

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO

Form 10-Q

August 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission File Number : 001-31911

American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

Iowa

42-1447959

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

6000 Westown Parkway

West Des Moines, Iowa 50266

(Address of principal executive offices, including zip code)

(515) 221-0002

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

APPLICABLE TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of August 2, 2017, there were 88,917,403 shares of the registrant's common stock, \$1 par value, outstanding.

TABLE OF CONTENTS

	Page
<u>PART I — FINANCIAL INFORMATION</u>	
<u>Item 1: Financial Statements:</u>	<u>2</u>
<u>Consolidated Balance Sheets</u>	<u>2</u>
<u>Consolidated Statements of Operations</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>4</u>
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Note 1. Significant Accounting Policies</u>	<u>8</u>
<u>Note 2. Fair Values of Financial Instruments</u>	<u>9</u>
<u>Note 3. Investments</u>	<u>14</u>
<u>Note 4. Mortgage Loans on Real Estate</u>	<u>21</u>
<u>Note 5. Derivative Instruments</u>	<u>26</u>
<u>Note 6. Notes and Loan Payable and Amounts Due Under Repurchase Agreements</u>	<u>29</u>
<u>Note 7. Commitments and Contingencies</u>	<u>29</u>
<u>Note 8. Earnings (Loss) Per Share and Stockholders' Equity</u>	<u>30</u>
<u>Note 9. Subsequent Events</u>	<u>30</u>
<u>Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
<u>Item 3: Quantitative and Qualitative Disclosures about Market Risk</u>	<u>49</u>
<u>Item 4: Controls and Procedures</u>	<u>51</u>
<u>PART II — OTHER INFORMATION</u>	
<u>Item 1: Legal Proceedings</u>	<u>51</u>
<u>Item 1A: Risk Factors</u>	<u>51</u>
<u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>51</u>
<u>Item 6: Exhibits</u>	<u>52</u>
<u>Signatures</u>	<u>53</u>

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share and per share data)

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2017 - \$41,907,744; 2016 - \$39,953,955)	\$43,893,785	\$41,060,494
Held for investment, at amortized cost (fair value: 2017 - \$76,702; 2016 - \$68,766)	76,931	76,825
Mortgage loans on real estate	2,553,391	2,480,956
Derivative instruments	1,086,624	830,519
Other investments	314,421	308,774
Total investments	47,925,152	44,757,568
Cash and cash equivalents	1,574,913	791,266
Coinsurance deposits	4,710,650	4,639,492
Accrued investment income	416,482	397,773
Deferred policy acquisition costs	2,721,596	2,905,377
Deferred sales inducements	2,042,889	2,208,218
Deferred income taxes	64,074	168,578
Income taxes recoverable	952	11,474
Other assets	178,882	173,726
Total assets	\$59,635,590	\$56,053,472
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	\$53,903,497	\$51,637,026
Other policy funds and contract claims	287,381	298,347
Notes and loan payable	888,660	493,755
Subordinated debentures	242,045	241,853
Amounts due under repurchase agreements	61,673	—
Other liabilities	1,600,926	1,090,896
Total liabilities	56,984,182	53,761,877
Stockholders' equity:		
Preferred stock, par value \$1 per share, 2,000,000 shares authorized, 2017 and 2016 - no shares issued and outstanding	—	—
Common stock, par value \$1 per share, 200,000,000 shares authorized; issued and outstanding:		
2017 - 88,741,014 shares (excluding 2,573,000 treasury shares);	88,741	88,001
2016 - 88,001,130 shares (excluding 2,887,082 treasury shares)		
Additional paid-in capital	778,376	770,344
Accumulated other comprehensive income	610,122	339,966

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Retained earnings	1,174,169	1,093,284
Total stockholders' equity	2,651,408	2,291,595
Total liabilities and stockholders' equity	\$59,635,590	\$56,053,472

See accompanying notes to unaudited consolidated financial statements.

2

Table of ContentsAMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues:				
Premiums and other considerations	\$7,720	\$11,458	\$17,122	\$18,803
Annuity product charges	48,603	41,124	92,175	77,629
Net investment income	493,489	459,830	979,086	910,656
Change in fair value of derivatives	266,820	39,099	653,353	(34,966)
Net realized gains on investments, excluding other than temporary impairment ("OTTI") losses	3,873	2,737	6,211	5,424
OTTI losses on investments:				
Total OTTI losses	—	(762)	—	(6,780)
Portion of OTTI losses recognized from other comprehensive income	(949)	(3,684)	(1,090)	(3,360)
Net OTTI losses recognized in operations	(949)	(4,446)	(1,090)	(10,140)
Loss on extinguishment of debt	(428)	—	(428)	—
Total revenues	819,128	549,802	1,746,429	967,406
Benefits and expenses:				
Insurance policy benefits and change in future policy benefits	9,986	13,393	21,861	22,502
Interest sensitive and index product benefits	472,596	111,121	891,735	208,792
Amortization of deferred sales inducements	33,695	30,672	96,020	58,151
Change in fair value of embedded derivatives	174,973	284,303	399,143	550,160
Interest expense on notes and loan payable	8,678	6,882	16,400	13,762
Interest expense on subordinated debentures	3,422	3,206	6,758	6,374
Amortization of deferred policy acquisition costs	49,547	50,665	139,225	100,378
Other operating costs and expenses	25,964	26,823	53,543	53,653
Total benefits and expenses	778,861	527,065	1,624,685	1,013,772
Income (loss) before income taxes	40,267	22,737	121,744	(46,366)
Income tax expense (benefit)	13,321	8,029	40,859	(16,233)
Net income (loss)	\$26,946	\$14,708	\$80,885	\$(30,133)
Earnings (loss) per common share				
Earnings (loss) per common share	\$0.30	\$0.18	\$0.91	\$(0.37)
Earnings (loss) per common share - assuming dilution	\$0.30	\$0.18	\$0.90	\$(0.37)
Weighted average common shares outstanding (in thousands):				
Earnings (loss) per common share	88,897	82,517	88,773	82,323
Earnings (loss) per common share - assuming dilution	90,112	83,184	90,045	83,073
See accompanying notes to unaudited consolidated financial statements.				

Table of ContentsAMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income (loss)	\$26,946	\$14,708	\$80,885	\$(30,133)
Other comprehensive income:				
Change in net unrealized investment gains/losses (1)	283,345	555,412	412,469	1,060,760
Noncredit component of OTTI losses (1)	450	1,713	515	1,566
Reclassification of unrealized investment gains/losses to net income (loss) (1)	1,711	1,511	2,641	1,627
Other comprehensive income before income tax	285,506	558,636	415,625	1,063,953
Income tax effect related to other comprehensive income	(99,927)	(195,523)	(145,469)	(372,384)
Other comprehensive income	185,579	363,113	270,156	691,569
Comprehensive income	\$212,525	\$377,821	\$351,041	\$661,436

(1) Net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs.

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsAMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except share data)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2015	\$ 81,354	\$ 630,367	\$ 201,663	\$ 1,031,151	\$ 1,944,535
Net loss for period	—	—	—	(30,133)	(30,133)
Other comprehensive income	—	—	691,569	—	691,569
Share-based compensation, including excess income tax benefits	—	3,889	—	—	3,889
Issuance of 831,694 shares of common stock under compensation plans, including excess income tax benefits	832	2,699	—	—	3,531
Issuance of 92,998 shares of common stock to settle warrants that have reached their expiration	93	(94)	—	—	(1)
Balance at June 30, 2016	\$ 82,279	\$ 636,861	\$ 893,232	\$ 1,001,018	\$ 2,613,390
Balance at December 31, 2016	\$ 88,001	\$ 770,344	\$ 339,966	\$ 1,093,284	\$ 2,291,595
Net income for period	—	—	—	80,885	80,885
Other comprehensive income	—	—	270,156	—	270,156
Share-based compensation	—	4,154	—	—	4,154
Issuance of 739,884 shares of common stock under compensation plans	740	3,878	—	—	4,618
Balance at June 30, 2017	\$ 88,741	\$ 778,376	\$ 610,122	\$ 1,174,169	\$ 2,651,408

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsAMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Operating activities		
Net income (loss)	\$80,885	\$(30,133)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Interest sensitive and index product benefits	891,735	208,792
Amortization of deferred sales inducements	96,020	58,151
Annuity product charges	(92,175)	(77,629)
Change in fair value of embedded derivatives	399,143	550,160
Change in traditional life and accident and health insurance reserves	122	2,261
Policy acquisition costs deferred	(221,909)	(304,877)
Amortization of deferred policy acquisition costs	139,225	100,378
Provision for depreciation and other amortization	1,961	1,745
Amortization of discounts and premiums on investments	8,644	(5,342)
Realized gains (losses) on investments and net OTTI losses recognized in operations	(5,121)	4,716
Change in fair value of derivatives	(653,939)	34,172
Deferred income taxes	(40,965)	(40,257)
Loss on extinguishment of debt	428	—
Share-based compensation	4,154	3,448
Change in accrued investment income	(18,709)	(15,289)
Change in income taxes recoverable/payable	10,522	(6,078)
Change in other assets	433	706
Change in other policy funds and contract claims	(14,824)	(23,793)
Change in collateral held for derivatives	289,258	10,615
Change in other liabilities	(36,848)	(41,573)
Other	(6,960)	(7,793)
Net cash provided by operating activities	831,080	422,380
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	970,752	1,421,976
Mortgage loans on real estate	185,406	215,904
Derivative instruments	750,345	15,859
Other investments	7,511	11,597
Acquisitions of investments:		
Fixed maturity securities - available for sale	(2,680,972)	(2,542,281)
Mortgage loans on real estate	(257,050)	(229,328)
Derivative instruments	(320,583)	(289,412)
Other investments	(6,950)	(6,945)
Purchases of property, furniture and equipment	(2,494)	(506)
Net cash used in investing activities	(1,354,035)	(1,403,136)

Table of Contents

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	\$2,243,180	\$4,181,709
Coinsurance deposits	30,938	(884,741)
Return of annuity policyholder account balances	(1,401,086)	(1,168,302)
Financing fees incurred and deferred	(5,823)	—
Proceeds from issuance of notes payable	499,650	—
Repayment of debt	(100,000)	—
Net proceeds from amounts due under repurchase agreements	61,673	—
Excess tax benefits realized from share-based compensation plans	—	441
Proceeds from issuance of common stock	4,618	3,779
Change in checks in excess of cash balance	(26,548)	(2,838)
Net cash provided by financing activities	1,306,602	2,130,048
Increase in cash and cash equivalents	783,647	1,149,292
Cash and cash equivalents at beginning of period	791,266	397,749
Cash and cash equivalents at end of period	\$1,574,913	\$1,547,041
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	\$22,739	\$19,390
Income taxes	71,526	29,961
Non-cash operating activity:		
Deferral of sales inducements	128,092	196,207
Non-cash financing activity:		
Common stock issued to settle warrants that have expired	—	93
See accompanying notes to unaudited consolidated financial statements.		

Table of Contents

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(Unaudited)

1. Significant Accounting Policies

Consolidation and Basis of Presentation

The accompanying consolidated financial statements of American Equity Investment Life Holding Company (“we”, “us” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ended December 31, 2017. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued an accounting standards update (“ASU”) related to the accounting for share-based payment transactions. The aspects of accounting guidance affected by this ASU are income taxes, classification of awards as either equity or liabilities, and classification on the statement of cash flows. We adopted this ASU on January 1, 2017. The adoption of this ASU resulted in an income tax benefit of \$0.3 million and \$1.6 million being recognized in operations during the three and six month periods ended June 30, 2017 due to the requirement under this standard to recognize excess tax benefits related to share-based payment awards in income tax expense.

New Accounting Pronouncements

In January 2016, the FASB issued an ASU that, among other aspects of recognition, measurement, presentation and disclosure of financial instruments, primarily requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Additionally, it changes the accounting for financial liabilities measured at fair value under the fair value option and eliminates some disclosures regarding fair value of financial assets and liabilities measured at amortized cost. This ASU will be effective for us on January 1, 2018, and we have not determined the effect it will have on our consolidated financial statements.

In February 2016, the FASB issued an ASU that will require recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU affects accounting and disclosure more dramatically for lessees as accounting for lessors is mainly unchanged. This ASU will be effective for us on January 1, 2019, with early adoption permitted, and we have not determined the effect it will have on our consolidated financial statements.

In June 2016, the FASB issued an ASU that significantly changes the impairment model for most financial assets that are measured at amortized cost and certain other instruments from an incurred loss model to an expected loss model that requires these assets be presented at the net amount expected to be collected. In addition, credit losses on available for sale debt securities should be recorded through an allowance account. This ASU will be effective for us on January 1, 2020, with early adoption permitted, and we have not yet determined the impact this updated guidance

will have on our consolidated financial statements.

In August 2016, the FASB issued an ASU that clarifies how certain cash receipts and cash payments are to be presented and classified in the statement of cash flows. This ASU will be effective for us on January 1, 2018, with early adoption permitted, and we have not yet determined the impact this updated guidance will have on our consolidated financial statements.

In March 2017, the FASB issued an ASU that applies to certain callable debt securities where the amortized cost basis is at a premium to the price repayable by the issuer at the earliest call date. Under this guidance, the premium will be amortized to the first call date. This ASU will be effective for us on January 1, 2019, with early adoption permitted, and we have not yet determined the impact this updated guidance will have on our consolidated financial statements.

Table of Contents

2. Fair Values of Financial Instruments

The following sets forth a comparison of the carrying amounts and fair values of our financial instruments:

	June 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(Dollars in thousands)				
Assets				
Fixed maturity securities:				
Available for sale	\$43,893,785	\$43,893,785	\$41,060,494	\$41,060,494
Held for investment	76,931	76,702	76,825	68,766
Mortgage loans on real estate	2,553,391	2,554,995	2,480,956	2,522,035
Derivative instruments	1,086,624	1,086,624	830,519	830,519
Other investments	314,421	305,551	308,774	300,918
Cash and cash equivalents	1,574,913	1,574,913	791,266	791,266
Coinsurance deposits	4,710,650	4,213,996	4,639,492	4,150,792
Interest rate caps	468	468	1,082	1,082
Counterparty collateral	144,283	144,283	145,693	145,693
Liabilities				
Policy benefit reserves	53,546,680	44,785,605	51,280,331	43,104,183
Single premium immediate annuity (SPIA) benefit reserves	286,856	296,948	297,724	308,028
Notes and loan payable	888,660	929,437	493,755	519,440
Subordinated debentures	242,045	245,190	241,853	225,106
Amounts due under repurchase agreements	61,673	61,673	—	—
Interest rate swap	2,001	2,001	2,113	2,113

Fair value is the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The objective of a fair value measurement is to determine that price for each financial instrument at each measurement date. We meet this objective using various methods of valuation that include market, income and cost approaches.

We categorize our financial instruments into three levels of fair value hierarchy based on the priority of inputs used in determining fair value. The hierarchy defines the highest priority inputs (Level 1) as quoted prices in active markets for identical assets or liabilities. The lowest priority inputs (Level 3) are our own assumptions about what a market participant would use in determining fair value such as estimated future cash flows. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. We categorize financial assets and liabilities recorded at fair value in the consolidated balance sheets as follows:

- Level 1— Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.
- Level 2— Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.
- Level 3— Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant

would use in determining fair value.

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security. There were no transfers between levels during any period presented.

9

Table of Contents

Our assets and liabilities which are measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)				
June 30, 2017				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$12,174	\$5,807	\$6,367	\$ —
United States Government sponsored agencies	1,340,839	—	1,340,839	—
United States municipalities, states and territories	4,137,714	—	4,137,714	—
Foreign government obligations	238,869	—	238,869	—
Corporate securities	29,287,071	6	29,287,065	—
Residential mortgage backed securities	1,181,850	—	1,181,850	—
Commercial mortgage backed securities	5,540,383	—	5,540,383	—
Other asset backed securities	2,154,885	—	2,154,885	—
Other investments: equity securities, available for sale	7,982	—	7,982	—
Derivative instruments	1,086,624	—	1,086,624	—
Cash and cash equivalents	1,574,913	1,574,913	—	—
Interest rate caps	468	—	468	—
Counterparty collateral	144,283	—	144,283	—
	\$46,708,055	\$1,580,726	\$45,127,329	\$ —
Liabilities				
Interest rate swap	\$2,001	\$ —	\$2,001	\$ —
Fixed index annuities - embedded derivatives	7,552,365	—	—	7,552,365
	\$7,554,366	\$ —	\$2,001	\$7,552,365
December 31, 2016				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$11,805	\$5,381	\$6,424	\$ —
United States Government sponsored agencies	1,344,787	—	1,344,787	—
United States municipalities, states and territories	3,926,950	—	3,926,950	—
Foreign government obligations	236,341	—	236,341	—
Corporate securities	27,114,418	6	27,114,412	—
Residential mortgage backed securities	1,254,835	—	1,254,835	—
Commercial mortgage backed securities	5,365,235	—	5,365,235	—
Other asset backed securities	1,806,123	—	1,806,123	—
Other investments: equity securities, available for sale	8,000	—	8,000	—
Derivative instruments	830,519	—	830,519	—
Cash and cash equivalents	791,266	791,266	—	—
Interest rate caps	1,082	—	1,082	—
Counterparty collateral	145,693	—	145,693	—
	\$42,837,054	\$796,653	\$42,040,401	\$ —

Liabilities

Interest rate swap	\$2,113	\$—	\$2,113	\$—
Fixed index annuities - embedded derivatives	6,563,288	—	—	6,563,288
	\$6,565,401	\$—	\$2,113	\$ 6,563,288

10

Table of Contents

The following methods and assumptions were used in estimating the fair values of financial instruments during the periods presented in these consolidated financial statements.

Fixed maturity securities and equity securities

The fair values of fixed maturity securities and equity securities in an active and orderly market are determined by utilizing independent pricing services. The independent pricing services incorporate a variety of observable market data in their valuation techniques, including:

- reported trading prices,
- benchmark yields,
- broker-dealer quotes,
- benchmark securities,
- bids and offers,
- credit ratings,
- relative credit information, and
- other reference data.

The independent pricing services also take into account perceived market movements and sector news, as well as a security's terms and conditions, including any features specific to that issue that may influence risk and marketability. Depending on the security, the priority of the use of observable market inputs may change as some observable market inputs may not be relevant or additional inputs may be necessary.

The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. When quoted market prices are not available, the third parties use yield data and other factors relating to instruments or securities with similar characteristics to determine fair value for securities that are not actively traded. We generally obtain one value from our primary external pricing service. In situations where a price is not available from this service, we may obtain quotes or prices from additional parties as needed. In addition, for our callable United States Government sponsored agencies, we obtain multiple broker quotes and take the average of the broker prices received. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of June 30, 2017 and December 31, 2016.

Mortgage loans on real estate

Mortgage loans on real estate are not measured at fair value on a recurring basis. The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using current competitive market interest rates currently being offered for similar loans. The fair values of impaired mortgage loans on real estate that we have considered to be collateral dependent are based on the fair value of the real estate collateral (based on appraised values) less estimated costs to sell. The inputs utilized to determine fair value of all mortgage loans are unobservable market data (competitive market interest rates); therefore, fair value of mortgage loans falls into Level 3 in the fair value hierarchy.

Derivative instruments

The fair values of derivative instruments, primarily call options, are based upon the amount of cash that we will receive to settle each derivative instrument on the reporting date. These amounts are determined by our investment team using industry accepted valuation models and are adjusted for the nonperformance risk of each counterparty net of any collateral held. Inputs include market volatility and risk free interest rates and are used in income valuation techniques in arriving at a fair value for each option contract. The nonperformance risk for each counterparty is based

upon its credit default swap rate. We have no performance obligations related to the call options purchased to fund our fixed index annuity policy liabilities.

Other investments

Available for sale equity securities are the only financial instruments included in other investments that are measured at fair value on a recurring basis (see determination of fair value above). Financial instruments included in other investments that are not measured at fair value on a recurring basis are policy loans, equity method investments and company owned life insurance (COLI). We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived. The fair value of our equity method investments qualify as Level 3 fair values and were determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread and a liquidity discount. The risk spread and liquidity discount are rates determined by our investment professionals and are unobservable market inputs. The fair value of our COLI approximates the cash surrender value of the policies and whose fair values fall within Level 2 of the fair value hierarchy.

Table of Contents

Cash and cash equivalents

Amounts reported in the consolidated balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.

Interest rate swap and caps

The fair values of our pay fixed/receive variable interest rate swap and our interest rate caps are obtained from third parties and are determined by discounting expected future cash flows using projected LIBOR rates for the term of the swap and caps.

Counterparty collateral

Amounts reported in other assets in the consolidated balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.

Policy benefit reserves, coinsurance deposits and SPIA benefit reserves

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. For period-certain annuity benefit contracts, the fair value is determined by discounting the benefits at the interest rates currently in effect for newly issued immediate annuity contracts. We are not required to and have not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value. Policy benefit reserves, coinsurance deposits and SPIA benefit reserves are not measured at fair value on a recurring basis. All of the fair values presented within these categories fall within Level 3 of the fair value hierarchy as most of the inputs are unobservable market data.

Notes and loan payable

The fair values of our senior unsecured notes are based upon pricing matrices developed by a third party pricing service when quoted market prices are not available and are categorized as Level 2 within the fair value hierarchy. The fair value of our term loan is estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rate, which reflects our credit rating, for a similar type of borrowing with a maturity consistent with that remaining for the term loan. Notes and loan payable are not remeasured at fair value on a recurring basis.

Subordinated debentures

Fair values for subordinated debentures are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued. These fair values are categorized as Level 2 within the fair value hierarchy. Subordinated debentures are not measured at fair value on a recurring basis.

Amounts due under repurchase agreements

The amounts reported in the consolidated balance sheets for short term indebtedness under repurchase agreements with variable interest rates approximate their fair values.

Fixed index annuities - embedded derivatives

We estimate the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves at each valuation date by (i) projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and (ii) discounting the excess of the projected contract value amounts at the applicable risk free interest rates adjusted for our nonperformance risk related to those liabilities. The projections of policy contract values are based on our best estimate assumptions for future policy growth and future policy decrements. Our best estimate assumptions for future policy growth include assumptions for the expected index credit on the next policy anniversary date which are derived from the fair values of the underlying call options purchased to fund such index credits and the expected costs of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

Within this determination we have the following significant unobservable inputs: 1) the expected cost of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary and 2) our best estimates for future policy decrements, primarily lapse, partial withdrawal and mortality rates. As of June 30, 2017 and December 31, 2016, we utilized an estimate of 3.10% for the expected cost of annual call options, which are based on estimated long-term account value growth and a historical review of our actual option costs.

Table of Contents

Our best estimate assumptions for lapse, partial withdrawal and mortality rates are based on our actual experience and our outlook as to future expectations for such assumptions. These assumptions, which are consistent with the assumptions used in calculating deferred policy acquisition costs and deferred sales inducements, are reviewed on a quarterly basis and are revised as our experience develops and/or as future expectations change. Our mortality rate assumptions are based on 65% of the 1983 Basic Annuity Mortality Tables. The following table presents average lapse rate and partial withdrawal rate assumptions, by contract duration, used in estimating the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves at each reporting date:

Contract Duration (Years)	Average Lapse Rates		Average Partial Withdrawal Rates	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
1 - 5	1.95%	1.76%	3.31%	3.30%
6 - 10	6.85%	6.58%	3.32%	3.30%
11 - 15	11.28%	11.25%	3.33%	3.32%
16 - 20	11.99%	12.04%	3.19%	3.18%
20+	11.65%	11.68%	3.19%	3.18%

Lapse rates are generally expected to increase as surrender charge percentages decrease. Lapse expectations reflect a significant increase in the year in which the surrender charge period on a contract ends.

The following table provides a reconciliation of the beginning and ending balances for our Level 3 liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives				
Beginning balance	\$7,051,000	\$6,254,466	\$6,563,288	\$5,983,622
Premiums less benefits	497,689	44,632	909,191	135,761
Change in fair value, net	3,676	199,917	79,886	379,632
Ending balance	\$7,552,365	\$6,499,015	\$7,552,365	\$6,499,015

Change in fair value, net for each period in our embedded derivatives are included in change in fair value of embedded derivatives in the unaudited consolidated statements of operations.

Certain derivatives embedded in our fixed index annuity contracts are our most significant financial instrument measured at fair value that are categorized as Level 3 in the fair value hierarchy. The contractual obligations for future annual index credits within our fixed index annuity contracts are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We estimate the fair value of these embedded derivatives at each valuation date by the method described above under fixed index annuities - embedded derivatives. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at June 30, 2017, were to increase by 100 basis points, the fair value of the embedded derivatives would decrease by \$510.7 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of \$307.0 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as an increase in amortization of deferred policy acquisition costs and deferred sales inducements. A decrease by 100 basis points in the discount rate used to discount the excess projected contract values would increase the fair value of the embedded derivatives by \$570.3 million recorded through operations as an increase in the change in fair value of embedded derivatives and there would be a corresponding increase of \$337.7 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.

Table of Contents

3. Investments

At June 30, 2017 and December 31, 2016, the amortized cost and fair value of fixed maturity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(Dollars in thousands)				
June 30, 2017				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$12,114	\$228	\$(168)	\$12,174
United States Government sponsored agencies	1,348,391	30,288	(37,840)	1,340,839
United States municipalities, states and territories	3,777,760	369,526	(9,572)	4,137,714
Foreign government obligations	228,896	12,462	(2,489)	238,869
Corporate securities	27,813,420	1,656,805	(183,154)	29,287,071
Residential mortgage backed securities	1,090,846	93,316	(2,312)	1,181,850
Commercial mortgage backed securities	5,519,767	89,865	(69,249)	5,540,383
Other asset backed securities	2,116,550	51,796	(13,461)	2,154,885
	\$41,907,744	\$2,304,286	\$(318,245)	\$43,893,785
Held for investment:				
Corporate security	\$76,931	\$—	\$(229)	\$76,702
Other investments: equity securities, available for sale:				
Finance, insurance, and real estate	\$7,525	\$457	\$—	\$7,982
December 31, 2016				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$11,864	\$229	\$(288)	\$11,805
United States Government sponsored agencies	1,368,340	23,360	(46,913)	1,344,787
United States municipalities, states and territories	3,626,395	322,948	(22,393)	3,926,950
Foreign government obligations	229,589	11,832	(5,080)	236,341
Corporate securities	26,333,213	1,149,978	(368,773)	27,114,418
Residential mortgage backed securities	1,166,944	91,445	(3,554)	1,254,835
Commercial mortgage backed securities	5,422,255	59,994	(117,014)	5,365,235
Other asset backed securities	1,795,355	31,471	(20,703)	1,806,123
	\$39,953,955	\$1,691,257	\$(584,718)	\$41,060,494
Held for investment:				
Corporate security	\$76,825	\$—	\$(8,059)	\$68,766
Other investments: equity securities, available for sale:				
Finance, insurance, and real estate	\$7,521	\$479	\$—	\$8,000

At June 30, 2017, 37% of our fixed income securities have call features, of which 2.1% (\$899.1 million) were subject to call redemption and another 1.0% (\$409.5 million) will become subject to call redemption during the next twelve months. Approximately 72% of our fixed income securities that have call features are not callable until within six months of their stated maturities.

Table of Contents

The amortized cost and fair value of fixed maturity securities at June 30, 2017, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives and are shown below as separate lines.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	\$287,042	\$294,085	\$—	\$—
Due after one year through five years	3,482,397	3,645,145	—	—
Due after five years through ten years	11,828,053	12,116,887	—	—
Due after ten years through twenty years	8,981,750	9,715,165	—	—
Due after twenty years	8,601,339	9,245,385	76,931	76,702
	33,180,581	35,016,667	76,931	76,702
Residential mortgage backed securities	1,090,846	1,181,850	—	—
Commercial mortgage backed securities	5,519,767	5,540,383	—	—
Other asset backed securities	2,116,550	2,154,885	—	—
	\$41,907,744	\$43,893,785	\$76,931	\$76,702

Net unrealized gains on available for sale fixed maturity securities and equity securities reported as a separate component of stockholders' equity were comprised of the following:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	\$1,986,498	\$1,107,018
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(1,082,516)	(618,661)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax expense	(316,394)	(170,925)
Net unrealized gains reported as accumulated other comprehensive income	\$610,122	\$339,966

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade.” Based on the NAIC designations, we had 97% of our fixed maturity portfolio rated investment grade at both June 30, 2017 and December 31, 2016, respectively.

The following table summarizes the credit quality, as determined by NAIC designation, of our fixed maturity portfolio as of the dates indicated:

NAIC Designation	June 30, 2017		December 31, 2016	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	\$26,718,443	\$28,144,706	\$25,607,268	\$26,507,798
2	13,907,192	14,499,548	13,037,592	13,295,648
3	1,229,695	1,207,581	1,201,059	1,155,702
4	97,349	89,144	154,226	137,188
5	19,559	20,698	17,475	24,664
6	12,437	8,810	13,160	8,260

\$41,984,675 \$43,970,487 \$40,030,780 \$41,129,260

Table of Contents

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 956 and 1,514 securities, respectively) have been in a continuous unrealized loss position, at June 30, 2017 and December 31, 2016:

	Less than 12 months		12 months or more		Total	Unrealized
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Losses
	(Dollars in thousands)					
June 30, 2017						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	\$6,867	\$(168)	\$—	\$—	\$6,867	\$(168)
United States Government sponsored agencies	945,126	(35,343)	49,503	(2,497)	994,629	(37,840)
United States municipalities, states and territories	273,302	(9,572)	—	—	273,302	(9,572)
Foreign government obligations	—	—	11,844	(2,489)	11,844	(2,489)
Corporate securities:						
Finance, insurance and real estate	1,132,134	(37,599)	86,335	(1,495)	1,218,469	(39,094)
Manufacturing, construction and mining	458,458	(9,156)	200,709	(13,648)	659,167	(22,804)
Utilities and related sectors	523,863	(14,319)	43,553	(2,612)	567,416	(16,931)
Wholesale/retail trade	282,589	(9,583)	42,120	(4,812)	324,709	(14,395)
Services, media and other	1,156,695	(33,573)	619,260	(56,357)	1,775,955	(89,930)
Residential mortgage backed securities	40,684	(1,631)	8,036	(681)	48,720	(2,312)
Commercial mortgage backed securities	1,924,949	(44,461)	439,081	(24,788)	2,364,030	(69,249)
Other asset backed securities	528,570	(6,387)	65,296	(7,074)	593,866	(13,461)
	\$7,273,237	\$(201,792)	\$1,565,737	\$(116,453)	\$8,838,974	\$(318,245)
Held for investment:						
Corporate security:						
Insurance	\$—	\$—	\$76,702	\$(229)	\$76,702	\$(229)
December 31, 2016						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	\$7,405	\$(288)	\$—	\$—	\$7,405	\$(288)
United States Government sponsored agencies	995,548	(46,913)	—	—	995,548	(46,913)
United States municipalities, states and territories	463,409	(22,393)	—	—	463,409	(22,393)
Foreign government obligations	29,158	(913)	20,388	(4,167)	49,546	(5,080)
Corporate securities:						
Finance, insurance and real estate	1,940,107	(70,421)	82,907	(7,723)	2,023,014	(78,144)
Manufacturing, construction and mining	1,199,420	(34,304)	311,591	(23,273)	1,511,011	(57,577)
Utilities and related sectors	1,401,650	(45,015)	58,597	(5,820)	1,460,247	(50,835)
Wholesale/retail trade	637,121	(18,880)	29,719	(1,930)	666,840	(20,810)
Services, media and other	2,539,519	(82,196)	716,857	(79,211)	3,256,376	(161,407)
Residential mortgage backed securities	81,762	(3,463)	1,853	(91)	83,615	(3,554)
Commercial mortgage backed securities	3,148,395	(116,938)	895	(76)	3,149,290	(117,014)

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Other asset backed securities	751,533	(12,289)	146,167	(8,414)	897,700	(20,703)
	\$13,195,027	\$(454,013)	\$1,368,974	\$(130,705)	\$14,564,001	\$(584,718)

Held for investment:

Corporate security:

Insurance	\$—	\$—	\$68,766	\$(8,059)	\$68,766	\$(8,059)
-----------	-----	-----	----------	------------	----------	------------

Based on the results of our process for evaluating available for sale securities in unrealized loss positions for other than temporary impairments, which is discussed in detail later in this footnote, we have determined that the unrealized losses on the securities in the preceding table are temporary. The unrealized losses at June 30, 2017 are principally related to timing of the purchases of these securities, which carry less yield than those available at June 30, 2017.

Table of Contents

Approximately 81% and 86% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2017 and December 31, 2016, respectively, are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized gains on investments for the three and six months ended June 30, 2017 and 2016 are as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	2017	2016	2017	2016
	(Dollars in thousands)			
Fixed maturity securities held for investment carried at amortized cost	\$9,806	\$820	\$7,830	\$3,065
Investments carried at fair value:				
Fixed maturity securities, available for sale	\$598,408	\$1,167,861	\$879,502	\$2,282,946
Equity securities, available for sale	(9)	(1)	(22)	(18)
	598,399	1,167,860	879,480	2,282,928
Adjustment for effect on other balance sheet accounts:				
Deferred policy acquisition costs and deferred sales inducements	(312,893)	(609,224)	(463,855)	(1,218,975)
Deferred income tax asset/liability	(99,927)	(195,523)	(145,469)	(372,384)
	(412,820)	(804,747)	(609,324)	(1,591,359)
Change in net unrealized gains on investments carried at fair value	\$185,579	\$363,113	\$270,156	\$691,569

Proceeds from sales of available for sale securities for the six months ended June 30, 2017 and 2016 were \$376.9 million and \$186.1 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the six months ended June 30, 2017 and 2016 were \$593.8 million and \$1.2 billion, respectively. Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Net realized gains on investments, excluding net OTTI losses for the three and six months ended June 30, 2017 and 2016, are as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	2017	2016	2017	2016
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	\$4,479	\$4,604	\$10,051	\$6,091
Gross realized losses	(899)	(1,368)	(4,462)	(2,599)
	3,580	3,236	5,589	3,492
Other investments:				
Gain on sale of real estate	15	705	44	836
Loss on sale of real estate	—	(1)	—	(93)
	15	704	44	743
Mortgage loans on real estate:				
Decrease (increase) in allowance for credit losses	278	(2,885)	578	(3,833)
Recovery of specific allowance	—	1,682	—	5,022
	278	(1,203)	578	1,189
	\$3,873	\$2,737	\$6,211	\$5,424

Losses on available for sale fixed maturity securities were realized primarily due to strategies to reposition the fixed maturity security portfolio that result in improved net investment income, credit risk or duration profiles as they pertain to our asset liability management. Securities were sold at losses in 2017 and 2016 due to our long-term fundamental concern with the issuers' ability to meet their future financial obligations.

We review and analyze all investments on an ongoing basis for changes in market interest rates and credit deterioration. This review process includes analyzing our ability to recover the amortized cost basis of each investment that has a fair value that is materially lower than its amortized cost and requires a high degree of management judgment and involves uncertainty. The evaluation of securities for other than temporary impairments is a quantitative and qualitative process, which is subject to risks and uncertainties.

We have a policy and process to identify securities that could potentially have impairments that are other than temporary. This process involves monitoring market events and other items that could impact issuers. The evaluation includes but is not limited to such factors as:

- the length of time and the extent to which the fair value has been less than amortized cost or cost;
- whether the issuer is current on all payments and all contractual payments have been made as agreed;
- the remaining payment terms and the financial condition and near-term prospects of the issuer;

Table of Contents

- the lack of ability to refinance due to liquidity problems in the credit market;
- the fair value of any underlying collateral;
- the existence of any credit protection available;
- our intent to sell and whether it is more likely than not we would be required to sell prior to recovery for debt securities;
- our assessment in the case of equity securities including perpetual preferred stocks with credit deterioration that the security cannot recover to cost in a reasonable period of time;
- our intent and ability to retain equity securities for a period of time sufficient to allow for recovery;
- consideration of rating agency actions; and
- changes in estimated cash flows of mortgage and asset backed securities.

We determine whether other than temporary impairment losses should be recognized for debt and equity securities by assessing all facts and circumstances surrounding each security. Where the decline in fair value of debt securities is attributable to changes in market interest rates or to factors such as market volatility, liquidity and spread widening, and we anticipate recovery of all contractual or expected cash flows, we do not consider these investments to be other than temporarily impaired because we do not intend to sell these investments and it is not more likely than not we will be required to sell these investments before a recovery of amortized cost, which may be maturity. For equity securities, we recognize an impairment charge in the period in which we do not have the intent and ability to hold the securities until recovery of cost or we determine that the security will not recover to book value within a reasonable period of time. We determine what constitutes a reasonable period of time on a security-by-security basis by considering all the evidence available to us, including the magnitude of any unrealized loss and its duration.

Other than temporary impairment losses on equity securities are recognized in operations. If we intend to sell a debt security or if it is more likely than not that we will be required to sell a debt security before recovery of its amortized cost basis, other than temporary impairment has occurred and the difference between amortized cost and fair value will be recognized as a loss in operations.

If we do not intend to sell and it is not more likely than not we will be required to sell the debt security but also do not expect to recover the entire amortized cost basis of the security, an impairment loss would be recognized in operations in the amount of the expected credit loss. We determine the amount of expected credit loss by calculating the present value of the cash flows expected to be collected discounted at each security's acquisition yield based on our consideration of whether the security was of high credit quality at the time of acquisition. The difference between the present value of expected future cash flows and the amortized cost basis of the security is the amount of credit loss recognized in operations. The remaining amount of the other than temporary impairment is recognized in other comprehensive income (loss).

The determination of the credit loss component of a mortgage backed security is based on a number of factors. The primary consideration in this evaluation process is the issuer's ability to meet current and future interest and principal payments as contractually stated at time of purchase. Our review of these securities includes an analysis of the cash flow modeling under various default scenarios considering independent third party benchmarks, the seniority of the specific tranche within the structure of the security, the composition of the collateral and the actual default, loss severity and prepayment experience exhibited. With the input of third party assumptions for default projections, loss severity and prepayment expectations, we evaluate the cash flow projections to determine whether the security is performing in accordance with its contractual obligation.

We utilize the models from a leading structured product software specialist serving institutional investors. These models incorporate each security's seniority and cash flow structure. In circumstances where the analysis implies a potential for principal loss at some point in the future, we use the "best estimate" cash flow projection discounted at the security's effective yield at acquisition to determine the amount of our potential credit loss associated with this security. The discounted expected future cash flows equates to our expected recovery value. Any shortfall of the expected recovery when compared to the amortized cost of the security will be recorded as the credit loss component of other than temporary impairment.

The cash flow modeling is performed on a security-by-security basis and incorporates actual cash flows on the residential mortgage backed securities through the current period, as well as the projection of remaining cash flows using a number of assumptions including default rates, prepayment rates and loss severity rates. The default curves we use are tailored to the Prime or Alt-A residential mortgage backed securities that we own, which assume lower default rates and loss severity for Prime securities versus Alt-A securities. These default curves are scaled higher or lower depending on factors such as current underlying mortgage loan performance, rating agency loss projections, loan to value ratios, geographic diversity, as well as other appropriate considerations.

Table of Contents

The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the six months ended June 30, 2017 and 2016, which are all senior level tranches within the structure of the securities:

Sector	Vintage	Discount Rate		Default Rate		Loss Severity	
		Min	Max	Min	Max	Min	Max
Six months ended June 30, 2017							
Prime	2005	7.5%	7.7%	8%	16%	45%	50%
	2007	6.2%	6.6%	15%	19%	50%	60%
Six months ended June 30, 2016							
Prime	2005	7.7%	7.7%	14%	14%	50%	50%
	2006	7.3%	7.3%	13%	13%	50%	50%
	2007	6.2%	6.4%	18%	31%	50%	55%
Alt-A	2005	7.4%	7.4%	11%	11%	60%	60%

The determination of the credit loss component of a corporate bond (including redeemable preferred stocks) is based on the underlying financial performance of the issuer and their ability to meet their contractual obligations.

Considerations in our evaluation include, but are not limited to, credit rating changes, financial statement and ratio analysis, changes in management, significant changes in credit spreads, breaches of financial covenants and a review of the economic outlook for the industry and markets in which they trade. In circumstances where an issuer appears unlikely to meet its future obligation, or the security's price decline is deemed other than temporary, an estimate of credit loss is determined. Credit loss is calculated using default probabilities as derived from the credit default swaps markets in conjunction with recovery rates derived from independent third party analysis or a best estimate of credit loss. This credit loss rate is then incorporated into a present value calculation based on an expected principal loss in the future discounted at the yield at the date of purchase and compared to amortized cost to determine the amount of credit loss associated with the security.

In addition, for debt securities which we do not intend to sell and it is not more likely than not we will be required to sell, but our intent changes due to changes or events that could not have been reasonably anticipated, an other than temporary impairment charge is recognized. Once an impairment charge has been recorded, we then continue to review the other than temporarily impaired securities for appropriate valuation on an ongoing basis. Unrealized losses may be recognized in future periods through a charge to earnings should we later conclude that the decline in fair value below amortized cost is other than temporary pursuant to our accounting policy described above. The use of different methodologies and assumptions to determine the fair value of investments and the timing and amount of impairments may have a material effect on the amounts presented in our consolidated financial statements.

Table of Contents

The following table summarizes other than temporary impairments for the three and six months ended June 30, 2017 and 2016, by asset type:

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized in (from) Other Comprehensive Income	Net OTTI Losses Recognized in Operations
(Dollars in thousands)				
Three months ended June 30, 2017				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	2	\$—	\$ (662)	\$ (662)
Other asset backed securities	1	—	(287)	(287)
	3	\$—	\$ (949)	\$ (949)
Three months ended June 30, 2016				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	2	\$—	\$ (202)	\$ (202)
Commercial mortgage backed securities	2	(762)	—	(762)
Other asset backed securities	1	—	(3,482)	(3,482)
	5	\$(762)	\$ (3,684)	\$ (4,446)
Six months ended June 30, 2017				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	5	\$—	\$ (803)	\$ (803)
Other asset backed securities	1	—	(287)	(287)
	6	\$—	\$ (1,090)	\$ (1,090)
Six months ended June 30, 2016				
Fixed maturity securities, available for sale:				
Corporate securities:				
Energy	2	\$(642)	\$ —	\$ (642)
Telecommunications	1	(4,462)	562	(3,900)
Utilities	1	(136)	—	(136)
Residential mortgage backed securities	6	—	(440)	(440)
Commercial mortgage backed securities	5	(1,540)	—	(1,540)
Other asset backed securities	1	—	(3,482)	(3,482)
	16	\$(6,780)	\$ (3,360)	\$ (10,140)

The cumulative portion of other than temporary impairments determined to be credit losses which have been recognized in operations for debt securities are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Cumulative credit loss at beginning of period	\$(152,577)	\$(151,518)	\$(166,375)	\$(145,824)
Credit losses on securities for which OTTI has not previously been recognized	—	(762)	—	(6,218)
	(949)	(3,684)	(1,090)	(3,922)

Additional credit losses on securities for which OTTI has previously been recognized

Accumulated losses on securities that were disposed of during the period	—	1,556	13,939	1,556
Cumulative credit loss at end of period	\$(153,526)	\$(154,408)	\$(153,526)	\$(154,408)

20

Table of Contents

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security, for securities that are part of our investment portfolio at June 30, 2017 and December 31, 2016:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
(Dollars in thousands)				
June 30, 2017				
Fixed maturity securities, available for sale:				
Corporate securities	\$ 10,502	\$ (4,263)	\$ 9,231	\$ 15,470
Residential mortgage backed securities	327,388	(169,137)	204,438	362,689
Other asset backed securities	4,567	(1,356)	(1,778)	1,433
	\$ 342,457	\$ (174,756)	\$ 211,891	\$ 379,592
December 31, 2016				
Fixed maturity securities, available for sale:				
Corporate securities	\$ 17,549	\$ (5,910)	\$ 13,566	\$ 25,205
Residential mortgage backed securities	368,862	(169,941)	205,854	404,775
Commercial mortgage backed securities	6,596	—	(107)	6,489
Other asset backed securities	6,683	(1,643)	(1,566)	3,474
	\$ 399,690	\$ (177,494)	\$ 217,747	\$ 439,943

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio is summarized in the following table. There were commitments outstanding of \$46.9 million at June 30, 2017.

	June 30, 2017	December 31, 2016
(Dollars in thousands)		
Principal outstanding	\$ 2,562,449	\$ 2,490,619
Loan loss allowance	(7,849)	(8,427)
Deferred prepayment fees	(1,209)	(1,236)
Carrying value	\$ 2,553,391	\$ 2,480,956

Table of Contents

The portfolio consists of commercial mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	June 30, 2017		December 31, 2016	
	Principal	Percent	Principal	Percent
	(Dollars in thousands)			
Geographic distribution				
East	\$596,587	23.3 %	\$635,434	25.5 %
Middle Atlantic	155,234	6.1 %	151,640	6.1 %
Mountain	302,764	11.8 %	235,932	9.5 %
New England	12,496	0.5 %	12,724	0.5 %
Pacific	423,086	16.5 %	385,683	15.5 %
South Atlantic	542,146	21.2 %	519,065	20.8 %
West North Central	311,126	12.1 %	325,447	13.1 %
West South Central	219,010	8.5 %	224,694	9.0 %
	\$2,562,449	100.0 %	\$2,490,619	100.0 %
Property type distribution				
Office	\$291,118	11.4 %	\$308,578	12.4 %
Medical Office	35,248	1.4 %	50,780	2.1 %
Retail	989,810	38.6 %	886,942	35.6 %
Industrial/Warehouse	691,630	27.0 %	700,644	28.1 %
Apartment	377,170	14.7 %	375,837	15.1 %
Mixed use/other	177,473	6.9 %	167,838	6.7 %
	\$2,562,449	100.0 %	\$2,490,619	100.0 %

Our financing receivables currently consist of one portfolio segment which is our commercial mortgage loan portfolio. These are mortgage loans with collateral consisting of commercial real estate and borrowers consisting mostly of limited liability partnerships or limited liability corporations.

We evaluate our mortgage loan portfolio for the establishment of a loan loss allowance by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. A mortgage loan is impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. If we determine that the value of any specific mortgage loan is impaired, the carrying amount of the mortgage loan will be reduced to its fair value, based upon the present value of expected future cash flows from the loan discounted at the loan's effective interest rate, or the fair value of the underlying collateral less estimated costs to sell.

In addition, we analyze the mortgage loan portfolio for the need of a general loan allowance for probable losses on all other loans on a quantitative and qualitative basis. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions.

We rate each of the mortgage loans in our portfolio based on factors such as historical operating performance, loan to value ratio and economic outlook, among others. We calculate a loss factor to apply to each rating based on historical losses we have recognized in our mortgage loan portfolio. We apply the loss factors to the total principal outstanding within each rating category to determine an appropriate estimate of the general loan loss allowance. We also assess the portfolio qualitatively and apply a loss rate to all loans without a specific allowance based on management's assessment of economic conditions, and we apply an additional amount of loss allowance to a group of loans that we have identified as having higher risk of loss.

Table of Contents

The following table presents a rollforward of our specific and general valuation allowances for mortgage loans on real estate:

	Three Months Ended June 30, 2017		Three Months Ended June 30, 2016	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	\$(1,327)	\$(6,800)	\$(5,750)	\$(6,000)
Charge-offs	—	—	2,101	—
Recoveries	—	—	1,682	—
Change in provision for credit losses	(722)	1,000	(2,585)	(300)
Ending allowance balance	\$(2,049)	\$(5,800)	\$(4,552)	\$(6,300)

	Six Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	\$(1,327)	\$(7,100)	\$(7,842)	\$(6,300)
Charge-offs	—	—	2,101	—
Recoveries	—	—	5,022	—
Change in provision for credit losses	(722)	1,300	(3,833)	—
Ending allowance balance	\$(2,049)	\$(5,800)	\$(4,552)	\$(6,300)

The specific allowance represents the total credit loss allowances on loans which are individually evaluated for impairment. The general allowance is for the group of loans discussed above which are collectively evaluated for impairment. The following table presents the total outstanding principal of loans evaluated for impairment by basis of impairment method:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Individually evaluated for impairment	\$6,773	\$4,640
Collectively evaluated for impairment	2,555,676	2,485,979
Total loans evaluated for impairment	\$2,562,449	\$2,490,619

Charge-offs include allowances that have been established on loans that were satisfied either by taking ownership of the collateral or by some other means such as discounted pay-off or loan sale. When ownership of the property is taken it is recorded at the lower of the mortgage loan's carrying value or the property's fair value (based on appraised values) less estimated costs to sell. The real estate owned is recorded as a component of other investments and the mortgage loan is recorded as fully paid, with any allowance for credit loss that has been established charged off. Fair value of the real estate is determined by third party appraisal. Recoveries are situations where we have received a payment from the borrower in an amount greater than the carrying value of the loan (principal outstanding less specific allowance).

We did not own any real estate during the three and six months ended June 30, 2017. The following table summarizes the activity in real estate owned, included in Other investments, which was obtained in satisfaction of mortgage loans on real estate during the three and six months ended June 30, 2016:

	Three Months Ended June 30,	Six Months Ended June 30,

	2016	2016
	(Dollars in thousands)	
Real estate owned at beginning of period	\$5,356	\$6,485
Real estate acquired in satisfaction of mortgage loans	—	—
Additions	—	—
Sales	(5,338)	(6,444)
Impairments	—	—
Depreciation	(18)	(41)
Real estate owned at end of period	\$—	\$—

Table of Contents

We analyze credit risk of our mortgage loans by analyzing all available evidence on loans that are delinquent and loans that are in a workout period.

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Credit Exposure--By Payment Activity		
Performing	\$2,558,711	\$ 2,489,028
In workout	1,516	1,591
Delinquent	—	—
Collateral dependent	2,222	—
	\$2,562,449	\$ 2,490,619

The loans that are categorized as "in workout" consist of loans that we have agreed to lower or no mortgage payments for a period of time while the borrowers address cash flow and/or operational issues. The key features of these workouts have been determined on a loan-by-loan basis. Most of these loans are in a period of low cash flow due to tenants vacating their space or tenants requesting rent relief during difficult economic periods. Generally, we have allowed the borrower a six month interest only period and in some cases a twelve month period of interest only. Interest only workout loans are expected to return to their regular debt service payments after the interest only period. Interest only loans that are not fully amortizing will have a larger balance at their balloon date than originally contracted. Fully amortizing loans that are in interest only periods will have larger debt service payments for their remaining term due to lost principal payments during the interest only period. In limited circumstances we have allowed borrowers to pay the principal portion of their loan payment into an escrow account that can be used for capital and tenant improvements for a period of not more than twelve months. In these situations new loan amortization schedules are calculated based on the principal not collected during this twelve month workout period and larger payments are collected for the remaining term of each loan. In all cases, the original interest rate and maturity date have not been modified, and we have not forgiven any principal amounts.

Mortgage loans are considered delinquent when they become 60 days or more past due. In general, when loans become 90 days past due, become collateral dependent or enter a period with no debt service payments required we place them on non-accrual status and discontinue recognizing interest income. If payments are received on a delinquent loan, interest income is recognized to the extent it would have been recognized if normal principal and interest would have been received timely. If payments are received to bring a delinquent loan back to current we will resume accruing interest income on that loan. Outstanding principal of loans in non-accrual status at June 30, 2017 totaled \$2.2 million. There were no loans in non-accrual status at December 31, 2016.

We define collateral dependent loans as those mortgage loans for which we will depend on the value of the collateral real estate to satisfy the outstanding principal of the loan.

All of our commercial mortgage loans depend on the cash flow of the borrower to be at a sufficient level to service the principal and interest payments as they come due. In general, cash inflows of the borrowers are generated by collecting monthly rent from tenants occupying space within the borrowers' properties. Our borrowers face collateral risks such as tenants going out of business, tenants struggling to make rent payments as they become due, and tenants canceling leases and moving to other locations. We have a number of loans where the real estate is occupied by a single tenant. Our borrowers sometimes face both a reduction in cash flow on their mortgage property as well as a reduction in the fair value of the real estate collateral. If borrowers are unable to replace lost rent revenue and increases in the fair value of their property do not materialize, we could potentially incur more losses than what we have allowed for in our specific and general loan loss allowances.

Aging of financing receivables is summarized in the following table, with loans in a "workout" period as of the reporting date considered current if payments are current in accordance with agreed upon terms:

30 - 59 Days	60 - 89 Days	90 Days and Over	Total Past Due	Current	Collateral Dependent Receivables	Total Financing Receivables
-----------------	--------------------	---------------------------	----------------------	---------	--	-----------------------------------

(Dollars in thousands)

Commercial Mortgage Loans

June 30, 2017	\$—	\$	—\$	—\$—	\$2,560,227	\$ 2,222	\$ 2,562,449
December 31, 2016	\$2,737	\$	—\$	—\$2,737	\$2,487,882	\$ —	\$ 2,490,619

24

Table of Contents

Financing receivables summarized in the following two tables represent all loans that we are either not currently collecting, or those we feel it is probable we will not collect all amounts due according to the contractual terms of the loan agreements (all loans that we have worked with the borrower to alleviate short-term cash flow issues, loans delinquent for 60 days or more at the reporting date, loans we have determined to be collateral dependent and loans that we have recorded specific impairments on that we feel may continue to have performance issues).

	Recorded Investment	Unpaid Principal Balance	Related Allowance
(Dollars in thousands)			
June 30, 2017			
Mortgage loans with an allowance	\$4,724	\$ 6,773	\$ (2,049)
Mortgage loans with no related allowance	1,516	1,516	—
	\$6,240	\$ 8,289	\$ (2,049)

December 31, 2016			
Mortgage loans with an allowance	\$3,313	\$ 4,640	\$ (1,327)
Mortgage loans with no related allowance	1,591	1,591	—
	\$4,904	\$ 6,231	\$ (1,327)

	Average Recorded Investment	Interest Income Recognized
(Dollars in thousands)		
Three months ended June 30, 2017		
Mortgage loans with an allowance	\$5,107	\$ 104
Mortgage loans with no related allowance	1,535	23
	\$6,642	\$ 127
Three months ended June 30, 2016		
Mortgage loans with an allowance	\$6,921	\$ 164
Mortgage loans with no related allowance	4,737	74
	\$11,658	\$ 238
Six months ended June 30, 2017		
Mortgage loans with an allowance	\$5,135	\$ 207
Mortgage loans with no related allowance	1,553	46
	\$6,688	\$ 253
Six months ended June 30, 2016		
Mortgage loans with an allowance	\$7,166	\$ 329
Mortgage loans with no related allowance	4,793	150
	\$11,959	\$ 479

Three months ended June 30, 2017

Mortgage loans with an allowance	\$5,107	\$ 104
Mortgage loans with no related allowance	1,535	23
	\$6,642	\$ 127

Three months ended June 30, 2016

Mortgage loans with an allowance	\$6,921	\$ 164
Mortgage loans with no related allowance	4,737	74
	\$11,658	\$ 238

Six months ended June 30, 2017

Mortgage loans with an allowance	\$5,135	\$ 207
Mortgage loans with no related allowance	1,553	46
	\$6,688	\$ 253

Six months ended June 30, 2016

Mortgage loans with an allowance	\$7,166	\$ 329
Mortgage loans with no related allowance	4,793	150
	\$11,959	\$ 479

A Troubled Debt Restructuring ("TDR") is a situation where we have granted a concession to a borrower for economic or legal reasons related to the borrower's financial difficulties that we would not otherwise consider. A mortgage loan that has been granted new terms, including workout terms as described previously, would be considered a TDR if it meets conditions that would indicate a borrower is experiencing financial difficulty and the new terms constitute a concession on our part. We analyze all loans where we have agreed to workout terms and all loans that we have refinanced to determine if they meet the definition of a TDR. We consider the following factors in determining whether or not a borrower is experiencing financial difficulty:

- borrower is in default,
- borrower has declared bankruptcy,
- there is growing concern about the borrower's ability to continue as a going concern,
-

borrower has insufficient cash flows to service
debt,
borrower's inability to obtain funds from other sources, and
there is a breach of financial covenants by the borrower.

25

Table of Contents

If the borrower is determined to be in financial difficulty, we consider the following conditions to determine if the borrower was granted a concession:

- assets used to satisfy debt are less than our recorded investment,
- interest rate is modified,
- maturity date extension at an interest rate less than market rate,
- capitalization of interest,
- delaying principal and/or interest for a period of three months or more, and
- partial forgiveness of the balance or charge-off.

Mortgage loan workouts, refinances or restructures that are classified as TDRs are individually evaluated and measured for impairment. A summary of mortgage loans on commercial real estate with outstanding principal at June 30, 2017 and December 31, 2016 that we determined to be TDRs are as follows:

Geographic Region	Number of TDRs	Principal Balance Outstanding (Dollars in thousands)	Specific Loan Allowance (Dollars in thousands)	Net Carrying Amount
June 30, 2017				
South Atlantic	1	\$2,978	\$ —	\$ 2,978
East North Central	1	1,977	(467)	1,510
	2	\$4,955	\$ (467)	\$ 4,488
December 31, 2016				
South Atlantic	1	\$3,004	\$ —	\$ 3,004
East North Central	1	2,020	(467)	1,553
	2	\$5,024	\$ (467)	\$ 4,557

5. Derivative Instruments

None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the consolidated balance sheets are as follows:

	June 30, 2017	December 31, 2016
(Dollars in thousands)		
Assets		
Derivative instruments		
Call options	\$ 1,086,624	\$ 830,519
Other assets		
Interest rate caps	468	1,082
	\$ 1,087,092	\$ 831,601
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	\$ 7,552,365	\$ 6,563,288
Other liabilities		
Interest rate swap	2,001	2,113
	\$ 7,554,366	\$ 6,565,401

Table of Contents

The changes in fair value of derivatives included in the unaudited consolidated statements of operations are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Change in fair value of derivatives:				
Call options	\$267,705	\$40,394	\$654,441	\$(30,357)
Interest rate swap	(549)	(982)	(474)	(3,626)
Interest rate caps	(336)	(313)	(614)	(983)
	\$266,820	\$39,099	\$653,353	\$(34,966)
Change in fair value of embedded derivatives:				
Fixed index annuities—embedded derivatives	\$3,676	\$199,917	\$79,886	\$379,632
Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting	171,297	84,386	319,257	170,528
	\$174,973	\$284,303	\$399,143	\$550,160

The amounts presented as "Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting" represents the total change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date, less the change in fair value of our fixed index annuities embedded derivatives that is presented as Level 3 liabilities in Note 2.

We have fixed index annuity products that guarantee the return of principal to the policyholder and credit interest based on a percentage of the gain in a specified market index. When fixed index annuity deposits are received, a portion of the deposit is used to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to fixed index annuity policyholders. Substantially all such call options are one year options purchased to match the funding requirements of the underlying policies. The call options are marked to fair value with the change in fair value included as a component of revenues. The change in fair value of derivatives includes the gains or losses recognized at the expiration of the option term or upon early termination and the changes in fair value for open positions. On the respective anniversary dates of the index policies, the index used to compute the annual index credit is reset and we purchase new one-year call options to fund the next annual index credit. We manage the cost of these purchases through the terms of our fixed index annuities, which permit us to change caps, participation rates, and/or asset fees, subject to guaranteed minimums on each policy's anniversary date. By adjusting caps, participation rates, or asset fees, we can generally manage option costs except in cases where the contractual features would prevent further modifications.

Our strategy attempts to mitigate any potential risk of loss due to the nonperformance of the counterparties to these call options through a regular monitoring process which evaluates the program's effectiveness. We do not purchase call options that would require payment or collateral to another institution and our call options do not contain counterparty credit-risk-related contingent features. We are exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, we purchase our option contracts from multiple counterparties and evaluate the creditworthiness of all counterparties prior to purchase of the contracts. All of these options have been purchased from nationally recognized financial institutions with a Standard and Poor's credit rating of A- or higher at the time of purchase and the maximum credit exposure to any single counterparty is subject to concentration limits. We also have credit support agreements that allow us to request the counterparty to provide collateral to us when the fair value of our exposure to the counterparty exceeds specified amounts.

Table of Contents

The notional amount and fair value of our call options by counterparty and each counterparty's current credit rating are as follows:

Counterparty	Credit Rating (S&P)	Credit Rating (Moody's)	June 30, 2017		December 31, 2016	
			Notional Amount	Fair Value	Notional Amount	Fair Value
(Dollars in thousands)						
Bank of America	A+	A1	\$5,020,592	\$179,048	\$5,958,884	\$178,477
Barclays	A-	A1	3,760,675	103,317	3,441,832	89,721
BNP Paribas	A	A1	1,837,242	48,330	1,199,265	19,598
Citibank, N.A.	A+	A1	3,791,993	155,815	4,038,528	97,094
Credit Suisse	A	A1	3,721,586	92,577	2,130,710	44,242
Deutsche Bank	A-	Baa2	—	—	25,935	892
J.P. Morgan	A+	Aa3	1,622,559	53,359	1,785,583	19,645
Morgan Stanley	A+	A1	2,795,503	104,024	2,543,421	64,425
Royal Bank of Canada	AA-	A1	3,167,888	104,644	3,384,310	103,510
SunTrust	A-	Baa1	3,147,079	101,690	2,375,418	72,990
Wells Fargo	AA-	Aa2	3,986,928	131,676	3,850,842	130,545
Exchange traded			407,302	12,144	313,354	9,380
			\$33,259,347	\$1,086,624	\$31,048,082	\$830,519

As of June 30, 2017 and December 31, 2016, we held \$1.1 billion and \$0.8 billion, respectively, of cash and cash equivalents and other securities from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of economic loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to \$16.9 million and \$55.5 million at June 30, 2017 and December 31, 2016, respectively.

The future annual index credits on our fixed index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. We do not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. We must value both the call options and the related forward embedded options in the policies at fair value.

We entered into an interest rate swap and interest rate caps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures. See Note 10 in our Annual Report on Form 10-K for the year ended December 31, 2016 for more information on our subordinated debentures. The terms of the interest rate swap provide that we pay a fixed rate of interest and receive a floating rate of interest. The terms of the interest rate caps limit the three month London Interbank Offered Rate ("LIBOR") to 2.50%. The interest rate swap and caps are not effective hedges under accounting guidance for derivative instruments and hedging activities. Therefore, we record the interest rate swap and caps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swap are as follows:

Maturity Date	Notional		Pay		Counterparty	June 30,	December 31,
	Amount	Receive Rate	Rate	Fair Value		Fair Value	
March 15, 2021	\$85,500	LIBOR	2.415%	SunTrust		\$(2,001)	\$(2,113)

Details regarding the interest rate caps are as follows:

Maturity Date	Notional		Cap		Counterparty	June 30,	December 31,
	Amount	Floating Rate	Rate	Fair Value		Fair Value	

					(Dollars in thousands)
July 7, 2021	\$40,000	LIBOR	2.50%	SunTrust	\$233 \$ 542
July 8, 2021	12,000	LIBOR	2.50%	SunTrust	70 163
July 29, 2021	27,000	LIBOR	2.50%	SunTrust	165 377
	\$79,000				\$468 \$ 1,082

The interest rate swap converts floating rates to fixed rates for seven years which began in March 2014. The interest rate caps cap our interest rates for seven years which began in July 2014. As of June 30, 2017, we deposited \$1.8 million of collateral with the counterparty to the swap.

Table of Contents

6. Notes and Loan Payable and Amounts Due Under Repurchase Agreements

Notes and loan payable includes the following:

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Senior notes due 2021		
Principal	\$400,000	\$ 400,000
Unamortized debt issue costs	(5,187)	(5,733)
Senior notes due 2027		
Principal	500,000	—
Unamortized debt issue costs	(5,804)	—
Unamortized discount	(349)	—
Term loan due 2019		
Principal	—	100,000
Unamortized debt issue costs	—	(512)
	\$888,660	\$ 493,755

On June 16, 2017, we issued \$500 million aggregate principal amount of senior unsecured notes due 2027 which bear interest at 5.0% per year and will mature on June 15, 2027 (the "2027 Notes"). The 2027 Notes were issued at a \$0.3 million discount, which is being amortized over the term of the 2027 Notes using the effective interest method. Contractual interest is payable semi-annually in arrears each June 15th and December 15th. The initial transaction fees and costs totaling \$5.8 million were capitalized as deferred financing costs and are being amortized over the term of the 2027 Notes using the effective interest method. We used the net proceeds from the issuance of the 2027 Notes to prepay our \$100 million term loan that was scheduled to mature in 2019 on June 16, 2017, and to redeem our \$400 million notes due 2021 (the "2021 Notes") on July 17, 2017. See Note 9 for further details surrounding the early redemption of the 2021 Notes.

As part of our investment strategy, we enter into securities repurchase agreements (short-term collateralized borrowings). When we do borrow cash on these repurchase agreements, we pledge collateral in the form of debt securities with fair values approximately equal to the amount due and we use the cash to purchase debt securities ahead of the time we collect the cash from selling annuity policies to avoid a lag between the investment of funds and the obligation to credit interest to policyholders. We earn investment income on the securities purchased with these borrowings at a rate in excess of the cost of these borrowings. Such borrowings averaged \$36.1 million and \$69.1 million during the three and six months ended June 30, 2017, respectively, and the maximum amount borrowed was \$274.5 million during the six months ended June 30, 2017. We had no borrowings under repurchase agreements during the three and six months ended June 30, 2016. The weighted average interest rate on amounts due under repurchase agreements was 1.02% and 0.74% for the three and six months ended June 30, 2017.

7. Commitments and Contingencies

We are occasionally involved in litigation, both as a defendant and as a plaintiff. In addition, state regulatory bodies, such as state insurance departments, the Securities and Exchange Commission, Financial Industry Regulatory Authority, the Department of Labor, and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, the Employee Retirement Income Security Act of 1974, as amended, and laws governing the activities of broker/dealers.

In accordance with applicable accounting guidelines, we establish an accrued liability for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. As a litigation or regulatory matter is developing we, in conjunction with outside counsel, evaluate on an ongoing basis whether the matter presents a loss contingency that meets conditions indicating the need for accrual and/or disclosure, and if not the matter will continue to be monitored for further developments. If and when the loss contingency related to litigation or regulatory matters is deemed to be both probable and estimable, we will establish an accrued liability with respect to that matter and will continue to monitor the matter for further developments that may affect the amount of the accrued liability.

There can be no assurance that any pending or future litigation will not have a material adverse effect on our business, financial condition, or results of operations.

In addition to our commitments to fund mortgage loans, we have unfunded commitments at June 30, 2017 to limited partnerships of \$58.2 million and to secured bank loans of \$9.3 million.

Table of Contents

8. Earnings (Loss) Per Share and Stockholders' Equity

Earnings (Loss) Per Share

The following table sets forth the computation of earnings (loss) per common share and earnings (loss) per common share - assuming dilution:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
(Dollars in thousands, except per share data)				
Numerator:				
Net income (loss) - numerator for earnings (loss) per common share	\$26,946	\$ 14,708	\$80,885	\$(30,133)
Denominator:				
Weighted average common shares outstanding (1)	88,897,208	82,516,927	88,772,832	82,322,919
Effect of dilutive securities:				
2015 warrants	—	—	—	30,439
Stock options and deferred compensation agreements	850,870	353,052	899,594	422,809
Restricted stock and restricted stock units	364,211	314,158	372,214	296,649
Denominator for earnings (loss) per common share - assuming dilution	90,112,289	83,184,137	90,044,638	83,072,816
Earnings (loss) per common share	\$0.30	\$ 0.18	\$0.91	\$(0.37)
Earnings (loss) per common share - assuming dilution	\$0.30	\$ 0.18	\$0.90	\$(0.37)

(1) Weighted average common shares outstanding include shares vested under the NMO Deferred Compensation Plan. Options to purchase shares of our common stock that were outstanding during the respective periods indicated but were not included in the computation of diluted earnings (loss) per share because the options' exercise price was greater than the average market price of the common shares are as follows:

Period	Number of Shares	Range of Exercise Prices	
		Minimum	Maximum
Three months ended June 30, 2017	1,002,391	\$24.79	\$24.79
Three months ended June 30, 2016	1,061,541	\$24.79	\$24.79
Six months ended June 30, 2017	1,002,391	\$24.79	\$24.79
Six months ended June 30, 2016	1,061,541	\$24.79	\$24.79

Stockholders' Equity

In August 2015, we completed an underwritten public offering of 8,600,000 shares of our common stock at a public offering price of \$25.25 per share, of which 4,300,000 shares were subject to a forward sale agreement. The underwriters exercised in full their option to purchase 1,290,000 additional shares of common stock, which were subject to a separate forward sale agreement. We settled the forward sale agreements on August 1, 2016 and issued 5,590,000 shares of our common stock and received \$134.7 million in net proceeds. We contributed the net proceeds from the settlement to the capital and surplus of American Equity Life.

The forward sale agreements had no initial fair value since they were entered into at the then market price of the common stock. The forward sale agreements were equity instruments and qualified for an exception from derivative and fair value accounting.

9. Subsequent Events

As discussed in Note 6, we used a portion of the net proceeds from the issuance of the 2027 Notes to redeem our 2021 Notes on July 17, 2017. We paid \$413.3 million to redeem the 2021 Notes which included a redemption premium equal to 3.313% of the \$400 million principal amount of the 2021 Notes. We incurred a loss of \$18.4 million on the

redemption of the 2021 Notes.

30

Table of Contents

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

Management's discussion and analysis reviews our unaudited consolidated financial position at June 30, 2017, and the unaudited consolidated results of operations for the three and six month periods ended June 30, 2017 and 2016, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2016.

Cautionary Statement Regarding Forward-Looking Information

All statements, trend analyses and other information contained in this report and elsewhere (such as in filings by us with the Securities and Exchange Commission ("SEC"), press releases, presentations by us or our management or oral statements) relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", and other similar expressions, constitute forward-looking statements. We caution that these statements may and often do vary from actual results and the differences between these statements and actual results can be material. Accordingly, we cannot assure you that actual results will not differ materially from those expressed or implied by the forward-looking statements. Factors that could contribute to these differences include, among other things:

general economic conditions and other factors, including prevailing interest rate levels and stock and credit market performance which may affect (among other things) our ability to sell our products, our ability to access capital resources and the costs associated therewith, the fair value of our investments, which could result in impairments and other than temporary impairments, and certain liabilities, and the lapse rate and profitability of policies;

customer response to new products and marketing initiatives;

changes in Federal income tax laws and regulations which may affect the relative income tax advantages of our products;

increasing competition in the sale of annuities;

regulatory changes or actions, including those relating to regulation of financial services affecting (among other things) bank sales and underwriting of insurance products and regulation of the sale, underwriting and pricing of products; and

the risk factors or uncertainties listed from time to time in our filings with the SEC.

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 and Item 1A of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2017.

Our Business and Profitability

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a significantly lesser extent, we also sell life insurance policies. Under U.S. generally accepted accounting principles ("GAAP"), premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liabilities for policyholder account balances and not as expenses.

Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders, net realized gains (losses) on investments and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest sensitive and index product benefits (primarily interest credited to account balances and changes in lifetime income benefit rider reserves), changes in fair value of embedded derivatives, amortization of deferred sales inducements and deferred policy acquisition costs, other operating costs and expenses and income taxes.

Our business model contemplates continued growth in invested assets and non-GAAP operating income while maintaining a high quality investment portfolio that will not experience significant losses from impairments of invested assets. We are committed to maintaining a high quality investment portfolio with limited exposure to below investment grade securities and other riskier assets. Growth in invested assets is predicated on a continuation of our high sales achievements of the last five years while at the same time maintaining a high level of retention of the funds received. The economic and personal investing environments continued to be conducive for high sales levels as

retirees and others look to put their money in instruments that will protect their principal and provide them with consistent cash flow sources in their retirement years. However, our sales slowed during the last half of 2016 and first half of 2017 as competition in our distribution channels escalated, rates from several of our competitors were appreciably above prior levels, and there continues to be uncertainty regarding the Department of Labor ("DOL") conflict of interest fiduciary rule.

Our profitability depends in large part upon:

• the amount of assets under our management,

• investment spreads we earn on our policyholder account balances,

• our ability to manage our investment portfolio to maximize returns and minimize risks such as interest rate changes and defaults or impairment of investments,

• our ability to manage interest rates credited to policyholders and costs of the options purchased to fund the annual index credits on our fixed index annuities,

• our ability to manage the costs of acquiring new business (principally commissions to agents and bonuses credited to policyholders) and

• our ability to manage our operating expenses.

Table of Contents

Earnings from products accounted for as deposit liabilities are primarily generated from the excess of net investment income earned over the interest credited or the cost of providing index credits to the policyholder, or the "investment spread." Our investment spread is summarized as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Average yield on invested assets	4.45%	4.54%	4.46%	4.56%
Aggregate cost of money	1.73%	1.92%	1.75%	1.92%
Aggregate investment spread	2.72%	2.62%	2.71%	2.64%

Impact of:

Investment yield - additional prepayment income	0.07%	0.04%	0.07%	0.06%
Cost of money effect of over hedging	0.06%	—%	0.06%	—%

The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016.

We are currently in the midst of an unprecedented period of low interest rates and low yields for investments with the credit quality we prefer which presents a strong headwind to achieving our target rate for investment spread. In response to this persistent low interest rate environment, we have been reducing policyholder crediting rates for new annuities and existing annuities since the fourth quarter of 2011. Spread results for the 2017 and 2016 periods reflect the benefits from these reductions.

Renewal rate adjustments covering \$16 - 17 billion of policyholder account values began on September 1, 2016, and should lower the overall cost of money by 8 basis points when fully implemented. In addition, we began applying renewal rate adjustments on \$7.4 billion of policyholder account values beginning on December 6, 2016. These adjustments will be implemented over the next 6 to 9 months on policy anniversary dates and are expected to reduce a portion of the 0.46% cost of money differential between existing rates and guaranteed minimum rates we had at June 30, 2017.

Investment yields available to us in the first six months of 2017 increased compared to the last six months of 2016, however they remain below our portfolio rate. Investment yields at these levels will continue to put downward pressure on our investment spread and product returns.

Life insurance companies are subject to the NAIC risk-based capital ("RBC") requirements which are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. Rating agencies utilize a form of RBC to partially determine capital strength of insurance companies. Our RBC ratio at December 31, 2016 was 342%, and our estimated RBC ratio at June 30, 2017 was 366%.

Results of Operations for the Three and Six Months Ended June 30, 2017 and 2016

Annuity deposits by product type collected during the three and six months ended June 30, 2017 and 2016, were as follows:

	Three Months Ended	Six Months Ended
	June 30,	June 30,

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Product Type	2017	2016	2017	2016
	(Dollars in thousands)			
Fixed index annuities	\$ 1,121,192	\$ 1,525,546	\$ 2,150,031	\$ 3,213,548
Annual reset fixed rate annuities	20,870	15,866	35,713	32,571
Multi-year fixed rate annuities	27,535	550,558	57,436	935,590
Single premium immediate annuities	4,981	8,313	10,532	13,627
Total before coinsurance ceded	1,174,578	2,100,283	2,253,712	4,195,336
Coinsurance ceded	108,959	594,269	180,033	1,055,255
Net after coinsurance ceded	\$ 1,065,619	\$ 1,506,014	\$ 2,073,679	\$ 3,140,081

32

Table of Contents

Annuity deposits before and after coinsurance ceded decreased 44% and 29%, respectively, during the second quarter of 2017 compared to the same period in 2016, and decreased 46% and 34%, respectively, during the six months ended June 30, 2017 compared to the same period in 2016. The decrease in sales for the three and six months ended June 30, 2017 primarily reflects continued competitive pressures within each of our distribution channels along with continued uncertainty regarding the DOL fiduciary rule. The relatively smaller decline in net sales compared to gross sales is due to a decrease in coinsurance ceded premiums as a result of significantly lower sales of multi-year rate guaranteed ("MYGA") fixed annuity product which are substantially coinsured, a reduction in the portion of Eagle Life Insurance Company's ("Eagle Life") fixed index annuity sales that are coinsured and lower sales of Eagle Life's fixed index annuity products.

We coinsure 80% of the annuity deposits received from MYGA fixed annuity products and 50% of the fixed index annuities sold by Eagle Life through broker/dealers and banks. Prior to January 1, 2017, we coinsured 80% of the annuity deposits received from MYGA fixed annuity products and 80% of the fixed index annuities sold by Eagle Life.

Net income (loss), in general, has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. The average amount of annuity account balances outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 8% to \$46.5 billion for the second quarter of 2017 and 8% to \$46.0 billion for the six months ended June 30, 2017 compared to \$43.1 billion and \$42.5 billion for the same periods in 2016. Our investment spread measured in dollars was \$286.9 million for the second quarter of 2017 and \$565.6 million for the six months ended June 30, 2017 compared to \$248.9 million and \$492.5 million for the same periods in 2016. As previously mentioned, our investment spread has been negatively impacted by the extended low interest rate environment (see Net investment income).

Net income (loss) is also impacted by the change in fair value of derivatives and embedded derivatives which fluctuates from period to period based upon changes in fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in interest rates used to discount the embedded derivative liability. Net income (loss) for the three and six months ended June 30, 2017 and 2016 was negatively impacted by decreases in the discount rates used to estimate the fair value of our embedded derivative liabilities during the period.

We periodically revise the key assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements retrospectively through an unlocking process when estimates of current or future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. We review these assumptions quarterly and based on the results of our first and second quarter 2017 reviews, no assumptions were revised. Based on the results of our first quarter 2016 review, we lowered future investment spread assumptions as actual investment spreads being earned showed investment spread and gross profits being less than what we were assuming in our models due to decreases in the average yield earned on invested assets resulting from the continued low interest rate environment.

Net loss for the six months ended June 30, 2016 includes effects from unlocking as follows:

	Six Months Ended June 30, 2016 (Dollars in thousands)
Increase in amortization of deferred sales inducements	\$ 17,892
Increase in amortization of deferred policy acquisition costs	26,084
Effect on net income (loss)	(28,365)

Non-GAAP operating income increased 27% to \$63.7 million in the second quarter of 2017 and 73% to \$123.3 million for the six months ended June 30, 2017 compared to \$50.1 million and \$71.1 million for the same periods in 2016.

In addition to net income (loss), we have consistently utilized non-GAAP operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance.

Non-GAAP operating income equals net income (loss) adjusted to eliminate the impact of items that fluctuate from quarter to quarter in a manner unrelated to core operations, and we believe measures excluding their impact are useful in analyzing operating trends. The most significant adjustments to arrive at non-GAAP operating income eliminate the impact of fair value accounting for our fixed index annuity business and are not economic in nature but rather impact the timing of reported results. We believe the combined presentation and evaluation of non-GAAP operating income together with net income (loss) provides information that may enhance an investor's understanding of our underlying results and profitability.

Non-GAAP operating income is not a substitute for net income (loss) determined in accordance with GAAP. The adjustments made to derive non-GAAP operating income are important to understand our overall results from operations and, if evaluated without proper context, non-GAAP operating income possesses material limitations. As an example, we could produce a low level of net income in a given period, despite strong operating performance, if in that period we experience significant net realized losses from our investment portfolio. We could also produce a high level of net income in a given period, despite poor operating performance, if in that period we generate significant net realized gains from our investment portfolio. As an example of another limitation of operating income, it does not include the decrease in cash flows expected to be collected as a result of credit loss OTTI. Therefore, our management reviews net realized investment gains and analyses of our net investment income, including impacts related to OTTI write-downs, in connection with their review of our investment portfolio. In addition, our management examines net income (loss) as part of their review of our overall financial results.

Table of Contents

The adjustments made to net income (loss) to arrive at non-GAAP operating income for the three and six months ended June 30, 2017 and 2016 are set forth in the table that follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Reconciliation of net income (loss) to non-GAAP operating income:				
Net income (loss)	\$26,946	\$14,708	\$80,885	\$(30,133)
Adjustments to arrive at non-GAAP operating income:				
Net realized (gains) losses and net OTTI losses on investments, net of offsets	(1,559)	605	(3,501)	1,760
Change in fair value of derivatives and embedded derivatives - index annuities, net of offsets	57,571	53,129	68,548	150,678
Change in fair value of derivatives - debt	465	768	218	3,532
Income taxes	(19,741)	(19,108)	(22,846)	(54,737)
Non-GAAP operating income	\$63,682	\$50,102	\$123,304	\$71,100

The amounts disclosed in the reconciliation above are presented net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs where applicable.

Non-GAAP operating income for the six months ended June 30, 2016 includes expense from unlocking which increased amortization of deferred sales inducements by \$18.1 million and amortization of deferred policy acquisition costs by \$26.3 million and decreased non-GAAP operating income by \$28.6 million.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 18% to \$48.6 million in the second quarter of 2017 and 19% to \$92.2 million for the six months ended June 30, 2017 compared to \$41.1 million and \$77.6 million for the same periods in 2016. The components of annuity product charges are set forth in the table that follows:

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2017	2016	2017	2016	
	(Dollars in thousands)				
Surrender charges	\$13,896	\$11,997	\$27,530	\$26,562	
Lifetime income benefit riders (LIBR) fees	34,707	29,127	64,645	51,067	
	\$48,603	\$41,124	\$92,175	\$77,629	
Withdrawals from annuity policies subject to surrender charges	\$114,922	\$102,525	\$222,141	\$217,287	
Average surrender charge collected on withdrawals subject to surrender charges	12.1	% 11.7	% 12.4	% 12.2	%
Fund values on policies subject to LIBR fees	\$5,067,601	\$4,464,676	\$9,364,039	\$7,876,599	
Weighted average per policy LIBR fee	0.68	% 0.65	% 0.69	% 0.65	%

The increases in annuity product charges were primarily attributable to increases in fees assessed for lifetime income benefit riders due to a larger volume of business in force subject to the fee and increases in the average fees being charged as compared to prior periods. See Interest sensitive and index product benefits below for corresponding expense recognized on lifetime income benefit riders. Surrender charges increased in the 2017 periods due to increases in withdrawals from annuity policies subject to surrender charges.

Net investment income increased 7% to \$493.5 million in the second quarter of 2017 and 8% to \$979.1 million for the six months ended June 30, 2017 compared to \$459.8 million and \$910.7 million for the same periods in 2016. The increases were principally attributable to the growth in our annuity business and corresponding increases in our

invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 9% to \$44.4 billion for the second quarter of 2017 and 10% to \$44.0 billion for the six months ended June 30, 2017 compared to \$40.6 billion and \$40.0 billion for the same periods in 2016.

Table of Contents

The average yield earned on average invested assets was 4.45% for the second quarter of 2017 and 4.46% for the six months ended June 30, 2017 compared to 4.54% and 4.56% for the same periods in 2016. The decreases in yield earned on average invested assets were attributable to the investment of new premiums and portfolio cash flows during the first and second quarter of 2017 and the last two quarters of 2016 at rates below the overall portfolio yield partially offset by lower cash balances. The average yield on fixed income securities purchased and commercial mortgage loans funded in the three and six months ended June 30, 2017 was 3.96% and 4.03%, respectively, compared to 3.95% and 4.03% for the same periods in 2016. The average balance for cash and short-term investments was \$203 million and \$157 million during the three and six months ended June 30, 2017 compared to \$1.1 billion and \$950 million for the same periods in 2016. The unfavorable impact from lower new money investment yields was offset by non-trendable investment income items which added eight and nine basis points to the average yield on invested assets for the three and six months ended June 30, 2017 and seven and nine basis points to the average yield on invested assets for the three and six months ended June 30, 2016.

Change in fair value of derivatives consists of call options purchased to fund annual index credits on fixed index annuities, and an interest rate swap and interest rate caps that hedge our floating rate subordinated debentures. The components of change in fair value of derivatives are as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	(Dollars in thousands)			
Call options:				
Gain (loss) on option expiration	\$232,965	\$(135,558)	\$438,365	\$(245,198)
Change in unrealized gains/losses	34,740	175,952	216,076	214,841
Interest rate swap	(549)	(982)	(474)	(3,626)
Interest rate caps	(336)	(313)	(614)	(983)
	\$266,820	\$39,099	\$653,353	\$(34,966)

The differences between the change in fair value of derivatives between periods for call options are primarily due to the performance of the indices upon which our call options are based. A substantial portion of our call options are based upon the S&P 500 Index with the remainder based upon other equity and bond market indices. The range of index appreciation (after applicable caps, participation rates and asset fees) for options expiring during the three and six months ended June 30, 2017 and 2016 is as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
S&P 500 Index				
Point-to-point strategy	1.0% - 10.5%	0.0% - 1.9%	1.0% - 13.3%	0.0% - 1.9%
Monthly average strategy	0.5% - 9.0%	0.0% - 0.0%	0.1% - 10.6%	0.0% - 2.9%
Monthly point-to-point strategy	0.0% - 13.0%	0.0% - 0.0%	0.0% - 15.2%	0.0% - 0.0%
Fixed income (bond index) strategies	0.0% - 4.5%	0.0% - 10.0%	0.0% - 4.5%	0.0% - 10.0%

The change in fair value of derivatives is also influenced by the aggregate cost of options purchased. The aggregate cost of options has increased primarily due to an increased amount of fixed index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016.

Net realized gains on investments, excluding OTTI losses include gains and losses on the sale of securities and impairment losses on mortgage loans on real estate which fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments, as well as gains (losses) recognized on real estate owned due to any sales and impairments on long-lived assets. See Note 3 to our unaudited consolidated financial statements for a detailed presentation of the types of investments that generated the gains (losses).

Losses on available for sale fixed maturity securities were realized primarily due to strategies to reposition the fixed maturity security portfolio that resulted in improved net investment income, risk or duration profiles as they pertain to our asset liability management. Securities were sold at losses in 2017 and 2016 due to our long-term fundamental concern with the issuer's ability to meet their future financial obligations. See Financial Condition - Investments and Note 4 to our unaudited consolidated financial statements for additional discussion of allowance for credit losses recognized on mortgage loans on real estate.

Net OTTI losses recognized in operations decreased to \$0.9 million in the second quarter of 2017 and \$1.1 million for the six months ended June 30, 2017 compared to \$4.4 million and \$10.1 million for the same periods in 2016. See Financial Condition - Other Than Temporary Impairments and Note 3 to our unaudited consolidated financial statements for additional discussion of other than temporary impairments recognized during the periods presented.

Table of Contents

Interest sensitive and index product benefits increased 325% to \$472.6 million in the second quarter of 2017 and 327% to \$891.7 million for the six months ended June 30, 2017 compared to \$111.1 million and \$208.8 million for the same periods in 2016. The components of interest sensitive and index product benefits are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Index credits on index policies	\$371,623	\$8,900	\$693,503	\$15,431
Interest credited (including changes in minimum guaranteed interest for fixed index annuities)	65,133	68,461	132,139	132,973
Lifetime income benefit riders	35,840	33,760	66,093	60,388
	\$472,596	\$111,121	\$891,735	\$208,792

The increases in index credits were attributable to changes in the appreciation of the underlying indices (see discussion above under Change in fair value of derivatives) and the amount of funds allocated by policyholders to the respective index options. Total proceeds received upon expiration of the call options purchased to fund the annual index credits were \$378.5 million and \$705.1 million for the three and six months ended June 30, 2017, compared to \$9.3 million and \$16.1 million for the same periods in 2016. The decreases in interest credited were primarily due to lower crediting rates on annuity liabilities receiving a fixed rate of interest. The increases in benefits recognized for lifetime income benefit riders were due to increases in the number of policies with lifetime income benefit riders and correlate to the increases in fees discussed in Annuity product charges.

The reserve (net of coinsurance ceded) held for lifetime income benefit riders was \$599.5 million and \$533.4 million at June 30, 2017 and December 31, 2016, respectively.

Amortization of deferred sales inducements, in general, has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 87% and 88% of our net annuity account values at June 30, 2017 and June 30, 2016, respectively. The increases in amortization from these factors have been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, amortization associated with net realized gains (losses) on investments and net OTTI losses recognized in operations. Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options), because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected lives of the contracts which typically exceed ten years. Amortization of deferred sales inducements is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Amortization of deferred sales inducements before gross profit adjustments	\$68,245	\$58,699	\$136,029	\$134,180
Gross profit adjustments:				
Fair value accounting for derivatives and embedded derivatives	(35,136)	(27,541)	(40,724)	(74,707)
Net realized gains (losses) on investments and net OTTI losses recognized in operations	586	(486)	715	(1,322)
Amortization of deferred sales inducements after gross profit adjustments	\$33,695	\$30,672	\$96,020	\$58,151

See Net income (loss) and Non-GAAP operating income above for discussion of the impact of unlocking on amortization of deferred sales inducements for the six months ended June 30, 2016. See Critical Accounting Policies -

Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016.

Table of Contents

Change in fair value of embedded derivatives includes changes in the fair value of our fixed index annuity embedded derivatives (see Note 5 to our unaudited consolidated financial statements). The components of change in fair value of embedded derivatives are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives	\$3,676	\$199,917	\$79,886	\$379,632
Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting	171,297	84,386	319,257	170,528
	\$174,973	\$284,303	\$399,143	\$550,160

The change in fair value of the fixed index annuity embedded derivatives resulted from (i) changes in the expected index credits on the next policy anniversary dates, which are related to the change in fair value of the call options acquired to fund those index credits discussed above in Change in fair value of derivatives; (ii) changes in discount rates used in estimating our embedded derivative liabilities; and (iii) the growth in the host component of the policy liability. The amounts presented as "Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting" represents the total change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date, less the change in fair value of our fixed index annuities embedded derivative. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016. The primary reasons for the decreases in the change in fair value of the fixed index annuity embedded derivatives during the three and six months ended June 30, 2017 were smaller decreases in the discount rate used in estimating the fair value of our liability during the three and six months ended June 30, 2017 as compared to the same periods of 2016 combined with a decrease in the expected index credits on the next policy anniversary dates resulting from a smaller increase in the fair value of the call options acquired to fund these index credits during the three and six months ended June 30, 2017 as compared to the same periods of 2016. The discount rates used in estimating our embedded derivative liabilities fluctuate based on changes in the general level of interest rates. Interest expense on notes and loan payable increased 26% to \$8.7 million in the second quarter of 2017 and 19% to \$16.4 million for the six months ended June 30, 2017 compared to \$6.9 million and \$13.8 million for the same periods in 2016. The increases in interest expense were attributable to interest expense on the \$100 million variable rate term loan originated on September 30, 2016 and prepaid on June 16, 2017, as well as interest expense on the \$500 million senior unsecured notes due 2027 issued on June 16, 2017.

Amortization of deferred policy acquisition costs, in general, has been increasing each period due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The increases in amortization from these factors have been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business and amortization associated with net realized gains (losses) on investments and net OTTI losses recognized in operations. As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. Amortization of deferred policy acquisition costs is summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			

Amortization of deferred policy acquisition costs before gross profit adjustments	\$96,343	\$83,354	\$191,774	\$192,952
Gross profit adjustments:				
Fair value accounting for derivatives and embedded derivatives	(47,576)	(32,070)	(53,454)	(90,939)
Net realized gains (losses) on investments and net OTTI losses recognized in operations	780	(619)	905	(1,635)
Amortization of deferred policy acquisition costs after gross profit adjustments	\$49,547	\$50,665	\$139,225	\$100,378

See Net income (loss) and Non-GAAP operating income above for discussion of the impact of unlocking on amortization of deferred policy acquisition costs for the six months ended June 30, 2016. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016.

Table of Contents

Other operating costs and expenses decreased 3.2% to \$26.0 million in the second quarter of 2017 and 0.2% to \$53.5 million for the six months ended June 30, 2017 compared to \$26.8 million and \$53.7 million for the same periods in 2016 and are summarized as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
				(Dollars in thousands)
Salary and benefits	\$13,282	\$12,754	\$27,059	\$26,828
Risk charges	7,144	7,283	14,199	14,059
Other	5,538	6,786	12,285	12,766
Total other operating costs and expenses	\$25,964	\$26,823	\$53,543	\$53,653

The three months ended June 30, 2017 reflect an increase in salary and benefits of \$0.8 million due to an increased number of employees related to our growth, an increase of \$0.4 million related to a deferred compensation liability that is based upon the value of our common stock and an increase of \$0.5 million related to expense recognized under our short-term incentive compensation program and other bonus programs as compared to the same period in 2016. These increases were offset by a decrease of \$1.4 million in expenses related to a retirement agreement with our former executive chairman. The six months ended June 30, 2017 reflect an increase in salary and benefits of \$1.9 million due to an increased number of employees related to our growth and an increase of \$1.3 million related to a deferred compensation liability that is based upon the value of our common stock as compared to the same period in 2016. These increases were offset by a decrease of \$3.0 million in expenses related to a retirement agreement with our former executive chairman.

The decrease in reinsurance risk charges expense for the three months ended June 30, 2017 as compared to the same period in 2016 was due to a lower risk charge percentage which was included in an October 1, 2016 amendment to the reinsurance agreement which was partially offset by growth in our policyholder liabilities subject to the reinsurance agreement pursuant to which we cede excess regulatory reserves to an unaffiliated reinsurer. The increase in reinsurance risk charges expense for the six months ended June 30, 2017 as compared to the same period in 2016 was due to the growth in our policyholder liabilities subject to the reinsurance agreement partially offset by the lower risk charge percentage noted above. The regulatory reserves ceded at June 30, 2017 and 2016 were \$700.0 million and \$570.5 million, respectively.

Other expenses decreased for the three and six months ended June 30, 2017 as compared to the three and six months ended June 30, 2016 primarily as a result of decreases in general expenses that vary from period to period based on the level of annuity deposits collected. The six months ended June 30, 2016 benefited from the recovery of \$1.0 million related to a state tax matter.

Income tax expense (benefit) was \$13.3 million in the second quarter of 2017 and \$40.9 million for the six months ended June 30, 2017 compared to \$8.0 million and \$(16.2) million for the same periods in 2016. The changes in income tax expense (benefit) were primarily due to changes in income (loss) before income taxes. The effective income tax rates for the three and six months ended June 30, 2017 were 33.1% and 33.6%, respectively, and 35.3% and 35.0% for the same periods in 2016, respectively.

Income tax expense (benefit) and the resulting effective tax rate are based upon two components of income (loss) before income taxes ("pretax income (loss)") that are taxed at different tax rates. Life insurance income is generally taxed at an effective rate of approximately 35.5% reflecting the absence of state income taxes for substantially all of the states that the life insurance subsidiaries do business in. The income (loss) for the parent company and other non-life insurance subsidiaries (the "non-life insurance group") is generally taxed at an effective tax rate of 41.5% reflecting the combined federal / state income tax rates. The effective income tax rates resulting from the combination of the income tax provisions for the life / non-life sources of income (loss) vary from period to period based primarily on the relative size of pretax income (loss) from the two sources.

The effective income tax rate decreased for the three and six month periods ended June 30, 2017 as compared to the same periods in 2016 due to a change in accounting for income taxes related to share-based compensation that reduced income tax expense by approximately \$0.3 million and \$1.6 million during the three and six month periods ended June 30, 2017. In addition, the rate decreased for the three and six month periods ended June 30, 2017 as compared to the same periods in 2016 due to lower projected income for the non-life insurance group which is primarily due to an \$18.4 million loss on extinguishment of debt that will be recognized in the third quarter.

Table of Contents

Financial Condition

Investments

Our investment strategy is to maintain a predominantly investment grade fixed income portfolio, provide adequate liquidity to meet our cash obligations to policyholders and others and maximize current income and total investment return through active investment management. Consistent with this strategy, our investments principally consist of fixed maturity securities and mortgage loans on real estate.

Insurance statutes regulate the type of investments that our life subsidiaries are permitted to make and limit the amount of funds that may be used for any one type of investment. In light of these statutes and regulations and our business and investment strategy, we generally seek to invest in United States government and government-sponsored agency securities, corporate securities, residential and commercial mortgage backed securities, other asset backed securities and United States municipalities, states and territories securities rated investment grade by established nationally recognized statistical rating organizations ("NRSRO's") or in securities of comparable investment quality, if not rated, and commercial mortgage loans on real estate.

The composition of our investment portfolio is summarized as follows:

	June 30, 2017		December 31, 2016	
	Carrying Amount	Percent	Carrying Amount	Percent
	(Dollars in thousands)			
Fixed maturity securities:				
United States Government full faith and credit	\$ 12,174	— %	\$ 11,805	— %
United States Government sponsored agencies	1,340,839	2.8 %	1,344,787	3.0 %
United States municipalities, states and territories	4,137,714	8.6 %	3,926,950	8.8 %
Foreign government obligations	238,869	0.5 %	236,341	0.5 %
Corporate securities	29,364,002	61.3 %	27,191,243	60.8 %
Residential mortgage backed securities	1,181,850	2.5 %	1,254,835	2.8 %
Commercial mortgage backed securities	5,540,383	11.6 %	5,365,235	12.0 %
Other asset backed securities	2,154,885	4.5 %	1,806,123	4.0 %
Total fixed maturity securities	43,970,716	91.8 %	41,137,319	91.9 %
Mortgage loans on real estate	2,553,391	5.3 %	2,480,956	5.5 %
Derivative instruments	1,086,624	2.3 %	830,519	1.9 %
Other investments	314,421	0.6 %	308,774	0.7 %
	\$47,925,152	100.0 %	\$44,757,568	100.0 %

Fixed Maturity Securities

Our fixed maturity security portfolio is managed to minimize risks such as interest rate changes and defaults or impairments while earning a sufficient and stable return on our investments. The largest portion of our fixed maturity securities are in investment grade (NAIC designation 1 or 2) publicly traded or privately placed corporate securities.

A summary of our fixed maturity securities by NRSRO ratings is as follows:

Rating Agency Rating	June 30, 2017		December 31, 2016	
	Carrying Amount	Percent of Fixed Maturity Securities	Carrying Amount	Percent of Fixed Maturity Securities
	(Dollars in thousands)			
Aaa/Aa/A	\$27,599,755	62.8 %	\$26,431,700	64.3 %
Baa	14,852,167	33.8 %	13,002,964	31.6 %
Total investment grade	42,451,922	96.6 %	39,434,664	95.9 %
Ba	1,056,659	2.4 %	1,048,379	2.5 %
B	104,835	0.2 %	155,619	0.4 %

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Caa	264,733	0.6	%	79,763	0.2	%
Ca and lower	92,567	0.2	%	418,894	1.0	%
Total below investment grade	1,518,794	3.4	%	1,702,655	4.1	%
	\$43,970,716	100.0	%	\$41,137,319	100.0	%

39

Table of Contents

The National Association of Insurance Commissioner's ("NAIC") Securities Valuation Office ("SVO") is responsible for the the day-to-day credit quality assessment and the valuation of fixed maturity securities owned by state regulated insurance companies. The purpose of such assessment and valuation is for determining regulatory capital requirements and regulatory reporting. Insurance companies report ownership to the SVO when such securities are eligible for regulatory filings. The SVO conducts credit analysis on these securities for the purpose of assigning a NAIC designation and/or unit price. Typically, if a security has been rated by a NRSRO, the SVO utilizes that rating and assigns a NAIC designation based upon the following system:

NAIC Designation NRSRO Equivalent Rating

1	Aaa/Aa/A
2	Baa
3	Ba
4	B
5	Caa
6	Ca and lower

For most of the bonds held in our portfolio the NAIC designation matches the NRSRO equivalent rating. However, for certain loan-backed and structured securities, as defined by the NAIC, the NAIC rating is not always equivalent to the NRSRO rating presented in the previous table. The NAIC has adopted revised rating methodologies for certain loan-backed and structured securities comprised of non-agency residential mortgage backed securities ("RMBS") and commercial mortgage backed securities ("CMBS"). The NAIC's objective with the revised rating methodologies for these structured securities is to increase the accuracy in assessing expected losses and use the improved assessment to determine a more appropriate capital requirement for such structured securities. The revised methodologies reduce regulatory reliance on rating agencies and allow for greater regulatory input into the assumptions used to estimate expected losses from structured securities.

The use of this process by the SVO may result in certain non-agency RMBS and CMBS being assigned a NAIC designation that is higher than the equivalent NRSRO rating. The NAIC designations for non-agency RMBS and CMBS are based on security level expected losses as modeled by an independent third party (engaged by the NAIC) and the statutory carrying value of the security, including any purchase discounts or impairment charges previously recognized. Evaluation of non-agency RMBS and CMBS held by insurers using the NAIC rating methodologies is performed on an annual basis.

As stated previously, our fixed maturity security portfolio is managed to minimize risks such as defaults or impairments while earning a sufficient and stable return on our investments. Our strategy has been to invest primarily in investment grade fixed maturity securities. Investment grade is NAIC 1 and 2 securities and Baa3/BBB- and better securities on the NRSRO scale. This strategy meets the objective of minimizing risk while also managing asset capital charges on a regulatory capital basis.

A summary of our fixed maturity securities by NAIC designation is as follows:

NAIC Designation	June 30, 2017				December 31, 2016			
	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount
	(Dollars in thousands)				(Dollars in thousands)			
1	\$26,718,443	\$28,144,706	\$28,144,706	64.0 %	\$25,607,268	\$26,507,798	\$26,507,798	64.5 %
2	13,907,192	14,499,548	14,499,548	33.0 %	13,037,592	13,295,648	13,295,648	32.3 %
3	1,229,695	1,207,581	1,207,810	2.7 %	1,201,059	1,155,702	1,163,761	2.8 %
4	97,349	89,144	89,144	0.2 %	154,226	137,188	137,188	0.3 %
5	19,559	20,698	20,698	0.1 %	17,475	24,664	24,664	0.1 %
6	12,437	8,810	8,810	— %	13,160	8,260	8,260	— %
	\$41,984,675	\$43,970,487	\$43,970,716	100.0 %	\$40,030,780	\$41,129,260	\$41,137,319	100.0 %

The amortized cost and fair value of fixed maturity securities at June 30, 2017, by contractual maturity, are presented in Note 3 to our unaudited consolidated financial statements in this form 10-Q, which is incorporated by reference in this Item 2.

40

Table of Contents

Unrealized Losses

The amortized cost and fair value of fixed maturity securities that were in an unrealized loss position were as follows:

	Number of Securities	Amortized Cost	Unrealized Losses	Fair Value
(Dollars in thousands)				
June 30, 2017				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	2	\$7,035	\$(168)	\$6,867
United States Government sponsored agencies	17	1,032,469	(37,840)	994,629
United States municipalities, states and territories	60	282,874	(9,572)	273,302
Foreign government obligations	1	14,333	(2,489)	11,844
Corporate securities:				
Finance, insurance and real estate	113	1,257,563	(39,094)	1,218,469
Manufacturing, construction and mining	74	681,971	(22,804)	659,167
Utilities and related sectors	67	584,347	(16,931)	567,416
Wholesale/retail trade	33	339,104	(14,395)	324,709
Services, media and other	185	1,865,885	(89,930)	1,775,955
Residential mortgage backed securities	14	51,032	(2,312)	48,720
Commercial mortgage backed securities	303	2,433,279	(69,249)	2,364,030
Other asset backed securities	86	607,327	(13,461)	593,866
	955	\$9,157,219	\$(318,245)	\$8,838,974
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	\$76,931	\$(229)	\$76,702
December 31, 2016				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	3	\$7,693	\$(288)	\$7,405
United States Government sponsored agencies	18	1,042,461	(46,913)	995,548
United States municipalities, states and territories	113	485,802	(22,393)	463,409
Foreign government obligations	4	54,626	(5,080)	49,546
Corporate securities:				
Finance, insurance and real estate	175	2,101,158	(78,144)	2,023,014
Manufacturing, construction and mining	155	1,568,588	(57,577)	1,511,011
Utilities and related sectors	137	1,511,082	(50,835)	1,460,247
Wholesale/retail trade	63	687,650	(20,810)	666,840
Services, media and other	301	3,417,783	(161,407)	3,256,376
Residential mortgage backed securities	25	87,169	(3,554)	83,615
Commercial mortgage backed securities	407	3,266,304	(117,014)	3,149,290
Other asset backed securities	112	918,403	(20,703)	897,700
	1,513	\$15,148,719	\$(584,718)	\$14,564,001
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	\$76,825	\$(8,059)	\$68,766

The decrease in unrealized losses from December 31, 2016 to June 30, 2017 was primarily due to a decrease in interest rates in addition to price improvements due to tighter credit spreads during the six months ended June 30, 2017. The 10-year U.S. Treasury yields at June 30, 2017 and December 31, 2016 were 2.31% and 2.45%, respectively. The 30-year U.S. Treasury yields at June 30, 2017 and December 31, 2016 were 2.84% and 3.06%,

respectively.

41

Table of Contents

The following table sets forth the composition by credit quality (NAIC designation) of fixed maturity securities with gross unrealized losses:

NAIC Designation	Carrying Value of Securities with Gross Unrealized Losses	Percent of Total	Gross Unrealized Losses	Percent of Total
(Dollars in thousands)				
June 30, 2017				
1	\$5,763,404	64.7 %	\$(182,013)	57.2 %
2	2,482,302	27.8 %	(76,724)	24.1 %
3	589,388	6.6 %	(43,515)	13.7 %
4	60,716	0.7 %	(8,734)	2.7 %
5	11,292	0.1 %	(3,854)	1.2 %
6	8,803	0.1 %	(3,634)	1.1 %
	\$8,915,905	100.0 %	\$(318,474)	100.0 %
December 31, 2016				
1	\$8,754,856	59.8 %	\$(330,920)	55.8 %
2	5,091,437	34.8 %	(176,557)	29.8 %
3	657,549	4.5 %	(60,689)	10.3 %
4	119,986	0.8 %	(17,786)	3.0 %
5	8,744	0.1 %	(1,920)	0.3 %
6	8,254	— %	(4,905)	0.8 %
	\$14,640,826	100.0 %	\$(592,777)	100.0 %

Our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 956 and 1,514 securities, respectively) have been in a continuous unrealized loss position at June 30, 2017 and December 31, 2016, along with a description of the factors causing the unrealized losses is presented in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Table of Contents

The amortized cost and fair value of fixed maturity securities in an unrealized loss position and the number of months in a continuous unrealized loss position (fixed maturity securities that carry an NRSRO rating of BBB/Baa or higher are considered investment grade) were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
June 30, 2017				
Fixed maturity securities:				
Investment grade:				
Less than six months	227	\$ 1,711,069	\$ 1,694,645	\$(16,424)
Six months or more and less than twelve months	539	5,605,428	5,425,525	(179,903)
Twelve months or greater	114	1,228,182	1,164,181	(64,001)
Total investment grade	880	8,544,679	8,284,351	(260,328)
Below investment grade:				
Less than six months	22	87,423	84,595	(2,828)
Six months or more and less than twelve months	5	71,108	68,472	(2,636)
Twelve months or greater	49	530,940	478,258	(52,682)
Total below investment grade	76	689,471	631,325	(58,146)
	956	\$9,234,150	\$8,915,676	\$(318,474)
December 31, 2016				
Fixed maturity securities:				
Investment grade:				
Less than six months	1,265	\$ 12,767,396	\$ 12,374,177	\$(393,219)
Six months or more and less than twelve months	69	669,022	621,784	(47,238)
Twelve months or greater	90	970,424	901,674	(68,750)
Total investment grade	1,424	14,406,842	13,897,635	(509,207)
Below investment grade:				
Less than six months	15	132,087	126,236	(5,851)
Six months or more and less than twelve months	10	80,535	72,830	(7,705)
Twelve months or greater	65	606,080	536,066	(70,014)
Total below investment grade	90	818,702	735,132	(83,570)
	1,514	\$ 15,225,544	\$ 14,632,767	\$(592,777)

Table of Contents

The amortized cost and fair value of fixed maturity securities (excluding United States Government and United States Government sponsored agency securities) segregated by investment grade (NRSRO rating of BBB/Baa or higher) and below investment grade that had unrealized losses greater than 20% and the number of months in a continuous unrealized loss position were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
June 30, 2017				
Investment grade:				
Less than six months	—	\$—	\$—	\$—
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	—	—	—	—
Total investment grade	—	—	—	—
Below investment grade:				
Less than six months	2	4,747	3,684	(1,063)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	6	62,432	37,470	(24,962)
Total below investment grade	8	67,179	41,154	(26,025)
	8	\$67,179	\$41,154	\$(26,025)
December 31, 2016				
Investment grade:				
Less than six months	—	\$—	\$—	\$—
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	—	—	—	—
Total investment grade	—	—	—	—
Below investment grade:				
Less than six months	1	19,930	15,961	(3,969)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	10	85,831	58,436	(27,395)
Total below investment grade	11	105,761	74,397	(31,364)
	11	\$105,761	\$74,397	\$(31,364)

Table of Contents

The amortized cost and fair value of fixed maturity securities, by contractual maturity, that were in an unrealized loss position are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars in thousands)				
June 30, 2017				
Due in one year or less	\$—	\$—	\$—	\$—
Due after one year through five years	258,123	246,519	—	—
Due after five years through ten years	2,368,457	2,306,035	—	—
Due after ten years through twenty years	1,826,206	1,762,754	—	—
Due after twenty years	1,612,795	1,517,050	76,931	76,702
	6,065,581	5,832,358	76,931	76,702
Residential mortgage backed securities	51,032	48,720	—	—
Commercial mortgage backed securities	2,433,279	2,364,030	—	—
Other asset backed securities	607,327	593,866	—	—
	\$9,157,219	\$8,838,974	\$76,931	\$76,702
December 31, 2016				
Due in one year or less	\$—	\$—	\$—	\$—
Due after one year through five years	177,550	172,375	—	—
Due after five years through ten years	4,943,504	4,806,216	—	—
Due after ten years through twenty years	2,736,298	2,621,945	—	—
Due after twenty years	3,019,491	2,832,860	76,825	68,766
	10,876,843	10,433,396	76,825	68,766
Residential mortgage backed securities	87,169	83,615	—	—
Commercial mortgage backed securities	3,266,304	3,149,290	—	—
Other asset backed securities	918,403	897,700	—	—
	\$15,148,719	\$14,564,001	\$76,825	\$68,766

International Exposure

We hold fixed maturity securities with international exposure. As of June 30, 2017, 18% of the carrying value of our fixed maturity securities was comprised of corporate debt securities of issuers based outside of the United States and debt securities of foreign governments. Our investment professionals analyze each holding for credit risk by economic and other factors of each country and industry. The following table presents our international exposure in our fixed maturity portfolio by country or region:

June 30, 2017			
	Amortized Cost	Carrying Amount/ Fair Value	Percent of Total Carrying Amount
(Dollars in thousands)			
GIIPS (1)	\$252,371	\$278,565	0.6%
Asia/Pacific	433,800	453,465	1.0%
Non-GIIPS Europe	3,243,273	3,376,643	7.7%
Latin America	281,708	286,183	0.7%
Non-U.S. North America	1,310,375	1,366,367	3.1%

Australia & New Zealand	781,832	795,288	1.8%
Other	1,524,249	1,554,297	3.5%
	\$7,827,608	\$8,110,808	18.4%

(1) Greece, Ireland, Italy, Portugal and Spain continue to cause credit risk as economic conditions in these countries continue to be volatile, especially within the financial and banking sectors. All of our exposure in GIIPS are corporate securities with issuers domiciled in these countries. None of our foreign government obligations were held in any of these countries.

Table of Contents

All of the securities presented in the table above are denominated in U.S. dollars and all are investment grade (NAIC designation of either 1 or 2), except for the following:

	June 30, 2017	
	Amortized Cost	Carrying Amount/ Fair Value
	(Dollars in thousands)	
GIIPS (1)	\$28,733	\$31,078
Asia/Pacific	11,000	9,444
Non-GIIPS Europe	148,742	145,376
Latin America	74,260	66,720
Non-U.S. North America	104,928	105,374
	\$367,663	\$357,992

Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment, we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 25% or greater change in market price relative to its amortized cost and a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our residential and commercial mortgage backed securities as we monitor all of our residential and commercial mortgage backed securities on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At June 30, 2017, the amortized cost and fair value of securities on the watch list (all fixed maturity securities) are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
(Dollars in thousands)						
Below investment grade						
Corporate securities:						
Energy	4	\$29,058	\$(6,217)	\$22,841	1 - 50	0 - 30
Industrials	1	4,984	(2,640)	2,344	32	23
Materials	1	3,990	(17)	3,973	1	—
Telecommunications	1	2,100	(15)	2,085	36	—
Other asset backed securities:						
Financials	2	6,347	(3,601)	2,746	49 - 75	26 - 30
	9	\$46,479	\$(12,490)	\$33,989		

We have determined that the unrealized losses of the securities on the watch list are temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before recovery of their amortized cost. Our analysis of these securities and their credit performance at June 30, 2017 is as follows:

Corporate securities:

Energy, Industrials and Materials: The decline in the value of these securities relates to ongoing operational issues related to the decline in certain commodity prices specific to their businesses. The decline in these commodity prices creates financial challenges as the companies realign to accommodate the lower prices. These issuers will be stressed greater than the average company due to their price sensitivity and the specific position they hold in the supply chain. We recognized an other than temporary impairment on one security during the third quarter of 2016 due to our evaluation of the operating performance and the credit worthiness of the issuer. While the remaining issuers have seen their financial and profitability profile weakened, we have determined that the remaining securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of the issuer.

Table of Contents

Telecommunications: The decline in the value of this security is the result of regional economic recessionary pressure in Brazil and an increase in competition in the markets it operates. This issuer has seen weakened performance and heightened risk. We recognized an other than temporary impairment on this security during the first quarter of 2016 due to our evaluation of the operating performance and the credit worthiness of the issuer.

Other asset backed securities:

Financials: The decline in value of one of the asset backed securities is due to poor performance in the underlying pool of student loans. The investment is backed by a guarantee from the for-profit education services provider. We have determined that this security was not other than temporarily impaired, because the guarantee is in good standing and all required payments have been made, including hyper-amortization payments triggered by the performance of the student loan portfolio. The decline in value of the the other asset backed security is related directly to the decline in oil prices and the financial stability of its operator. The issuer has direct exposure to the oil market as its primary business is deep water drilling. As oil prices have declined the operator of the deep water vessel has experienced financial pressure on its balance sheet. We recognized other than temporary impairments on this security during the second quarter of 2017, the second quarter of 2016 and the third quarter of 2015.

Other Than Temporary Impairments

We have a policy and process to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016. During the three and six months ended June 30, 2017 and 2016, we recognized additional credit losses on residential mortgage backed securities on which we have previously recognized OTTI. During the three months ended June 30, 2017 and 2016, we recognized additional impairments of \$0.3 million and \$3.5 million, respectively, on an other asset backed security as sales of similar assets during the second quarters of 2017 and 2016 led us to conclude that the asset backing our security is worth less than our previous estimates. During the six months ended June 30, 2016, we recognized an OTTI of \$3.9 million in income on a corporate security issued by a Brazilian telecommunications company. Developments in 2016 led us to the conclusion that we will not be able to fully recover our amortized cost basis due to liquidity concerns. The other OTTI that we recognized in income during the three and six months ended June 30, 2016, on corporate securities and commercial mortgage backed securities were due to our intent to sell the securities, which were in an unrealized loss position at the reporting date. Several factors led us to believe that full recovery of amortized cost is not expected on the securities for which we recognized credit losses and reclassified OTTI from accumulated other comprehensive income to net income. A discussion of these factors, our policy and process to identify securities that could potentially have impairment that is other than temporary and a summary of OTTI is presented in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, net of loan loss allowances and deferred prepayment fees. At June 30, 2017 and December 31, 2016, the largest principal amount outstanding for any single mortgage loan was \$20.7 million and \$20.9 million, respectively, and the average loan size was \$3.4 million and \$3.2 million, respectively. In addition, the average loan to value ratio for the overall portfolio was 53.8% and 53.7%, at June 30, 2017 and December 31, 2016, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value is indicative of our conservative underwriting policies and practices for making commercial mortgage loans and may not be indicative of collateral values at the current reporting date. Our current practice is to only obtain market value appraisals of the underlying collateral at the inception of the loan unless we identify indicators of impairment in our ongoing analysis of the portfolio, in which case, we either calculate a value of the collateral using a capitalization method or obtain a third party appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type in Note 4 to our unaudited consolidated financial statements, incorporated by reference in this Item 2.

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At June 30, 2017, we had commitments to fund commercial mortgage loans totaling \$46.9 million, with fixed interest rates ranging from 4.20% to 4.77%. During 2017 and 2016, due to historically low interest rates, the commercial mortgage loan industry has been very competitive. This competition has resulted in a number of borrowers refinancing with other lenders. For the six months ended June 30, 2017, we received \$135.8 million in cash for loans being paid in full compared to \$174.2 million for the six months ended June 30, 2016. Some of the loans being paid off have either reached their maturity or are nearing maturity; however, some borrowers are paying the prepayment fee and refinancing at a lower rate.

See Note 4 to our unaudited consolidated financial statements, incorporated by reference for a presentation of our specific and general loan loss allowances, impaired loans, foreclosure activity and troubled debt restructure analysis.

Table of Contents

We have a process by which we evaluate the credit quality of each of our commercial mortgage loans. This process utilizes each loan's debt service coverage ratio as a primary metric. A summary of our portfolio by debt service coverage ratio (based on most recent information collected) follows:

	June 30, 2017		December 31, 2016	
	Principal Outstanding	Percent of Total Principal Outstanding	Principal Outstanding	Percent of Total Principal Outstanding
	(Dollars in thousands)			
Debt Service Coverage Ratio:				
Greater than or equal to 1.5	\$1,753,471	68.4 %	\$1,781,928	71.5 %
Greater than or equal to 1.2 and less than 1.5	600,484	23.4 %	517,697	20.8 %
Greater than or equal to 1.0 and less than 1.2	134,598	5.3 %	122,115	4.9 %
Less than 1.0	73,896	2.9 %	68,879	2.8 %
	\$2,562,449	100.0 %	\$2,490,619	100.0 %

Approximately 95% of our mortgage loans (based on principal outstanding) that have a debt service coverage ratio of less than 1.0 are performing under the original contractual loan terms at June 30, 2017.

Mortgage loans summarized in the following table represent all loans that we are either not currently collecting or those we feel it is probable we will not collect all amounts due according to the contractual terms of the loan agreements (all loans that we have worked with the borrower to alleviate short-term cash flow issues, loans delinquent for 60 days or more at the reporting date, loans we have determined to be collateral dependent and loans that we have recorded specific impairments on that we feel may continue to have performance issues).

	June 30, 2017	December 31, 2016
	(Dollars in thousands)	
Impaired mortgage loans with an allowance	\$6,773	\$ 4,640
Impaired mortgage loans with no related allowance	1,516	1,591
Allowance for probable loan losses	(2,049)	(1,327)
Net carrying value of impaired mortgage loans	\$6,240	\$ 4,904

At June 30, 2017, we had no commercial mortgage loans that were delinquent (60 days or more past due at the reporting date) in their principal and interest payments.

Derivative Instruments

Our derivative instruments primarily consist of call options purchased to provide the income needed to fund the annual index credits on our fixed index annuity products. The fair value of the call options is based upon the amount of cash that would be required to settle the call options obtained from the counterparties adjusted for the nonperformance risk of the counterparty. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options.

None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives that are not classified as equity is recognized immediately in the consolidated statements of operations. A presentation of our derivative instruments along with a discussion of the business strategy involved with our derivatives is included in [Note 5](#) to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Liquidity and Capital Resources

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were \$0.9 billion for the six months ended June 30, 2017 compared to \$2.1 billion for the six months ended June 30, 2016, with the decrease attributable to a \$1.1 billion decrease in net annuity deposits after coinsurance and a \$192.3 million (after coinsurance) increase in funds returned to policyholders. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed

maturity securities and fixed rate commercial mortgage loans.

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. We need liquidity primarily to service our debt (senior notes and subordinated debentures issued to subsidiary trusts), pay operating expenses and pay dividends to stockholders. Our assets consist primarily of the capital stock and surplus notes of our subsidiaries. Accordingly, our future cash flows depend upon the availability of dividends, surplus note interest payments and other statutorily permissible payments from our subsidiaries, such as payments under our investment advisory agreements and tax allocation agreement with our subsidiaries. These sources provide adequate cash flow for us to meet our current and reasonably foreseeable future obligations.

Table of Contents

The ability of our life insurance subsidiaries to pay dividends or distributions, including surplus note payments, will be limited by applicable laws and regulations of the states in which our life insurance subsidiaries are domiciled, which subject our life insurance subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, our insurance subsidiaries to maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay.

Currently, American Equity Life may pay dividends or make other distributions without the prior approval of the Iowa Insurance Commissioner, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory capital and surplus at the preceding December 31. For 2017, up to \$272.7 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Commissioner. In addition, dividends and surplus note payments may be made only out of statutory earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities in the life subsidiary's state of domicile. American Equity Life had \$1.5 billion of statutory earned surplus at June 30, 2017.

The maximum distribution permitted by law or contract is not necessarily indicative of an insurer's actual ability to pay such distributions, which may be constrained by business and regulatory considerations, such as the impact of such distributions on surplus, which could affect the insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends or make other distributions. Further, state insurance laws and regulations require that the statutory surplus of our life subsidiaries following any dividend or distribution must be reasonable in relation to their outstanding liabilities and adequate for their financial needs. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from A.M. Best and Standard and Poor's. Both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries. As of June 30, 2017, we estimate American Equity Life has sufficient statutory capital and surplus, combined with capital available to the holding company, to meet this rating objective. However, this capital may not be sufficient if significant future losses are incurred or a rating agency modifies its rating criteria and access to additional capital could be limited.

The transfer of funds by American Equity Life is also restricted by a covenant in our line of credit agreement which requires American Equity Life to maintain a minimum risk-based capital ratio of 275% and a minimum level of statutory surplus equal to the sum of 1) 80% of statutory surplus at June 30, 2016, 2) 50% of the statutory net income for each fiscal quarter ending after June 30, 2016, and 3) 50% of all capital contributed to American Equity Life after June 30, 2016. American Equity Life's risk-based capital ratio was 342% at December 31, 2016. Under this agreement, we are also required to maintain a maximum ratio of adjusted debt to total adjusted capital of 0.35. Cash and cash equivalents of the parent holding company at June 30, 2017, were \$450.2 million, of which \$413.3 million was used to redeem the \$400 million notes due 2021 (the "2021 Notes") on July 17, 2017. In addition, we have a \$150 million revolving line of credit, with no borrowings outstanding, available through September 2021 for general corporate purposes of the parent company and its subsidiaries. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution under a currently effective shelf registration statement on Form S-3. The terms of any offering would be established at the time of the offering, subject to market conditions. On June 16, 2017, we issued \$500 million aggregate principal amount of senior unsecured notes due 2027 which bear interest at 5.0% per year and will mature on June 15, 2027 (the "2027 Notes"). We used the net proceeds from the issuance of the 2027 Notes to prepay our \$100 million term loan that was scheduled to mature in 2019 on June 16, 2017, and to redeem the 2021 Notes on July 17, 2017. We paid \$413.3 million to redeem the 2021 Notes which included an early redemption premium equal to 3.313% of the \$400 million principal amount of the 2021 Notes.

New Accounting Pronouncements

See Note 1 to our unaudited consolidated financial statements, which is incorporated by reference in this Item 2.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to invest our available funds in a manner that will maximize shareholder value and fund future obligations to policyholders and debtors, subject to appropriate risk considerations. We seek to meet this objective through

investments that: (i) consist substantially of investment grade fixed maturity securities; (ii) have projected returns which satisfy our spread targets; and (iii) have characteristics which support the underlying liabilities. Many of our products incorporate surrender charges, market interest rate adjustments or other features to encourage persistency. We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs; and (vi) other factors.

Table of Contents

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate term loan and subordinated debentures. Our floating rate trust preferred securities bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was \$164.5 million at June 30, 2017, of which \$85.5 million has been swapped to a fixed rate which began in March 2014 and \$79.0 million has been capped for a term of seven years which began in July 2014 (see [Note 5](#) to our unaudited consolidated financial statements). The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (caps, participation rates or asset fee rates for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

A major component of our interest rate risk management program is structuring the investment portfolio with cash flow characteristics consistent with the cash flow characteristics of our insurance liabilities. We use models to simulate cash flows expected from our existing business under various interest rate scenarios. These simulations enable us to measure the potential gain or loss in fair value of our interest rate-sensitive financial instruments, to evaluate the adequacy of expected cash flows from our assets to meet the expected cash requirements of our liabilities and to determine if it is necessary to lengthen or shorten the average life and duration of our investment portfolio. The "duration" of a security is the time weighted present value of the security's expected cash flows and is used to measure a security's sensitivity to changes in interest rates. When the durations of assets and liabilities are similar, exposure to interest rate risk is minimized because a change in value of assets should be largely offset by a change in the value of liabilities.

If interest rates were to increase 10% (28 basis points) from levels at June 30, 2017, we estimate that the fair value of our fixed maturity securities would decrease by approximately \$1.0 billion. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be a decrease of \$307.2 million in accumulated other comprehensive income and a decrease in stockholders' equity. The models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2016.

At June 30, 2017, 37% of our fixed income securities have call features, of which 2.1% (\$899.1 million) were subject to call redemption. Another 1.0% (\$409.5 million) will become subject to call redemption during the next twelve months. Approximately 72% of our fixed income securities that have call features are not callable until within six months of their stated maturities. We have reinvestment risk related to these redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to the redeemed bonds. Such reinvestment risk typically occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on annuity liabilities, we have the ability to reduce crediting rates (caps, participation rates or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At June 30, 2017, approximately 99% of our annuity liabilities

were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies.

We purchase call options on the applicable indices to fund the annual index credits on our fixed index annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for fixed index products. The difference between proceeds received at expiration of these options and index credits, as shown in the following table, is primarily due to over-hedging as a result of policyholder behavior being different than our expectations.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands)			
Annual index credits to policyholders on their anniversaries	\$371,623	\$8,900	\$693,503	\$15,431
Proceeds received at expiration of options related to such credits	378,517	9,308	705,069	16,050

On the anniversary dates of the index policies, we purchase new one-year call options to fund the next annual index credits. The risk associated with these prospective purchases is the uncertainty of the cost, which will determine whether we are able to earn our spread on our index business. We manage this risk through the terms of our fixed index annuities, which permit us to change caps, participation rates and asset fees, subject to contractual features. By modifying caps, participation rates or asset fees, we can limit option costs to budgeted amounts, except in cases where the contractual features would prevent further modifications. Based upon actuarial testing which we conduct as a part of the design of our index products and on an ongoing basis, we believe the risk that contractual features would prevent us from controlling option costs is not material.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15(e) and 15d-15(e), our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective as of June 30, 2017 in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

There were no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7 - Commitments and Contingencies to the unaudited consolidated financial statements, which is incorporated by reference in this Item 1, for litigation and regulatory disclosures.

Item 1A. Risk Factors

Our 2016 Annual Report on Form 10-K described our Risk Factors. Other than as set forth below, there have been no material changes to the Risk Factors during the six months ended June 30, 2017.

Changes in federal regulation may affect our annuity sales and profitability

On April 6, 2016, the U.S. Department of Labor (“DOL”) released a final regulation which substantially expands the range of activities that will be considered to be fiduciary advice under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986. As released, the final regulation provided for a phased implementation beginning April 10, 2017, with full implementation by January 1, 2018. Lawsuits are pending challenging the regulation and efforts continue to delay, repeal or revise the regulation. The success of efforts to overturn, delay, repeal or revise the regulation cannot be predicted. We believe it could materially impact our business and have an adverse effect on sales of annuity products to individual retirement account (“IRA”) holders, particularly index annuity products sold in the independent insurance agent distribution channel. A significant portion of our annuity sales are to IRAs. The new regulation deems advisors, including independent insurance agents, who sell fixed index annuities to IRAs, IRA rollovers or 401(k) plans fiduciaries and prohibits them from receiving compensation unless they comply with a prohibited transaction exemption.

On February 3, 2017, a presidential memorandum directed the DOL to review the regulation to determine whether it would adversely impact retirement savers ability to access retirement information and financial advice. On April 7, 2017, the DOL issued a final rule delaying the applicability date of the regulation and related exemptions. The new definition of fiduciary and the impartial conduct standards became effective on June 9, 2017. Compliance with the remaining conditions and related exemptions is not required until January 1, 2018. This rule also changed some requirements of the April 2016 regulation, including permitting insurance agents to rely on Prohibited Transaction Exemption 84-24 until January 1, 2018 for all annuity sales. On May 22, 2017, the DOL issued a temporary enforcement policy covering the transition period between June 9, 2017 and January 1, 2018, during which the DOL will not pursue claims against advisers who are working diligently and in good faith to comply with their fiduciary duties and the conditions of the prohibited transaction exemptions. On July 6, 2017, DOL issued a request for information seeking comment on whether the January 1, 2018 applicability date should be delayed and on possible revisions to the final regulation including the prohibited transaction exemptions. Additional changes to the regulation’s requirement are possible given the presidential directive to the DOL to review the regulation and the DOL’s recent request for information.

Although the precise impact of the regulation is difficult to assess, compliance with the prohibited transaction exemptions will likely result in increased regulatory burdens, decreases in sales, changes to our compensation practices and product offerings and increased litigation risk, which could negatively impact our business, results of operations or financial condition.

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

There were no issuer purchases of equity securities for the quarter ended June 30, 2017.

51

Table of Contents

Item 6. Exhibits

Exhibit No.	Description	Method of Filing
4.2	<u>Third Supplemental Indenture, dated as of June 16, 2017, between American Equity Investment Life Holding Company and U.S. Bank National Association</u>	Incorporated by reference to Exhibit 4.2 to Form 8-K filed on June 16, 2017
12.1	<u>Ratio of Earnings to Fixed Charges</u>	Filed herewith
31.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith
31.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith
32.1	<u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith
32.2	<u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>	Filed herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith

Table of Contents

SIGNATURES

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.

Date: August 7, 2017 AMERICAN EQUITY INVESTMENT LIFE
HOLDING COMPANY

By: /s/ John M. Matovina
John M. Matovina, Chief Executive Officer and President
(Principal Executive Officer)

By: /s/ Ted M. Johnson
Ted M. Johnson, Chief Financial Officer and Treasurer
(Principal Financial Officer)

By: /s/ Scott A. Samuelson
Scott A. Samuelson, Vice President and Chief Accounting Officer
(Principal Accounting Officer)