainties associated with determining whether declines in market values are other-than-temporary. These include significant changes in general economic conditions and business markets, trends in certain industry segments, interest rate fluctuations, rating agency actions, changes in significant accounting estimates and assumptions, commission of fraud, and legislative actions. We continuously monitor these factors as they relate to the investment portfolio in determining the status of each investment.

## Realized Gains and Losses

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

	Three Months Ended June 30,			Six Months Ended June 30,			
	2008	2007	Change	2008	2007	Change	
	(Dollars In Thousands)						
Fixed maturity gains - sales	\$ 12,952	\$ 1,661	\$ 11,291	\$ 22,014	\$ 3,863	\$ 18,151	
Fixed maturity losses - sales	(181)	(1,789)	1,608	(702)	(4,806)	4,104	
Equity gains - sales	60	460	(400)	60	5,911	(5,851)	
Equity losses - sales							
Impairments on fixed maturity securities	(79,986)		(79,986)	(79,986)	(48)	(79,938)	
Impairments on equity securities							
Modco trading portfolio trading activity	(50,527)	(70,765)	20,238	(86,523)	(65,269)	(21,254)	
Other	5,271	3,824	1,447	4,681	7,034	(2,353)	
Total realized gains (losses) - investments	\$ (112,411)	\$ (66,609)	\$ (45,802)	\$ (140,456)	\$ (53,315)	\$ (87,141)	

Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Foreign currency swaps	\$	(309)	\$	396	\$	(705)	\$	2,862	\$	4,972	\$	(2,110)
Foreign currency adjustments on stable value contracts		143		(366)		509		(2,864)		(809)		(2,055)
Derivatives related to mortgage loan commitments		8,700				8,700		(4,893)				(4,893)
Embedded derivatives related to reinsurance		48,201		73,246		(25,045)		77,566		70,409		7,157
Derivatives related to corporate debt		(2,764)		(8,812)		6,048		3,729		(7,490)		11,219
Credit default swaps		13,148		(739)		13,887		(2,002)		(739)		(1,263)
Other derivatives		(2,032)		12,556		(14,588)		(10,968)		7,647		(18,615)
Total realized gains - derivatives	\$	65,087	\$	76,281	\$	(11,194)	\$	63,430	\$	73,990	\$	(10,560)

## Table of Contents

Realized gains and losses on investments reflect portfolio management activities designed to maintain proper matching of assets and liabilities and to enhance long-term investment portfolio performance. The change in net realized investment gains (losses), excluding impairments, during the six months ended June 30, 2008 primarily reflects the normal operation of our asset/liability program within the context of the changing interest rate and spread environment.

Realized losses are comprised of both write-downs on other-than-temporary impairments and actual sales of investments. For the six months ended June 30, 2008, there were pre-tax other-than-temporary impairments of \$80.0 million in our investments compared to less than \$0.1 million for the six months ended June 30, 2007. The impairments occurred during the three months ended June 30, 2008, and related to residential mortgage-backed securities collateralized by Alt-A mortgages. The decline in the estimated fair value of these securities resulted from factors including downgrades in rating, interest rate changes, and the current distressed credit markets. These other-than-temporary impairments resulted from our analysis of circumstances and our belief that credit events, loss severity, changes in credit enhancement, and/or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to these investments.

As previously discussed, management considers several factors when determining other-than-temporary impairments. Although we generally intend to hold securities until maturity, we may change our position as a result of a change in circumstances. Any such decision is consistent with our classification of all but a specific portion of our investment portfolio as available for sale. For the six months ended June 30, 2008, we sold securities in an unrealized loss position with a market value of \$99.6 million resulting in a realized loss of \$0.7 million. The remaining security sales that generated realized losses included a significant number of US Treasury and government obligations and were sold as a result of normal portfolio rebalancing activity and tax planning. No single security sold during the six months ended June 30, 2008 incurred a loss greater than \$0.1 million. For such securities, the proceeds, realized loss, and total time period that the security had been in an unrealized loss position are presented in the table below:

	Proceeds	% Proceeds	Realized Loss	% Realized Loss
	(Dollars In Thousands)			
<= 90 days	\$ 72,817	73.1%	\$ (205)	29.2%
>90 days but <= 180 days	7,000	7.0	(129)	18.4
>180 days but <= 270 days	4,446	4.5	(72)	10.3
>270 days but <= 1 year	12,490	12.5	(167)	23.8
>1 year	2,871	2.9	(129)	18.3
Total	\$ 99,624	100.0%	\$ (702)	100.0%

The \$4.7 million of other realized gains recognized for the six months ended June 30, 2008 includes foreign exchange gains of \$6.0 million and other losses totaling \$1.3 million. As of June 30, 2008, net losses of \$86.5 million primarily related to mark-to-market changes on our modified coinsurance ( Modco ) trading portfolios associated with the Chase Insurance Group acquisition were also included in realized gains and losses. Of this amount, approximately \$1.9 million of losses were realized through the sale of certain securities, which will be reimbursed to us over time through the reinsurance settlement process for this block of business. Additional details on our investment performance and evaluation are provided in the sections below.

Realized investment gains and losses related to derivatives represent changes in the fair value of derivative financial instruments and gains (losses) on derivative contracts closed during the period. We have entered into foreign currency swaps to mitigate the risk of changes in the value of principal and interest payments to be made on certain of our foreign currency denominated stable value contracts. We recorded net realized losses of \$0.2 million and an immaterial loss from these securities for the three and six months ended June 30, 2008, respectively. These losses were the result of differences in the related foreign currency spot and forward rates used to value the stable value contracts and foreign currency swaps. We have taken short positions in U.S. Treasury futures to mitigate interest rate risk related to our mortgage loan commitments. The net gains for the three months ended June 30, 2008 were the result of \$5.7 million of gains related to closed positions and

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

\$3.0 million of mark-to-market gains. The net losses for the six months ended June 30, 2008 were the result of \$5.0 million of losses related to closed positions, partially offset by \$0.1 million of mark-to-market gains.

## Table of Contents

We also have in place various modified coinsurance and funds withheld arrangements that, in accordance with DIG B36 ( Embedded Derivatives: Modified Coinsurance Arrangements and Debt Instruments That Incorporate Credit Risk Exposures That Are Unrelated or Only Partially Related to the Creditworthiness of the Obligor under Those Instruments ), contain embedded derivatives. The \$48.2 million and \$77.6 million of gains on these embedded derivatives in the three and six months ended June 30, 2008, respectively, were a result of spread widening, partially offset by lower interest rates. In the three and six months ended June 30, 2008, the investment portfolios that support the related modified coinsurance reserves and funds withheld arrangements had mark-to-market losses that offset the gains on these embedded derivatives.

We use interest rate swaps to mitigate interest rate risk related to certain Senior Notes, Medium-Term Notes, and subordinated debt securities. These positions resulted in losses of \$2.8 million and gains of \$3.7 million for the three and six months ended June 30, 2008, respectively.

We reported net gains of \$13.1 million and net losses of \$2.0 million related to credit default swaps for the three and six months ended June 30, 2008, respectively. The net gains for the three months ended June 30, 2008 were primarily the result of \$8.6 million of mark-to-market gains and \$4.2 million of gains related to closed positions. The net losses for the six months ended June 30, 2008 were primarily the result of \$7.9 million of mark-to-market losses, partly offset by \$4.2 million of gains related to closed positions. We entered into these credit default swaps to enhance the return on our investment portfolio.

We also use various swaps, options, and swaptions to mitigate risk related to other interest rate exposures. We realized losses of \$0.6 million and \$3.1 million on swaptions for the three and six months ended June 30, 2008, respectively. Equity call options generated losses of \$1.2 million and \$4.7 million for the three and six months ended June 30, 2008, respectively. The GMWB rider embedded derivatives on certain variable deferred annuities had realized losses of \$0.6 million and \$3.4 million for the three and six months ended June 30, 2008, respectively. Other derivative contracts generated net gains of \$0.4 million and \$0.2 million for the three and six months ended June 30, 2008, respectively.

## **Unrealized Gains and Losses Available for Sale Securities**

The information presented below relates to investments at a certain point in time and is not necessarily indicative of the status of the portfolio at any time after June 30, 2008, the balance sheet date. Information about unrealized gains and losses is subject to rapidly changing conditions, including volatility of financial markets and changes in interest rates. As indicated above, management considers a number of factors in determining if an unrealized loss is other-than-temporary, including our ability and intent to hold the security until recovery. Furthermore, since the timing of recognizing realized gains and losses is largely based on management's decisions as to the timing and selection of investments to be sold, the tables and information provided below should be considered within the context of the overall unrealized gain (loss) position of the portfolio. As of June 30, 2008, we had an overall pre-tax net unrealized loss of \$875.4 million.

Credit markets have experienced reduced liquidity, higher volatility and widening credit spreads across numerous asset classes over the past several quarters, primarily as a result of marketplace uncertainty arising from higher defaults in sub-prime and Alt-A residential mortgage loans and a weakening of the overall economy. In connection with this uncertainty, we believe investors have departed from many investments in asset-backed securities including those associated with sub-prime and Alt-A residential mortgage loans, as well as types of debt investments with fewer lender protections or those with reduced transparency and/or complex features which may hinder investor understanding. We believe these factors have contributed to an increase in our net unrealized investment losses through declines in market values. We expect to experience continued volatility in connection with the valuation of our fixed maturity investments.



# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

For traded and private fixed maturity and equity securities held that are in an unrealized loss position as of June 30, 2008, the estimated market value, amortized cost, unrealized loss, and total time period that the security has been in an unrealized loss position are presented in the table below:

	Estimated Market Value	% Market Value	Amortized Cost (Dollars In Thousands)	% Amortized Cost	Unrealized Loss	% Unrealized Loss
<= 90 days	\$ 4,145,142	28.9%	\$ 4,276,103	27.7%	\$ (130,961)	12.1%
>90 days but <= 180 days	5,356,797	37.3	5,609,019	36.3	(252,222)	23.3
>180 days but <= 270 days	1,435,776	10.1	1,629,346	10.6	(193,570)	17.8
>270 days but <= 1 year	690,078	4.8	789,893	5.1	(99,815)	9.2
>1 year but <= 2 years	1,413,623	9.8	1,628,505	10.6	(214,882)	19.8
>2 years but <= 3 years	1,004,156	7.0	1,141,178	7.4	(137,022)	12.6
>3 years but <= 4 years	183,115	1.3	205,848	1.3	(22,733)	2.1
>4 years but <= 5 years	62,828	0.4	81,702	0.5	(18,874)	1.7
>5 years	57,010	0.4	71,723	0.5	(14,713)	1.4
Total	\$ 14,348,525	100.0%	\$ 15,433,317	100.0%	\$ (1,084,792)	100.0%

The unrealized losses as of June 30, 2008, primarily relate to the widening of credit spreads and fluctuations in treasury rates during the quarter. Factors such as credit enhancements within the deal structures and the underlying collateral performance/characteristics support the recoverability of the investments. We do not consider these unrealized loss positions to be other-than-temporary, based on the factors discussed and because we have the ability and intent to hold these investments until maturity or until the fair values of the investments have recovered.

As of June 30, 2008, there were estimated unrealized losses of \$93.7 million and \$15.5 million, related to our mortgage-backed securities collateralized by Alt-A mortgage loans and sub-prime mortgage loans, respectively. Gross unrealized losses in our securities collateralized by sub-prime and Alt-A residential mortgage loans as of June 30, 2008, were primarily the result of continued widening spreads during 2008, representing marketplace uncertainty arising from higher defaults in sub-prime and Alt-A residential mortgage loans and rating agency downgrades of securities collateralized by sub-prime and Alt-A residential mortgage loans. For the six months ended June 30, 2008, we recorded \$80.0 million of pre-tax other-than-temporary impairments on residential mortgage-backed securities collateralized by Alt-A mortgages. The decline in the estimated fair value of these securities resulted from factors including downgrades in rating, interest rate changes, and the current distressed credit markets. These other-than-temporary impairments resulted from our analysis of circumstances and our belief that credit events, loss severity, changes in credit enhancement, and/or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to these investments. Excluding the securities on which other-than-temporary impairments were recorded, we expect these investments to continue to perform in accordance with their original contractual terms. We have the ability and intent to hold these investments until maturity or until the fair values of the investments have recovered, which may be at maturity. Additionally, we do not expect these investments to adversely affect our liquidity or ability to maintain proper matching of assets and liabilities.

As of June 30, 2008, securities with a market value of \$720.7 million and unrealized losses of \$123.3 million were issued in commercial mortgage loan securitizations that we sponsored, including \$7.7 million of unrealized losses greater than five years. We do not consider these unrealized positions to be other-than-temporary because the underlying mortgage loans continue to perform consistently with our original expectations. Our underwriting procedures relative to our commercial loan portfolio are based on a conservative, disciplined approach. We concentrate our underwriting expertise on a small number of commercial real estate asset types associated with the necessities of life (retail, multi-family, professional office buildings, and warehouses). We believe these asset types tend to weather economic downturns better than other commercial asset classes that we have chosen to avoid. We believe this disciplined approach has helped to maintain a relatively low delinquency and foreclosure rate throughout our history.

In assessing whether or not these unrealized positions should be considered other-than-temporary, we review the underlying cash flows, as well as the associated values of the real estate collateral for the loans included in our commercial mortgage loan securitizations.

# Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

## Table of Contents

We have no material concentrations of issuers or guarantors of fixed maturity securities. The industry segment composition of all securities in an unrealized loss position held as of June 30, 2008, is presented in the following table:

	Estimated Market Value	% Market Value	Amortized Cost (Dollars In Thousands)	% Amortized Cost	Unrealized Loss	% Unrealized Loss
Agency Mortgages	\$ 626,313	4.4%	\$ 639,776	4.1%	\$ (13,463)	1.2%
Banking	1,446,071	10.1	1,642,995	10.6	(196,924)	18.2
Basic Industrial	382,189	2.7	425,925	2.8	(43,736)	4.0
Brokerage	457,203	3.2	501,075	3.2	(43,872)	4.0
Capital Goods	178,542	1.2	189,559	1.2	(11,017)	1.0
Communications	443,641	3.1	486,143	3.2	(42,502)	3.9
Consumer Cyclical	334,092	2.3	377,563	2.5	(43,471)	4.0
Consumer Noncyclical	368,167	2.6	384,715	2.5	(16,548)	1.5
Electric	1,143,947	8.0	1,209,728	7.8	(65,781)	6.1
Energy	361,901	2.5	375,559	2.4	(13,658)	1.3
Finance Companies	322,480	2.2	349,835	2.3	(27,355)	2.5
Insurance	782,786	5.5	851,577	5.5	(68,791)	6.3
Municipal Agencies	1,585	0.0	1,612	0.0	(27)	0.0
Natural Gas	685,098	4.8	725,700	4.7	(40,602)	3.7
Non-Agency Mortgages	4,298,181	30.0	4,627,811	30.0	(329,630)	30.4
Other Finance	1,943,162	13.5	2,045,927	13.2	(102,765)	9.5
Other Industrial	120,917	0.8	126,509	0.8	(5,592)	0.5
Other Utility	17,757	0.1	19,044	0.1	(1,287)	0.1
Real Estate	11,807	0.1	12,476	0.1	(669)	0.1
Technology	89,995	0.6	94,045	0.6	(4,050)	0.4
Transportation	226,516	1.6	235,523	1.5	(9,007)	0.8
U.S. Government	3,641	0.0	3,670	0.0	(29)	0.0
U.S. Govt Agencies	102,534	0.7	106,550	0.9	(4,016)	0.5
Total	\$ 14,348,525	100.0%	\$ 15,433,317	100.0%	\$ (1,084,792)	100.0%

The range of maturity dates for securities in an unrealized loss position as of June 30, 2008, varies, with 13.0% maturing in less than 5 years, 22.2% maturing between 5 and 10 years, and 64.8% maturing after 10 years. The following table shows the credit rating of securities in an unrealized loss position as of June 30, 2008:

S&P or Equivalent Designation	Estimated Market Value	% Market Value	Amortized Cost (Dollars In Thousands)	% Amortized Cost	Unrealized Loss	% Unrealized Loss
AAA/AA/A	\$ 10,141,033	70.7%	\$ 10,747,519	69.6%	\$ (606,486)	55.9%
BBB	3,318,293	23.1	3,558,850	23.1	(240,557)	22.2
Investment grade	13,459,326	93.8	14,306,369	92.7	(847,043)	78.1
BB	585,191	4.1	674,714	4.4	(89,523)	8.3
B	239,290	1.7	337,116	2.2	(97,826)	9.0
CCC or lower	64,718	0.4	115,118	0.7	(50,400)	4.6
Below investment grade	889,199	6.2	1,126,948	7.3	(237,749)	21.9
Total	\$ 14,348,525	100.0%	\$ 15,433,317	100.0%	\$ (1,084,792)	100.0%

As of June 30, 2008, securities in an unrealized loss position that were rated as below investment grade represented 6.2% of the total market value and 21.9% of the total unrealized loss. Unrealized losses related to below investment grade securities that had been in an unrealized loss

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

position for more than twelve months were \$103.3 million. Securities in an unrealized loss position rated below investment grade were 3.0% of invested assets. We generally purchase our investments with the intent to hold to maturity. We do not expect these investments to adversely affect our liquidity or ability to maintain proper matching of assets and liabilities.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

### Table of Contents

The following table shows the estimated market value, amortized cost, unrealized loss, and total time period that the security has been in an unrealized loss position for all below investment grade securities:

	Estimated Market Value	% Market Value	Amortized Cost (Dollars In Thousands)	% Amortized Cost	Unrealized Loss	% Unrealized Loss
<= 90 days	\$ 226,649	25.5%	\$ 240,261	21.3%	\$ (13,612)	5.7%
>90 days but <= 180 days	136,106	15.3	173,583	15.4	(37,477)	15.8
>180 days but <= 270 days	171,198	19.3	213,774	19.0	(42,576)	17.9
>270 days but <= 1 year	58,892	6.6	99,634	8.8	(40,742)	17.1
>1 year but <= 2 years	96,341	10.8	128,260	11.4	(31,919)	13.4
>2 years but <= 3 years	138,691	15.6	175,610	15.6	(36,919)	15.5
>3 years but <= 4 years	29,995	3.4	41,925	3.7	(11,930)	5.0
>4 years but <= 5 years	15,349	1.7	30,728	2.7	(15,379)	6.5
>5 years	15,978	1.8	23,173	2.1	(7,195)	3.1
Total	\$ 889,199	100.0%	\$ 1,126,948	100.0%	\$ (237,749)	100.0%

As of June 30, 2008, below investment grade securities with a market value of \$26.1 million and \$10.4 million of unrealized losses were issued in commercial mortgage loan securitizations that we sponsored, including securities in an unrealized loss position greater than five years with a market value of \$14.7 million and \$6.0 million of unrealized losses. We do not consider these unrealized positions to be other-than-temporary, because the underlying mortgage loans continue to perform consistently with our original expectations. In addition, of the total below investment grade securities, approximately \$752.8 million and \$73.5 million, respectively, relate to corporate securities and public utility securities.

## LIQUIDITY AND CAPITAL RESOURCES

### Liquidity

We meet our liquidity requirements primarily through positive cash flows from our operating subsidiaries. Primary sources of cash from the operating subsidiaries are premiums, deposits for policyholder accounts, investment sales and maturities, and investment income. Primary uses of cash for the operating subsidiaries include benefit payments, withdrawals from policyholder accounts, investment purchases, policy acquisition costs, and other operating expenses.

*While we generally anticipate that the cash flow of our operating subsidiaries will be sufficient to meet our investment commitments and operating cash needs, we recognize that investment commitments scheduled to be funded may, from time to time, exceed the funds then available. Therefore, we have established repurchase agreement programs for certain of our insurance subsidiaries to provide liquidity*

*when needed. We expect that the rate received on our investments will equal or exceed our borrowing rate. As of June 30, 2008, we had \$360.0 million related to such borrowings. Additionally, we may, from time to time, sell short-duration stable value products to complement our cash management practices. We may also use securitization transactions involving our commercial mortgage loans to increase liquidity for the operating subsidiaries.*

*During the second quarter of 2008, we joined the FHLB of Cincinnati. FHLB advances provide an attractive funding source for short-term borrowing and for the sale of funding agreements. Membership in the FHLB requires that we purchase FHLB capital stock based on a minimum requirement and a percentage of the dollar amount of advances outstanding. We held \$50.8 million of common stock as of June 30, 2008, which is included in equity securities. In addition, our obligations under the advances must be collateralized. We maintain control over any such pledged assets, including the right of substitution. As of June 30, 2008 we had \$250 million of short-term advances and \$375 million of funding agreement-related advances outstanding under the FHLB program.*

Table of Contents

Under a revolving line of credit arrangement, we have the ability to borrow on an unsecured basis at an interest rate of LIBOR plus 0.30%, up to a maximum principal amount of \$500 million (the New Credit Facility). This replaced our previously existing \$200 million revolving line of credit. We have the right in certain circumstances to request that the commitment under the New Credit Facility be increased up to a maximum principal amount of \$600 million. Balances outstanding under the New Credit Facility accrue interest at a rate equal to (i) either the prime rate or the London Interbank Offered Rate (LIBOR), plus (ii) a spread based on the ratings of our senior unsecured long-term debt. The Credit Agreement provides that we are liable for the full amount of any obligations for borrowings or letters of credit, including those of PLICO, under the New Credit Facility. The maturity date on the New Credit Facility is April 16, 2013. There was no balance outstanding under the New Credit Facility as of June 30, 2008. However, approximately \$32 million of capacity has been utilized to issue intercompany letters of credit relating to certain reinsurance arrangements. In addition, the Company was in compliance with all financial debt covenants as of June 30, 2008.

Our positive cash flows from operations are used to fund an investment portfolio that provides for future benefit payments. We employ a formal asset/liability program to manage the cash flows of our investment portfolio relative to our long-term benefit obligations. The life insurance subsidiaries were committed as of June 30, 2008, to fund mortgage loans in the amount of \$786.0 million. Our subsidiaries held \$900.5 million in cash and short-term investments as of June 30, 2008. We had an additional \$6.9 million in cash and short-term investments available for general corporate purposes.

*Sources and Uses of Cash*

Our primary sources of funding are dividends from our operating subsidiaries; revenues from investment, data processing, legal, and management services rendered to subsidiaries; investment income; and external financing. These sources of cash support our general corporate needs including our common stock dividends and debt service. The states in which our insurance subsidiaries are domiciled impose certain restrictions on the insurance subsidiaries' ability to pay us dividends. These restrictions are generally based in part on the prior year's statutory income and surplus. Generally, these restrictions pose no short-term liquidity concerns. We plan to retain substantial portions of the earnings of our insurance subsidiaries in those companies primarily to support their future growth.

The following chart shows the cash flows provided by or used in operating, investing, and financing activities for the six months ended June 30, 2008 and June 30, 2007:

	Six Months Ended June 30,	
	2008	2007
	(Dollars In Thousands)	
Net cash provided by operating activities	\$ 852,536	\$ 345,570
Net cash (used in) provided by investing activities	(1,964,977)	7,160
Net cash provided by (used in) financing activities	1,073,656	(61,117)
Total	\$ (38,785)	\$ 291,613

*Six Months Ended June 30, 2008 compared to Six Months Ended June 30, 2007*

*Net cash provided by operating activities* - Cash flows from operating activities are affected by the timing of premiums received, fees received, investment income, and expenses paid. Principal sources of cash include sales of our products and services. As an insurance business, we typically generate positive cash flows from operating activities, as premiums and deposits collected from our insurance and investment products exceed benefits paid and redemptions, and we invest the excess. Accordingly, in analyzing our cash flows we focus on the change in the amount of cash available and used in investing activities.

*Net cash (used in) provided by investing activities* - The variance in net cash used in investing activities for the six months ended June 30, 2008 compared to June 30, 2007 was primarily the result of activity related to our investment portfolio.

Table of Contents

*Net cash provided by (used in) financing activities* - Changes in cash from financing activities primarily relate to the issuance and repayment of borrowings, dividends to our stockholders and other capital transactions, as well as the issuance of, and redemptions and benefit payments on, investment contracts. The increase for the six months ended June 30, 2008 compared to June 30, 2007 was primarily the result of fluctuations in investment product deposits and withdrawals and repurchase agreement activity.

**Capital Resources**

To give us flexibility in connection with future acquisitions and other funding needs, we have registered debt securities, preferred and common stock, and stock purchase contracts of Protective Life Corporation, and additional preferred securities of special purpose finance subsidiaries under the Securities Act of 1933 on a delayed (or shelf) basis.

As of June 30, 2008, our capital structure consisted of Medium-Term Notes, Senior Notes, Subordinated Debentures, and shareowners' equity. We also have a \$500 million revolving line of credit, under which we could borrow funds at an interest rate of LIBOR plus 0.30%, with balances due April 16, 2013. We have the right in certain circumstances to request that the commitment under the New Credit Facility be increased up to a maximum principal amount of \$600 million. No compensating balances are required to maintain the line of credit. The line of credit arrangement contains, among other provisions, requirements for maintaining certain financial ratios and restrictions on the indebtedness that we and our subsidiaries can incur. Additionally, the line of credit arrangement precludes us, on a consolidated basis, from incurring debt in excess of 40% of our total capital. There is currently no balance outstanding under the New Credit Facility. However, approximately \$32 million of capacity has been utilized to issue intercompany letters of credit relating to certain reinsurance arrangements. We were in compliance with all debt covenants as of June 30, 2008.

Golden Gate Captive Insurance Company ( "Golden Gate" ), a special purpose financial captive insurance company wholly owned by Protective Life, our largest operating subsidiary, had \$800.0 million of non-recourse funding obligations outstanding as of June 30, 2008, the maximum amount available under a surplus notes facility established with certain purchasers. These non-recourse funding obligations bear a floating rate of interest and mature in 2037. As the block of business grows and ages, unless additional funding mechanisms are put into place, reserving increases will reduce our available statutory capital and surplus. We also have experienced higher proportional borrowing costs associated with the non-recourse funding obligations supporting the business reinsured to Golden Gate. The maximum rate we could be required to pay under these obligations is LIBOR plus 425 basis points. These costs have been partially mitigated by a drop in LIBOR during the six months ended June 30, 2008.

Golden Gate II Captive Insurance Company ( "Golden Gate II" ), a special purpose financial captive insurance company wholly owned by Protective Life, had \$575.0 million of non-recourse funding obligations outstanding as of June 30, 2008. These non-recourse funding obligations mature in 2052. We do not anticipate having to pursue additional funding related to this block of business; however, we have contingent approval to issue an additional \$100 million of obligations if necessary. We have experienced higher proportional borrowing costs associated with certain of our non-recourse funding obligations supporting the business reinsured to Golden Gate II. These higher costs are the result of higher interest costs associated with the illiquidity of the current market for auction rate securities, as well as a rating downgrade of our guarantor by certain rating agencies. The maximum rate we could be required to pay under these obligations is LIBOR plus 200 basis points. These costs have been partially mitigated by a drop in LIBOR during the six months ended June 30, 2008.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

On May 7, 2007, our Board of Directors extended our previously authorized \$100 million share repurchase program. The current authorization extends through May 6, 2010. During the first three months of 2008, we repurchased approximately 450,800 shares, at a total cost of approximately \$17.1million. We did not repurchase any additional shares during the months of April through June, 2008. For additional information, see Part II, Item 2, *Unregistered Sales of Equity Securities and Use of Proceeds*. Future activity will be dependent upon many factors, including capital levels, rating agency expectations, and the relative attractiveness of alternative uses for capital.

## Table of Contents

A life insurance company's statutory capital is computed according to rules prescribed by the National Association of Insurance Commissioners (NAIC), as modified by state law. Generally speaking, other states in which a company does business defer to the interpretation of the domiciliary state with respect to NAIC rules, unless inconsistent with the other state's law. Statutory accounting rules are different from U.S. GAAP and are intended to reflect a more conservative view, for example, requiring immediate expensing of policy acquisition costs. The NAIC's risk-based capital requirements require insurance companies to calculate and report information under a risk-based capital formula. The achievement of long-term growth will require growth in the statutory capital of our insurance subsidiaries. The subsidiaries may secure additional statutory capital through various sources, such as retained statutory earnings or equity contributions by us.

We cede material amounts of insurance and transfer related assets to other insurance companies through reinsurance. However, notwithstanding the transfer of related assets, we remain liable with respect to ceded insurance should any reinsurer fail to meet the obligations that such reinsurer assumed. We evaluate the financial condition of our reinsurers and monitor the concentration of credit risk arising from them. During the three and six months ended June 30, 2008, we ceded premiums to third-party reinsurers amounting to \$423.8 million and \$794.8 million, respectively. In addition, we had receivables from reinsurers amounting to \$5.2 billion as of June 30, 2008. We review reinsurance receivable amounts for collectability and establish appropriate bad debt reserves if deemed appropriate.

As of June 30, 2008, we reported approximately \$705.0 million (fair value) of Auction Rate Securities (ARSs), which were all rated AAA. These holdings are student loan-backed auction rate securities, which are guaranteed by the Federal Family Education Loan Program. While the auction rate market has experienced certain liquidity constraints, we believe that based on our current liquidity position and our operating cash flows, any lack of liquidity in the ARS market will not have a material impact on our liquidity, financial condition, or cash flows.

As of June 30, 2008, we reported residential mortgage-backed securities with a total market value of \$72.8 million, or 0.2% of total invested assets, that were supported by collateral classified as sub-prime. \$34.0 million, or 46.7%, of these securities were rated AAA. Additionally, as of June 30, 2008, we held \$754.7 million, or 2.5% of invested assets, of securities supported by collateral classified as Alt-A. While the estimated fair market values of certain of these securities have experienced significant declines, we believe that based on our current liquidity position and our operating cash flows, continuing to hold these securities until the fair value recovers will not have a material impact on our liquidity, financial condition, or cash flows.

As of June 30, 2008, we reported \$400.0 million of liabilities related to variable interest entities. During June 2008, we received notification of the intent to terminate the notes in existence under the trust facility. Management is in the process of reviewing the implications of this termination of the trust, which is consolidated on our financial statements in accordance with FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51* (FIN 46(R)). Based on our current liquidity position and our operating cash flows, we do not believe the termination of this variable interest entity will have a material impact on our liquidity, financial condition, or cash flows.

## **Liabilities**

Many of our products contain surrender charges and other features that reward persistency and penalize the early withdrawal of funds. Certain stable value and annuity contracts have market-value adjustments that protect us against investment losses if interest rates are higher at the time of surrender than at the time of issue.

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

As of June 30, 2008, we had policy liabilities and accruals of approximately \$18.0 billion. Our interest-sensitive life insurance policies have a weighted average minimum credited interest rate of approximately 3.71%.

Table of Contents**Contractual Obligations**

The table below sets forth future maturities of debt, non-recourse funding obligations, subordinated debt securities, stable value products, notes payable, operating lease obligations, other property lease obligations, mortgage loan commitments, liabilities related to variable interest entities, policyholder obligations, and defined benefit pension obligations.

As of June 30, 2008, in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement 109*, we recorded a \$33.4 million liability for uncertain tax positions, including interest on unrecognized tax benefits. These amounts are not included in the long-term contractual obligations table because of the difficulty in making reasonably reliable estimates of the occurrence or timing of cash settlements with the respective taxing authorities.

	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
			(Dollars In Thousands)		
Long-term debt <sup>(1)</sup>	\$ 752,481	\$ 28,396	\$ 56,793	\$ 314,342	\$ 352,950
Non-recourse funding obligations <sup>(2)</sup>	3,685,672	69,614	139,228	139,228	3,337,602
Subordinated debt securities <sup>(3)</sup>	1,919,815	37,147	74,294	74,294	1,734,080
Stable value products <sup>(4)</sup>	6,508,150	1,500,004	2,365,710	1,156,886	1,485,550
Operating leases <sup>(5)</sup>	30,320	6,671	11,296	6,685	5,668
Home office lease <sup>(6)</sup>	88,177	2,392	4,790	4,783	76,212
Mortgage loan commitments	786,049	786,049			
Liabilities related to variable interest entities <sup>(7)</sup>	402,758	402,758			
Policyholder obligations <sup>(8)</sup>	21,221,433	1,527,988	2,908,675	2,702,487	14,082,283
Defined benefit pension obligations <sup>(9)</sup>	2,326	2,326			

(1) Long-term debt includes all principal amounts owed on note agreements and expected interest payments due over the term of notes.

(2) Non-recourse funding obligations include all principal amounts owed on note agreements and expected interest payments due over the term of the notes.

(3) Subordinated debt securities includes all principal amounts owed to our non-consolidated special purpose finance subsidiaries and interest payments due over the term of the obligations.

(4) Anticipated stable value products cash flows including interest.

(5) Includes all lease payments required under operating lease agreements.

(6) The lease payments shown assume we exercise our option to purchase the building at the end of the lease term. Additionally, the payments due by period above were computed based on the terms of the renegotiated lease agreement, which was entered in January 2007.

(7) Liabilities related to variable interest entities are not our legal obligations, but will be repaid with cash flows generated by the variable interest entities. The amounts represent scheduled principal and expected interest payments.

(8) Estimated contractual policyholder obligations are based on mortality, morbidity, and lapse assumptions comparable to our historical experience, modified for recent observed trends. These obligations are based on current balance sheet values and include expected interest crediting, but do not incorporate an expectation of future market growth, or future deposits. Due to the significance of the assumptions used, the amounts presented could materially differ from actual results. As separate account obligations are legally insulated from general account obligations, the separate account obligations will be fully funded by cash flows from separate account assets. We expect to fully fund the general account obligations from cash flows from general account investments.

(9) Estimated 2008 contributions to our defined benefit pension plan and unfunded excess benefit plan approximate the projected expense to be recognized in 2008. Due to the significance of the assumptions used, this amount could differ from actual results. No estimate has been made of amounts to be contributed to these plans in years subsequent to 2008.

Table of Contents

**FAIR VALUE OF FINANCIAL INSTRUMENTS**

On January 1, 2008, we adopted SFAS No. 157. This standard defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The term "fair value" as used in this document is defined in accordance with SFAS No. 157. The cumulative effect of adopting this standard resulted in an increase to January 1, 2008 retained earnings of \$1.5 million and a decrease in income before income taxes of \$0.4 million for the six months ended June 30, 2008. The standard describes three levels of inputs that may be used to measure fair value. For more information, see Note 1, *Basis of Presentation and Summary of Significant Accounting Policies* and Note 10, *Fair Value of Financial Instruments*.

Available-for-sale securities and trading account securities are recorded at fair value, which is primarily based on actively traded markets where prices are based on either direct market quotes or observed transactions. Liquidity is a significant factor in the determination of the fair value for these securities. Market price quotes may not be readily available for some positions, or for some positions within a market sector where trading activity has slowed significantly or ceased. Situations of illiquidity generally are triggered by the market's perception of credit uncertainty regarding a single company or a specific market sector. In these instances, fair value is determined based on limited available market information and other factors, principally from reviewing the issuer's financial position, changes in credit ratings, and cash flows on the investments. As of June 30, 2008, \$5.5 billion of available-for-sale and trading account assets were classified as level three fair value assets.

The fair values of derivative assets and liabilities include adjustments for market liquidity, counterparty credit quality and other deal specific factors, where appropriate. The fair values of derivative assets and liabilities traded in the over-the-counter market are determined using quantitative models that require the use of multiple market inputs including interest rates, prices and indices to generate continuous yield or pricing curves and volatility factors, which are used to value the position. The predominance of market inputs are actively quoted and can be validated through external sources. Estimation risk is greater for derivative asset and liability positions that are either option-based or have longer maturity dates where observable market inputs are less readily available or are unobservable, in which case quantitative based extrapolations of rate, price or index scenarios are used in determining fair values. At June 30, 2008, the level three fair values of derivative assets and liabilities determined by these quantitative models was \$44.4 million and \$6.5 million. These amounts reflect the full fair value of the derivatives as defined in accordance with SFAS No. 157 and do not isolate the discrete value associated with the specific subjective valuation variable.

The liabilities of certain of our annuity account balances are calculated at fair value using actuarial valuation models. These models use various observable and unobservable inputs including projected future cash flows, policyholder behavior, the Company's credit rating and other market conditions. At June 30, 2008, the level three fair value of these liabilities was \$146.6 million. This amount reflects the full fair value of the liabilities as defined in accordance with SFAS No. 157 and does not isolate the discrete value associated with the specific subjective valuation variable.

**MARKET RISK EXPOSURES AND OFF-BALANCE SHEET ARRANGEMENTS**

Our financial position and earnings are subject to various market risks including changes in interest rates, changes in the yield curve, changes in spreads between risk-adjusted and risk-free interest rates, changes in foreign currency rates, changes in used vehicle prices, and equity price risks. We analyze and manage the risks arising from market exposures of financial instruments, as well as other risks, through an integrated asset/liability management process. Our asset/liability management programs and procedures involve the monitoring of asset and liability durations for various product lines; cash flow testing under various interest rate scenarios; and the continuous rebalancing of assets and liabilities with respect to yield, risk, and cash flow characteristics. These programs also incorporate the use of derivative financial instruments primarily to

reduce our exposure to interest rate risk, inflation risk, currency exchange risk, and equity market risk.

The primary focus of our asset/liability program is the management of interest rate risk within the insurance operations. This includes monitoring the duration of both investments and insurance liabilities to maintain an appropriate balance between risk and profitability for each product category, and for us as a whole. It is our policy to generally maintain asset and liability durations within one-half year of one another, although, from time to time, a broader interval may be allowed.

Table of Contents

Derivative instruments that are used as part of our interest rate risk management strategy include interest rate swaps, interest rate futures, interest rate options and interest rate swaptions. Our inflation risk management strategy involves the use of swaps that require us to pay a fixed rate and receive a floating rate that is based on changes in the Consumer Price Index ( CPI ). We use foreign currency swaps to manage our exposure to changes in the value of foreign currency denominated stable value contracts. We also use S&P 500® options to mitigate our exposure to the value of equity indexed annuity contracts.

We have sold credit derivatives to enhance the return on our investment portfolio. These credit default swaps create credit exposure similar to an investment in publicly-issued fixed maturity cash investments. As of June 30, 2008, the notional amount of these credit default swaps was \$65.0 million and the swaps were in an unrealized loss position of \$7.6 million, respectively. As a result of the ongoing disruption in the credit markets, the fair value of these derivatives is expected to fluctuate in response to changing market conditions. We believe that the unrealized loss recorded on these credit default swaps is not indicative of the economic value of the investment. We expect the unrealized loss to reverse over the remaining life of the credit default swap portfolio.

Derivative instruments expose us to credit and market risk and could result in material changes from quarter-to-quarter. We minimize our credit risk by entering into transactions with highly rated counterparties. We manage the market risk associated with interest rate and foreign exchange contracts by establishing and monitoring limits as to the types and degrees of risk that may be undertaken. We monitor our use of derivatives in connection with our overall asset/liability management programs and procedures.

In the ordinary course of our commercial mortgage lending operations, we will commit to provide a mortgage loan before the property to be mortgaged has been built or acquired. The mortgage loan commitment is a contractual obligation to fund a mortgage loan when called upon by the borrower. The commitment is not recognized in our financial statements until the commitment is actually funded. The mortgage loan commitment contains terms, including the rate of interest, which may be different than prevailing interest rates. As of June 30, 2008, we had outstanding mortgage loan commitments of \$786.0 million at an average rate of 6.33%.

We believe our asset/liability management programs and procedures and certain product features provide protection against the effects of changes in interest rates under various scenarios. Additionally, we believe our asset/liability management programs and procedures provide sufficient liquidity to enable us to fulfill our obligation to pay benefits under our various insurance and deposit contracts. However, our asset/liability management programs and procedures incorporate assumptions about the relationship between short-term and long-term interest rates (i.e., the slope of the yield curve), relationships between risk-adjusted and risk-free interest rates, market liquidity, spread movements and other factors, and the effectiveness of our asset/liability management programs and procedures may be negatively affected whenever actual results differ from those assumptions.

**RECENTLY ISSUED ACCOUNTING STANDARDS**

See Note 1, *Basis of Presentation and Summary of Significant Accounting Policies*, to the Consolidated Condensed Financial Statements for information regarding recently issued accounting standards.

Table of Contents

**RECENT DEVELOPMENTS**

Credit markets have experienced reduced liquidity, higher volatility and widening credit spreads across numerous asset classes over the past several quarters, primarily as a result of marketplace uncertainty arising from higher defaults in sub-prime and Alt-A residential mortgage loans and a weakening of the overall economy. In connection with this uncertainty, we believe investors and lenders have retreated from many investments in asset-backed securities including those associated with sub-prime and Alt-A residential mortgage loans, as well as types of debt investments with weak lender protections or those with limited transparency and/or complex features which hinder investor understanding. We believe such uncertainty has contributed to an increase in our net unrealized investment losses through declines in market values. We expect to experience continued volatility in connection with the valuation of our fixed maturity investments. However, we believe that the current credit environment also provides us with opportunities to invest in select asset classes and sectors that may enhance our investment yields over time.

Revised Actuarial Guideline 38 was approved by the NAIC, with an effective date of July 1, 2005. Actuarial Guideline 38, also known as XXXX, sets forth the reserve requirements for universal life insurance with secondary guarantees ( ULSG ). The changes to Actuarial Guideline 38 increased the reserve levels required for many ULSG products, and potentially make those products more expensive and less competitive as compared to other products including term and whole life products. To the extent that the additional reserves are generally considered to be economically redundant, capital market or other solutions may emerge to reduce the impact of the amendment. The NAIC has issued additional changes to AG38 and Regulation XXX, which had the effect of modestly decreasing the reserves required for certain traditional and universal life policies that are issued on January 1, 2007, and later. In addition, accounting and actuarial groups within the NAIC are studying whether to change the accounting standards that relate to certain reinsurance credits, and whether, if changes are made, they are to be applied retrospectively, prospectively only, or in a phased-in manner; a requirement to reduce the reserve credit on ceded business, if applied retroactively, would have a negative impact on our statutory capital. The NAIC is also currently working to reform state regulation in various areas, including comprehensive reforms relating to life insurance reserves.

Our ability to implement financing solutions designed to fund a portion of our statutory reserves on both the traditional and universal life blocks of business is dependent on factors such as our ratings, the size of the blocks of business affected, our mortality experience, credit market guarantors, and other factors. We cannot predict the continued availability of such solutions or the form that the solution may take. To the extent that such solutions are not available, our financial position could be adversely affected through impacts including, but not limited to, higher borrowing costs, surplus strain, lower sales capacity and possible reduced earnings expectations. Management continues to monitor options related to these financing solutions.

During 2006, the NAIC made the determination that certain securities previously classified as preferred securities had both debt and equity characteristics and because of this, required unique reporting treatment. Under a short-term solution, NAIC guidance mandated that certain of these securities may have to carry a lower rating for asset valuation reserve and risk based capital calculations. As a result, certain securities receive a lower rating classification for asset valuation reserve and risk based capital calculations.

Our insurance subsidiaries currently invest in hybrid securities. As of June 30, 2008, we (including both insurance and non-insurance subsidiaries) held approximately \$1.3 billion (statutory carrying value) in securities that meet the aforementioned notch-down criteria, based on evaluation of the underlying characteristics of the securities. The NAIC has since established a long-term solution, which effective January 1, 2009, provides for the classification of these hybrid securities as debt securities.



Table of Contents

During 2006, the NAIC's Reinsurance Task Force adopted a proposal suggesting broad changes to the United States reinsurance market, with the stated intent to establish a regulatory system that distinguishes financially strong reinsurers from weak reinsurers, without relying exclusively on their state or country of domicile, with collateral to be determined as appropriate. The task force recommended that regulation of reinsurance procedures be amended to focus on broad based risk and credit criteria and not solely on U.S. licensure status. Evaluation of this proposal will be taken under consideration by the NAIC's Financial Condition (E) Committee, the Reinsurance Task Force's parent committee, as one of its charges during 2007. We cannot provide any assurance as to what impact such changes to the United States reinsurance industry will have on the availability, cost, or collateral restrictions associated with ongoing or future reinsurance transactions.

The NAIC adopted amendment(s) to the Unfair Trade Practices Act regarding the use of travel in insurance underwriting. The amendment states that the denial of life insurance based upon an individual's past lawful travel experiences or future lawful travel plans, is prohibited unless (i) the risk of loss for individuals traveling to a specified destination at a specified time is reasonably anticipated to be greater than if the individuals did not travel to that destinations at that time, and (ii) the risk of traveling to a specific destination is based on sound actuarial principles and actual or reasonably anticipated experience. We cannot predict at this time what impact, if any, such changes would have on us.

The California Department of Insurance has promulgated proposed regulations that would characterize some life insurance agents as brokers and impose certain obligations on those agents that may conflict with the interests of insurance carriers or require the agent to, among other things, advise the client with respect to the best available insurer. We cannot predict the outcome of this regulatory proposal or whether any other state will propose or adopt similar actions.

In connection with our discontinued lender's indemnity product, we have discovered facts and circumstances that support allegations against third parties (including policyholders and the administrator of the associated loan program), and we have instituted litigation to establish the rights and liabilities of various parties; we have also received claims seeking to assert liability against us for various matters, including claims alleging payments owing for bad faith refusal to pay and payments with respect to policies for which premiums were not received by us and this matter is addressed by the pending litigation matters. In addition, we are defending an arbitration claim by the reinsurer of this lender's indemnity product. The reinsurer asserts that it is entitled to a return of most of the lender's indemnity claims that were paid on behalf of us by the administrator, claiming that the claims were not properly payable under the terms of the policies. The reinsurer was under common ownership with the program administrator, and we are vigorously defending this arbitration. Although we cannot predict the outcome of any litigation or arbitration, we do not believe that the outcome of these matters will have a material impact on our financial condition or results of operations.

## **IMPACT OF INFLATION**

Inflation increases the need for life insurance. Many policyholders who once had adequate insurance programs may increase their life insurance coverage to provide the same relative financial benefit and protection. Higher interest rates may result in higher sales of certain of our investment products.

The higher interest rates that have traditionally accompanied inflation could also affect our operations. Policy loans increase as policy loan interest rates become relatively more attractive. As interest rates increase, disintermediation of stable value and annuity account balances and individual life policy cash values may increase. The market value of our fixed-rate, long-term investments may decrease, we may be unable to implement fully the interest rate reset and call provisions of our mortgage loans, and our ability to make attractive mortgage loans, including participating mortgage loans, may decrease. In addition, participating mortgage loan income may decrease. The difference between the interest rate earned on investments and the interest rate credited to life insurance and investment products may also be adversely affected by rising

interest rates.

Table of Contents

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There has been no material change from the disclosures in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**Item 4. CONTROLS AND PROCEDURES**

**(a) Disclosure controls and procedures**

In order to ensure that the information the Company must disclose in its filings with the Securities and Exchange Commission is recorded, processed, summarized and reported on a timely basis, the Company's management, under the direction of its Chief Executive Officer and Chief Financial Officer, evaluated its disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective for the purposes set forth in the definition thereof in Exchange Act Rule 13a-15(e) as of such date. It should be noted that any system of controls, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of any control system is based in part upon certain judgments, including the costs and benefits of controls and the likelihood of future events. Because of these and other inherent limitations of control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within the Company have been detected.

**(b) Changes in internal control over financial reporting**

There have been no changes in the Company's internal control over financial reporting that occurred during the period ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, such internal control over financial reporting. The Company's internal controls exist within a dynamic environment and the Company continually strives to improve its internal controls and procedures to enhance the quality of its financial reporting.

**PART II**

**Item 1A. Risk Factors**

The operating results of companies in the insurance industry have historically been subject to significant fluctuations. The factors which could affect the Company's future results include, but are not limited to, general economic conditions and the known trends and uncertainties. In addition to other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors and

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Cautionary Factors that may Affect Future Results in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect the Company's business, financial condition, or future results of operations.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the quarter ended June 30, 2008, the Company issued no securities in transactions which were not registered under the Securities Act of 1933, as amended (the "Act").

#### ***Issuer Purchases of Equity Securities***

In May 2004, the Company announced the initiation of its \$100 million share repurchase program, which commenced execution on February 12, 2008. On May 7, 2007, the Board of Directors extended the share repurchase program through May 6, 2010. In the first quarter of 2008, the Company purchased 450,800 shares as part of the publicly announced program, at an average price of \$38.00. There were no shares repurchased during the second quarter of 2008. The approximate value of shares that may yet be purchased under the program is \$82.9 million.

Table of Contents

**Item 4. Submission of Matters to a Vote of Security Holders**

The Annual Meeting of Shareowners of Protective Life Corporation (the Company) was held on May 5, 2008. Shares entitled to vote at the Annual Meeting totaled 70,227,995 of which 65,835,213 shares were represented.

At the Annual Meeting the following directors were elected. The number of shares cast for and authorized withheld for each nominee is shown below:

<b>Name of Director</b>	<b>Number of Shares Voted For</b>	<b>Number of Shares Withheld</b>
James S. M. French	59,172,448	5,431,966
Thomas L. Hamby	62,656,248	1,948,166
John D. Johns	58,809,475	5,794,939
Vanessa Leonard	62,881,277	1,723,137
Charles D. McCrary	57,267,176	7,337,238
John J. McMahon, Jr.	59,168,454	5,435,960
Malcolm Portera	62,882,590	1,721,824
C. Dowd Ritter	62,745,569	1,858,845
William A. Terry	62,883,254	1,721,160
W. Michael Warren, Jr.	62,880,458	1,723,956
Vanessa Wilson	62,878,797	1,725,617

Shareowners approved a proposal to ratify the appointment by the Board of Directors of the Company of PricewaterhouseCoopers LLP as the independent public accountants for the Company and its subsidiaries for 2008. Shares voting for this proposal were 61,487,323, shares voting against were 4,282,927, and shares abstaining were 64,961.

Shareowners also approved the Company's Long-Term Incentive Plan (as Amended and Restated as of May 5, 2008) as presented to the shareowners at the meeting. Shares voting for this proposal were 52,098,276, shares voting against were 8,513,348, and shares abstaining were 157,213.

**Item 6. Exhibits**

- Exhibit 10(a) - Amended and Restated Protective Life Corporation Long-Term Incentive Plan
- Exhibit 31(a) - Certification Pursuant to §302 of the Sarbanes Oxley Act of 2002.
- Exhibit 31(b) - Certification Pursuant to §302 of the Sarbanes Oxley Act of 2002.
- Exhibit 32(a) -

## Edgar Filing: PROTECTIVE LIFE CORP - Form 10-Q

Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

Exhibit 32(b) - Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

Exhibit 99 - Safe Harbor for Forward Looking Statements.

*Table of Contents*

*SIGNATURE*

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PROTECTIVE LIFE CORPORATION

Date: August 8, 2008

/s/ Steven G. Walker  
Steven G. Walker  
Senior Vice President, Controller  
and Chief Accounting Officer