

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO

Form 10-Q

August 08, 2013

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(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, 2013

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

50266

West Des Moines, Iowa

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area  
code

(515) 221-0002

(Telephone)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, par value \$1

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$1

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

**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.

Shares of common stock outstanding at July 31, 2013: 64,710,572

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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>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>50</u>     |
| <br><u>PART II — OTHER INFORMATION</u>                                                               |               |
| <u>Item 1: Legal Proceedings</u>                                                                     | <u>50</u>     |
| <u>Item 1A: Risk Factors</u>                                                                         | <u>52</u>     |
| <u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | <u>52</u>     |
| <u>Item 6: Exhibits</u>                                                                              | <u>52</u>     |
| <br><u>Signatures</u>                                                                                | <br><u>53</u> |

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

|                                                                                                                         | June 30, 2013<br>(Unaudited) | December 31,<br>2012 |
|-------------------------------------------------------------------------------------------------------------------------|------------------------------|----------------------|
| Assets                                                                                                                  |                              |                      |
| Investments:                                                                                                            |                              |                      |
| Fixed maturity securities:                                                                                              |                              |                      |
| Available for sale, at fair value (amortized cost: 2013 - \$24,789,087; 2012 - \$21,957,027)                            | \$25,545,642                 | \$24,172,136         |
| Held for investment, at amortized cost (fair value: 2013 - \$61,250; 2012 - \$61,521)                                   | 76,170                       | 76,088               |
| Equity securities, available for sale, at fair value (cost: 2013 - \$8,915; 2012 - \$44,598)                            | 9,790                        | 53,422               |
| Mortgage loans on real estate                                                                                           | 2,583,703                    | 2,623,940            |
| Derivative instruments                                                                                                  | 629,135                      | 415,258              |
| Other investments                                                                                                       | 208,635                      | 196,366              |
| Total investments                                                                                                       | 29,053,075                   | 27,537,210           |
| Cash and cash equivalents                                                                                               | 746,889                      | 1,268,545            |
| Coinsurance deposits                                                                                                    | 2,944,726                    | 2,910,701            |
| Accrued investment income                                                                                               | 287,692                      | 261,833              |
| Deferred policy acquisition costs                                                                                       | 2,147,252                    | 1,709,799            |
| Deferred sales inducements                                                                                              | 1,646,164                    | 1,292,341            |
| Deferred income taxes                                                                                                   | 153,701                      | —                    |
| Income taxes recoverable                                                                                                | 1,645                        | —                    |
| Other assets                                                                                                            | 307,406                      | 153,049              |
| Total assets                                                                                                            | \$37,288,550                 | \$35,133,478         |
| Liabilities and Stockholders' Equity                                                                                    |                              |                      |
| Liabilities:                                                                                                            |                              |                      |
| Policy benefit reserves                                                                                                 | \$33,635,600                 | \$31,773,988         |
| Other policy funds and contract claims                                                                                  | 440,217                      | 455,752              |
| Notes payable                                                                                                           | 303,126                      | 309,869              |
| Subordinated debentures                                                                                                 | 245,958                      | 245,869              |
| Amounts due under repurchase agreements                                                                                 | 160,436                      | —                    |
| Deferred income taxes                                                                                                   | —                            | 49,303               |
| Income taxes payable                                                                                                    | —                            | 4,756                |
| Other liabilities                                                                                                       | 1,061,137                    | 573,704              |
| Total liabilities                                                                                                       | 35,846,474                   | 33,413,241           |
| Stockholders' equity:                                                                                                   |                              |                      |
| Preferred stock, par value \$1 per share, 2,000,000 shares authorized, 2013 and 2012 - no shares issued and outstanding | —                            | —                    |

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Common stock, par value \$1 per share, 200,000,000 shares authorized; issued and outstanding:

|                                                                                     |              |              |
|-------------------------------------------------------------------------------------|--------------|--------------|
| 2013 - 63,500,933 shares (excluding 4,877,735 treasury shares);                     | 63,501       | 61,751       |
| 2012 - 61,750,601 shares (excluding 5,127,379 treasury shares)                      |              |              |
| Additional paid-in capital                                                          | 512,613      | 496,715      |
| Unallocated common stock held by ESOP; 2013 - 186,485 shares; 2012 - 239,799 shares | (2,009       | ) (2,583 )   |
| Accumulated other comprehensive income                                              | 244,280      | 686,807      |
| Retained earnings                                                                   | 623,691      | 477,547      |
| Total stockholders' equity                                                          | 1,442,076    | 1,720,237    |
| Total liabilities and stockholders' equity                                          | \$37,288,550 | \$35,133,478 |

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

|                                                                                                       | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |           |
|-------------------------------------------------------------------------------------------------------|--------------------------------|------------|------------------------------|-----------|
|                                                                                                       | 2013                           | 2012       | 2013                         | 2012      |
| Revenues:                                                                                             |                                |            |                              |           |
| Traditional life insurance premiums                                                                   | \$2,913                        | \$3,248    | \$5,611                      | \$6,470   |
| Annuity product charges                                                                               | 23,511                         | 21,908     | 44,992                       | 41,301    |
| Net investment income                                                                                 | 336,143                        | 320,259    | 665,833                      | 647,169   |
| Change in fair value of derivatives                                                                   | 64,040                         | (150,847)  | ) 438,002                    | 108,314   |
| Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses | 15,689                         | (611)      | ) 26,274                     | (6,687)   |
| OTTI losses on investments:                                                                           |                                |            |                              |           |
| Total OTTI losses                                                                                     | (2,775)                        | ) (375)    | ) (4,964)                    | ) (2,156) |
| Portion of OTTI losses recognized from other comprehensive income                                     | —                              | (603)      | ) (1,048)                    | ) (1,703) |
| Net OTTI losses recognized in operations                                                              | (2,775)                        | ) (978)    | ) (6,012)                    | ) (3,859) |
| Loss on extinguishment of debt                                                                        | (589)                          | ) —        | (589)                        | ) —       |
| Total revenues                                                                                        | 438,932                        | 192,979    | 1,174,111                    | 792,708   |
| Benefits and expenses:                                                                                |                                |            |                              |           |
| Insurance policy benefits and change in future policy benefits                                        | 2,106                          | 2,250      | 3,841                        | 4,367     |
| Interest sensitive and index product benefits                                                         | 336,025                        | 142,733    | 561,834                      | 281,856   |
| Amortization of deferred sales inducements                                                            | 120,536                        | 25,940     | 149,367                      | 42,650    |
| Change in fair value of embedded derivatives                                                          | (408,409)                      | ) (80,989) | ) (45,137)                   | ) 278,077 |
| Interest expense on notes payable                                                                     | 6,780                          | 7,072      | 14,028                       | 14,067    |
| Interest expense on subordinated debentures                                                           | 3,018                          | 3,563      | 6,027                        | 7,149     |
| Amortization of deferred policy acquisition costs                                                     | 169,270                        | 44,848     | 215,500                      | 79,132    |
| Other operating costs and expenses                                                                    | 24,851                         | 18,902     | 44,371                       | 40,615    |
| Total benefits and expenses                                                                           | 254,177                        | 164,319    | 949,831                      | 747,913   |
| Income before income taxes                                                                            | 184,755                        | 28,660     | 224,280                      | 44,795    |
| Income tax expense                                                                                    | 64,642                         | 9,901      | 78,136                       | 15,565    |
| Net income                                                                                            | \$120,113                      | \$18,759   | \$146,144                    | \$29,230  |
| Earnings per common share                                                                             | \$1.87                         | \$0.31     | \$2.29                       | \$0.49    |
| Earnings per common share - assuming dilution                                                         | \$1.71                         | \$0.30     | \$2.09                       | \$0.46    |
| Weighted average common shares outstanding (in thousands):                                            |                                |            |                              |           |
| Earnings per common share                                                                             | 64,254                         | 59,943     | 63,787                       | 59,822    |
| Earnings per common share - assuming dilution                                                         | 70,382                         | 64,254     | 69,882                       | 64,230    |
| See accompanying notes to unaudited consolidated financial statements.                                |                                |            |                              |           |

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

|                                                                          | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |              |
|--------------------------------------------------------------------------|--------------------------------|--------------|------------------------------|--------------|
|                                                                          | 2013                           | 2012         | 2013                         | 2012         |
| Net income                                                               | \$ 120,113                     | \$ 18,759    | \$ 146,144                   | \$ 29,230    |
| Other comprehensive income (loss):                                       |                                |              |                              |              |
| Change in net unrealized investment gains/losses (1)                     | (634,688                       | ) 263,366    | (669,871                     | ) 188,391    |
| Noncredit component of OTTI losses (1)                                   | —                              | (99          | ) 347                        | 290          |
| Reclassification of unrealized investment gains/losses to net income (1) | (7,439                         | ) —          | (11,286                      | ) —          |
| Other comprehensive income (loss) before income tax                      | (642,127                       | ) 263,267    | (680,810                     | ) 188,681    |
| Income tax effect related to other comprehensive income                  | 224,744                        | (92,142      | ) 238,283                    | (66,038      |
| Other comprehensive income (loss)                                        | (417,383                       | ) 171,125    | (442,527                     | ) 122,643    |
| Comprehensive income (loss)                                              | \$ (297,270                    | ) \$ 189,884 | \$ (296,383                  | ) \$ 151,873 |

(1) Net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs.  
See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except per share data)

(Unaudited)

|                                                                                                                                  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Unallocated<br>Common<br>Stock Held<br>by ESOP | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Total<br>Stockholders'<br>Equity |
|----------------------------------------------------------------------------------------------------------------------------------|-----------------|----------------------------------|------------------------------------------------|-------------------------------------------------|----------------------|----------------------------------|
| Balance at December 31, 2012                                                                                                     | \$61,751        | \$496,715                        | \$(2,583 )                                     | \$ 686,807                                      | \$477,547            | \$ 1,720,237                     |
| Net income for period                                                                                                            | —               | —                                | —                                              | —                                               | 146,144              | 146,144                          |
| Other comprehensive loss                                                                                                         | —               | —                                | —                                              | (442,527 )                                      | —                    | (442,527 )                       |
| Allocation of 53,314 shares of<br>common stock by ESOP, including<br>excess income tax benefits                                  | —               | 134                              | 574                                            | —                                               | —                    | 708                              |
| Share-based compensation,<br>including excess income tax<br>benefits                                                             | —               | 3,193                            | —                                              | —                                               | —                    | 3,193                            |
| Issuance of 1,533,603 shares of<br>common stock under compensation<br>plans, including excess income tax<br>benefits             | 1,533           | 11,024                           | —                                              | —                                               | —                    | 12,557                           |
| Extinguishment of convertible<br>senior notes, net of tax, including<br>216,729 shares of common stock<br>issued upon conversion | 217             | 1,547                            | —                                              | —                                               | —                    | 1,764                            |
| Balance at June 30, 2013                                                                                                         | \$63,501        | \$512,613                        | \$(2,009 )                                     | \$ 244,280                                      | \$623,691            | \$ 1,442,076                     |
| Balance at December 31, 2011                                                                                                     | \$57,837        | \$468,281                        | \$(3,620 )                                     | \$ 457,229                                      | \$428,952            | \$ 1,408,679                     |
| Net income for period                                                                                                            | —               | —                                | —                                              | —                                               | 29,230               | 29,230                           |
| Other comprehensive income                                                                                                       | —               | —                                | —                                              | 122,643                                         | —                    | 122,643                          |
| Conversion of \$12,554 of<br>subordinated debentures                                                                             | 1,550           | 10,291                           | —                                              | —                                               | —                    | 11,841                           |
| Allocation of 41,323 shares of<br>common stock by ESOP, including<br>excess income tax benefits                                  | —               | 22                               | 445                                            | —                                               | —                    | 467                              |
| Share-based compensation,<br>including excess income tax<br>benefits                                                             | —               | 3,719                            | —                                              | —                                               | —                    | 3,719                            |
| Issuance of 822,390 shares of<br>common stock under compensation<br>plans, including excess income tax<br>benefits               | 822             | 250                              | —                                              | —                                               | —                    | 1,072                            |
| Balance at June 30, 2012                                                                                                         | \$60,209        | \$482,563                        | \$(3,175 )                                     | \$ 579,872                                      | \$458,182            | \$ 1,577,651                     |

See accompanying notes to unaudited consolidated financial statements.



AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

|                                                                                   | Six Months Ended |               |
|-----------------------------------------------------------------------------------|------------------|---------------|
|                                                                                   | June 30,         |               |
|                                                                                   | 2013             | 2012          |
| Operating activities                                                              |                  |               |
| Net income                                                                        | \$ 146,144       | \$ 29,230     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |               |
| Interest sensitive and index product benefits                                     | 561,834          | 281,856       |
| Amortization of deferred sales inducements                                        | 149,367          | 42,650        |
| Annuity product charges                                                           | (44,992)         | ) (41,301)    |
| Change in fair value of embedded derivatives                                      | (45,137)         | ) 278,077     |
| Change in traditional life and accident and health insurance reserves             | (1,066)          | ) 12,652      |
| Policy acquisition costs deferred                                                 | (205,519)        | ) (186,573)   |
| Amortization of deferred policy acquisition costs                                 | 215,500          | 79,132        |
| Provision for depreciation and other amortization                                 | 9,356            | 9,150         |
| Amortization of discounts and premiums on investments                             | 9,546            | (64,020)      |
| Realized gains/losses on investments and net OTTI losses recognized in operations | (20,262)         | ) 10,546      |
| Change in fair value of derivatives                                               | (438,002)        | ) (108,314)   |
| Deferred income taxes                                                             | 38,781           | (14,249)      |
| Share-based compensation                                                          | 3,011            | 3,024         |
| Change in accrued investment income                                               | (25,859)         | ) (15,707)    |
| Change in income taxes payable                                                    | (8,483)          | ) (3,493)     |
| Change in other assets                                                            | (296)            | ) (10,077)    |
| Change in other policy funds and contract claims                                  | (15,535)         | ) 33,548      |
| Change in collateral held for derivatives                                         | 164,269          | 175,549       |
| Change in other liabilities                                                       | 475              | (11,421)      |
| Other                                                                             | (1,868)          | ) 164         |
| Net cash provided by operating activities                                         | 491,264          | 500,423       |
| Investing activities                                                              |                  |               |
| Sales, maturities, or repayments of investments:                                  |                  |               |
| Fixed maturity securities - available for sale                                    | 2,292,959        | 1,423,179     |
| Fixed maturity securities - held for investment                                   | —                | 1,688,329     |
| Equity securities - available for sale                                            | 44,829           | 5,605         |
| Mortgage loans on real estate                                                     | 266,539          | 219,423       |
| Derivative instruments                                                            | 409,050          | 110,201       |
| Other investments                                                                 | 11,737           | 10,362        |
| Acquisition of investments:                                                       |                  |               |
| Fixed maturity securities - available for sale                                    | (4,962,314)      | ) (3,542,142) |
| Mortgage loans on real estate                                                     | (228,735)        | ) (152,648)   |
| Derivative instruments                                                            | (190,997)        | ) (184,709)   |
| Other investments                                                                 | (19,594)         | ) (83,811)    |
| Purchases of property, furniture and equipment                                    | (288)            | ) (273)       |
| Net cash used in investing activities                                             | (2,376,814)      | ) (506,484)   |



AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

|                                                                        | Six Months Ended |             |
|------------------------------------------------------------------------|------------------|-------------|
|                                                                        | June 30,         |             |
|                                                                        | 2013             | 2012        |
| Financing activities                                                   |                  |             |
| Receipts credited to annuity policyholder account balances             | \$2,033,484      | \$1,808,845 |
| Coinsurance deposits                                                   | 15,960           | (28,630 )   |
| Return of annuity policyholder account balances                        | (829,047 )       | (760,423 )  |
| Financing fees incurred and deferred                                   | (1,153 )         | —           |
| Proceeds from notes payable                                            | 15,000           | —           |
| Repayment of notes payable                                             | (28,243 )        | —           |
| Proceeds from amounts due under repurchase agreements                  | 160,436          | —           |
| Excess tax benefits realized from share-based compensation plans       | 380              | 693         |
| Proceeds from issuance of common stock                                 | 12,284           | 1,062       |
| Change in checks in excess of cash balance                             | (15,207 )        | (12,608 )   |
| Net cash provided by financing activities                              | 1,363,894        | 1,008,939   |
| Increase (decrease) in cash and cash equivalents                       | (521,656 )       | 1,002,878   |
| Cash and cash equivalents at beginning of period                       | 1,268,545        | 404,952     |
| Cash and cash equivalents at end of period                             | \$746,889        | \$1,407,830 |
| Supplemental disclosures of cash flow information                      |                  |             |
| Cash paid during period for:                                           |                  |             |
| Interest expense                                                       | \$12,595         | \$14,308    |
| Income taxes                                                           | 47,700           | 32,650      |
| Non-cash operating activity:                                           |                  |             |
| Deferral of sales inducements                                          | 164,931          | 143,248     |
| Non-cash investing activity:                                           |                  |             |
| Real estate acquired in satisfaction of mortgage loans                 | 844              | 11,985      |
| Non-cash financing activities:                                         |                  |             |
| Conversion of subordinated debentures                                  | —                | 12,554      |
| Common stock issued in extinguishment of debt                          | 3,367            | —           |
| See accompanying notes to unaudited consolidated financial statements. |                  |             |

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

June 30, 2013

(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, 2013 are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. 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, 2012.

As previously reported in the notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012, we identified certain classification errors related to amounts reported in the financing activities section of our consolidated statements of cash flows. Consistent with that presentation, we have revised the consolidated statement of cash flows for the six months ended June 30, 2012 resulting in decreases of \$87.9 million to receipts credited to annuity and single premium universal life policyholder account balances and return of annuity policyholder account balances. These revisions had no net impact on net cash provided by financing activities, and no impact on our consolidated balance sheets, statements of operations, statements of comprehensive income or statements of changes in stockholders' equity.

Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") that expands the disclosure requirements related to other comprehensive income (loss). A reporting entity is now required to provide information about the amounts reclassified out of accumulated other comprehensive income (loss) by component. In addition, a reporting entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. This ASU became effective for interim and annual periods beginning after December 15, 2012. We adopted this ASU on January 1, 2013.

New Accounting Pronouncements

There are currently no accounting standards updates with effective dates after June 30, 2013 that will significantly affect our consolidated financial statements.

## 2. Fair Values of Financial Instruments

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

|                                                          | June 30, 2013          |              | December 31, 2012  |              |
|----------------------------------------------------------|------------------------|--------------|--------------------|--------------|
|                                                          | Carrying<br>Amount     | Fair Value   | Carrying<br>Amount | Fair Value   |
|                                                          | (Dollars in thousands) |              |                    |              |
| Assets                                                   |                        |              |                    |              |
| Fixed maturity securities:                               |                        |              |                    |              |
| Available for sale                                       | \$25,545,642           | \$25,545,642 | \$24,172,136       | \$24,172,136 |
| Held for investment                                      | 76,170                 | 61,250       | 76,088             | 61,521       |
| Equity securities, available for sale                    | 9,790                  | 9,790        | 53,422             | 53,422       |
| Mortgage loans on real estate                            | 2,583,703              | 2,808,973    | 2,623,940          | 2,848,235    |
| Derivative instruments                                   | 629,135                | 629,135      | 415,258            | 415,258      |
| Other investments                                        | 182,026                | 182,219      | 163,193            | 163,517      |
| Cash and cash equivalents                                | 746,889                | 746,889      | 1,268,545          | 1,268,545    |
| Coinsurance deposits                                     | 2,944,726              | 2,724,853    | 2,910,701          | 2,678,232    |
| Interest rate caps                                       | 5,565                  | 5,565        | 3,247              | 3,247        |
| Interest rate swap                                       | 274                    | 274          | —                  | —            |
| 2015 notes hedges                                        | 71,400                 | 71,400       | 43,105             | 43,105       |
| Liabilities                                              |                        |              |                    |              |
| Policy benefit reserves                                  | 33,304,622             | 27,895,416   | 31,452,496         | 26,264,831   |
| Single premium immediate annuity (SPIA) benefit reserves | 439,591                | 453,496      | 455,167            | 469,768      |
| Notes payable                                            | 303,126                | 481,406      | 309,869            | 422,175      |
| Subordinated debentures                                  | 245,958                | 229,623      | 245,869            | 218,283      |
| 2015 notes embedded derivatives                          | 71,400                 | 71,400       | 43,105             | 43,105       |
| Interest rate swap                                       | —                      | —            | 4,261              | 4,261        |

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 the six months ended June 30, 2013.

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Our assets and liabilities which are measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012 are presented below based on the fair value hierarchy levels:

|                                                                           | Total<br>Fair Value    | Quoted<br>Prices in<br>Active<br>Markets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---------------------------------------------------------------------------|------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                                           | (Dollars in thousands) |                                                       |                                                           |                                                    |
| June 30, 2013                                                             |                        |                                                       |                                                           |                                                    |
| Assets                                                                    |                        |                                                       |                                                           |                                                    |
| Fixed maturity securities:                                                |                        |                                                       |                                                           |                                                    |
| Available for sale:                                                       |                        |                                                       |                                                           |                                                    |
| United States Government full faith and credit                            | \$4,938                | \$4,938                                               | \$—                                                       | \$—                                                |
| United States Government sponsored agencies                               | 1,199,847              | —                                                     | 1,199,847                                                 | —                                                  |
| United States municipalities, states and territories                      | 3,543,158              | —                                                     | 3,543,158                                                 | —                                                  |
| Foreign government obligations                                            | 92,811                 | —                                                     | 92,811                                                    | —                                                  |
| Corporate securities                                                      | 15,999,327             | 8,924                                                 | 15,990,403                                                | —                                                  |
| Residential mortgage backed securities                                    | 2,488,057              | —                                                     | 2,486,516                                                 | 1,541                                              |
| Commercial mortgage backed securities                                     | 1,222,689              | —                                                     | 1,222,689                                                 | —                                                  |
| Other asset backed securities                                             | 994,815                | 378                                                   | 994,437                                                   | —                                                  |
| Equity securities, available for sale: finance, insurance and real estate | 9,790                  | 2,020                                                 | 7,770                                                     | —                                                  |
| Derivative instruments                                                    | 629,135                | —                                                     | 629,135                                                   | —                                                  |
| Cash and cash equivalents                                                 | 746,889                | 746,889                                               | —                                                         | —                                                  |
| Interest rate caps                                                        | 5,565                  | —                                                     | 5,565                                                     | —                                                  |
| Interest rate swap                                                        | 274                    | —                                                     | 274                                                       | —                                                  |
| 2015 notes hedges                                                         | 71,400                 | —                                                     | 71,400                                                    | —                                                  |
|                                                                           | \$27,008,695           | \$763,149                                             | \$26,244,005                                              | \$1,541                                            |
| Liabilities                                                               |                        |                                                       |                                                           |                                                    |
| 2015 notes embedded derivatives                                           | \$71,400               | \$—                                                   | \$71,400                                                  | \$—                                                |
| Fixed index annuities - embedded derivatives                              | 3,747,052              | —                                                     | —                                                         | 3,747,052                                          |
|                                                                           | \$3,818,452            | \$—                                                   | \$71,400                                                  | \$3,747,052                                        |
| December 31, 2012                                                         |                        |                                                       |                                                           |                                                    |
| Assets                                                                    |                        |                                                       |                                                           |                                                    |
| Fixed maturity securities:                                                |                        |                                                       |                                                           |                                                    |
| Available for sale:                                                       |                        |                                                       |                                                           |                                                    |
| United States Government full faith and credit                            | \$5,154                | \$5,154                                               | \$—                                                       | \$—                                                |
| United States Government sponsored agencies                               | 1,772,025              | —                                                     | 1,772,025                                                 | —                                                  |
| United States municipalities, states and territories                      | 3,578,323              | —                                                     | 3,578,323                                                 | —                                                  |
| Foreign government obligations                                            | 105,259                | —                                                     | 105,259                                                   | —                                                  |
| Corporate securities                                                      | 14,466,772             | 33,131                                                | 14,433,641                                                | —                                                  |
| Residential mortgage backed securities                                    | 2,888,113              | —                                                     | 2,886,301                                                 | 1,812                                              |
| Commercial mortgage backed securities                                     | 357,982                | —                                                     | 357,982                                                   | —                                                  |
| Other asset backed securities                                             | 998,508                | 378                                                   | 998,130                                                   | —                                                  |
| Equity securities, available for sale: finance, insurance and real estate | 53,422                 | 36,928                                                | 16,494                                                    | —                                                  |
| Derivative instruments                                                    | 415,258                | —                                                     | 415,258                                                   | —                                                  |
| Cash and cash equivalents                                                 | 1,268,545              | 1,268,545                                             | —                                                         | —                                                  |

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|                                              |              |             |              |             |
|----------------------------------------------|--------------|-------------|--------------|-------------|
| Interest rate caps                           | 3,247        | —           | 3,247        | —           |
| 2015 notes hedges                            | 43,105       | —           | 43,105       | —           |
|                                              | \$25,955,713 | \$1,344,136 | \$24,609,765 | \$1,812     |
| Liabilities                                  |              |             |              |             |
| 2015 notes embedded derivatives              | \$43,105     | \$—         | \$43,105     | \$—         |
| Interest rate swap                           | 4,261        | —           | 4,261        | —           |
| Fixed index annuities - embedded derivatives | 3,337,556    | —           | —            | 3,337,556   |
|                                              | \$3,384,922  | \$—         | \$47,366     | \$3,337,556 |



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 further quotes or prices from additional parties as needed. In addition, for our callable United States Government sponsored agencies, we obtain two broker quotes and take the average of the two 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, 2013 and December 31, 2012.

**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 and appraised property values); 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

None of the financial instruments included in other investments are measured at fair value on a recurring basis. Financial instruments included in other investments 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 values 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 falls within Level 2 of the fair value hierarchy.

#### 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 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.

#### 2015 notes hedges

The fair value of these call options is determined by a third party who applies market observable data such as our common stock price, its dividend yield and its volatility, as well as the time to expiration of the call options to determine a fair value of the buy side of these options.

#### 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 purchased 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 payable

The fair value of the convertible senior notes is 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. Notes 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.

#### 2015 notes embedded derivatives

The fair value of this embedded derivative is determined by pricing the call options that hedge this potential liability. The terms of the conversion premium are identical to the 2015 notes hedges and the method of determining fair value of the call options is based upon observable market data.

#### 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.



The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and six months ended June 30, 2013 and 2012:

|                                               | Three Months Ended<br>June 30,<br>2013 |         | Six Months Ended<br>June 30,<br>2013 |         |
|-----------------------------------------------|----------------------------------------|---------|--------------------------------------|---------|
|                                               | 2012                                   |         | 2012                                 |         |
|                                               | (Dollars in thousands)                 |         |                                      |         |
| Available for sale securities                 |                                        |         |                                      |         |
| Beginning balance                             | \$1,724                                | \$2,027 | \$1,812                              | \$2,098 |
| Principal returned                            | (193                                   | ) (52   | ) (561                               | ) (93   |
| Accretion of discount                         | 5                                      | 21      | 134                                  | 47      |
| Total gains (losses) (realized/unrealized):   |                                        |         |                                      |         |
| Included in other comprehensive income (loss) | 5                                      | 81      | 156                                  | 183     |
| Included in operations                        | —                                      | (72     | ) —                                  | (230    |
| Ending balance                                | \$1,541                                | \$2,005 | \$1,541                              | \$2,005 |

The Level 3 assets included in the table above are not material to our financial position, results of operations or cash flows, and it is management's opinion that the sensitivity of the inputs used in determining the fair value of these assets is not material as well.

|                                              | Three Months Ended<br>June 30,<br>2013 |             | Six Months Ended<br>June 30,<br>2013 |             |
|----------------------------------------------|----------------------------------------|-------------|--------------------------------------|-------------|
|                                              | 2012                                   |             | 2012                                 |             |
|                                              | (Dollars in thousands)                 |             |                                      |             |
| Fixed index annuities - embedded derivatives |                                        |             |                                      |             |
| Beginning balance                            | \$3,848,902                            | \$2,921,037 | \$3,337,556                          | \$2,530,496 |
| Premiums less benefits                       | 425,671                                | 105,279     | 672,393                              | 189,505     |
| Change in unrealized gains, net              | (527,521                               | ) (111,368  | ) (262,897                           | ) 194,947   |
| Ending balance                               | \$3,747,052                            | \$2,914,948 | \$3,747,052                          | \$2,914,948 |

Change in unrealized gains, 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, 2013, were to increase by 100 basis points, the fair value of the embedded derivatives would decrease by \$240.7 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of \$147.2 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 \$267.5 million recorded through operations as an increase in the change in fair value of embedded derivatives and increase our combined balance for deferred policy acquisition costs and deferred sales inducements by \$161.1 million recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.



## 3. Investments

At June 30, 2013 and December 31, 2012, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

|                                                      | Amortized<br>Cost      | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value     |
|------------------------------------------------------|------------------------|------------------------------|-------------------------------|----------------|
|                                                      | (Dollars in thousands) |                              |                               |                |
| June 30, 2013                                        |                        |                              |                               |                |
| Fixed maturity securities:                           |                        |                              |                               |                |
| Available for sale:                                  |                        |                              |                               |                |
| United States Government full faith and credit       | \$4,607                | \$367                        | \$(36                         | ) \$4,938      |
| United States Government sponsored agencies          | 1,241,898              | 4,796                        | (46,847                       | ) 1,199,847    |
| United States municipalities, states and territories | 3,299,732              | 268,127                      | (24,701                       | ) 3,543,158    |
| Foreign government obligations                       | 86,106                 | 9,230                        | (2,525                        | ) 92,811       |
| Corporate securities                                 | 15,527,755             | 808,241                      | (336,669                      | ) 15,999,327   |
| Residential mortgage backed securities               | 2,337,399              | 167,051                      | (16,393                       | ) 2,488,057    |
| Commercial mortgage backed securities                | 1,304,028              | 1,714                        | (83,053                       | ) 1,222,689    |
| Other asset backed securities                        | 987,562                | 27,416                       | (20,163                       | ) 994,815      |
|                                                      | \$24,789,087           | \$1,286,942                  | \$(530,387                    | ) \$25,545,642 |
| Held for investment:                                 |                        |                              |                               |                |
| Corporate security                                   | \$76,170               | \$—                          | \$(14,920                     | ) \$61,250     |
| Equity securities, available for sale:               |                        |                              |                               |                |
| Finance, insurance, and real estate                  | \$8,915                | \$875                        | \$—                           | \$9,790        |
| December 31, 2012                                    |                        |                              |                               |                |
| Fixed maturity securities:                           |                        |                              |                               |                |
| Available for sale:                                  |                        |                              |                               |                |
| United States Government full faith and credit       | \$4,590                | \$564                        | \$—                           | \$5,154        |
| United States Government sponsored agencies          | 1,763,789              | 11,704                       | (3,468                        | ) 1,772,025    |
| United States municipalities, states and territories | 3,116,678              | 461,770                      | (125                          | ) 3,578,323    |
| Foreign government obligations                       | 86,099                 | 19,160                       | —                             | 105,259        |
| Corporate securities                                 | 12,930,173             | 1,568,223                    | (31,624                       | ) 14,466,772   |
| Residential mortgage backed securities               | 2,743,537              | 172,304                      | (27,728                       | ) 2,888,113    |
| Commercial mortgage backed securities                | 354,870                | 5,095                        | (1,983                        | ) 357,982      |
| Other asset backed securities                        | 957,291                | 44,190                       | (2,973                        | ) 998,508      |
|                                                      | \$21,957,027           | \$2,283,010                  | \$(67,901                     | ) \$24,172,136 |
| Held for investment:                                 |                        |                              |                               |                |
| Corporate security                                   | \$76,088               | \$—                          | \$(14,567                     | ) \$61,521     |
| Equity securities, available for sale:               |                        |                              |                               |                |
| Finance, insurance, and real estate                  | \$44,598               | \$10,227                     | \$(1,403                      | ) \$53,422     |

During the six months ended June 30, 2013 and 2012, we received \$1.0 billion and \$2.8 billion, respectively, in redemption proceeds related to calls of our callable United States Government sponsored agency securities and public and private corporate bonds, of which \$1.7 billion for the six months ended June 30, 2012, were classified as held for investment. The proceeds from these redemptions that have been reinvested have primarily been in United States government sponsored agencies, corporate securities, commercial mortgage backed securities and other asset backed securities. At June 30, 2013, 30% of our fixed income securities have call features of which 5% (\$1.3 billion) will become subject to call redemption during the next twelve months and \$500.6 million of which are U.S. Government

agency securities with a book yield of 0.75%. The \$500.6 million of U.S. Government securities were expected to be called in July. However, with the increase in interest rates during June, these securities were not called and are currently yielding 3.75%. These securities are callable quarterly and a modest decline in interest rates from current levels could result in the calls being exercised on the next call date in October of 2013.



The amortized cost and fair value of fixed maturity securities at June 30, 2013, 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                  | \$ 113,074         | \$ 116,889    | \$—                 | \$—        |
| Due after one year through five years    | 840,609            | 941,104       | —                   | —          |
| Due after five years through ten years   | 6,802,325          | 6,819,438     | —                   | —          |
| Due after ten years through twenty years | 5,829,419          | 6,033,288     | —                   | —          |
| Due after twenty years                   | 6,574,671          | 6,929,362     | 76,170              | 61,250     |
|                                          | 20,160,098         | 20,840,081    | 76,170              | 61,250     |
| Residential mortgage backed securities   | 2,337,399          | 2,488,057     | —                   | —          |
| Commercial mortgage backed securities    | 1,304,028          | 1,222,689     | —                   | —          |
| Other asset backed securities            | 987,562            | 994,815       | —                   | —          |
|                                          | \$ 24,789,087      | \$ 25,545,642 | \$ 76,170           | \$ 61,250  |

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,<br>2013 | December 31,<br>2012 |
|---------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| (Dollars in thousands)                                                                                              |                  |                      |
| Net unrealized gains on available for sale fixed maturity securities and equity securities                          | \$ 757,430       | \$ 2,223,933         |
| Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements | (416,281 )       | (1,201,974 )         |
| Deferred income tax valuation allowance reversal                                                                    | 22,534           | 22,534               |
| Deferred income tax benefit                                                                                         | (119,403 )       | (357,686 )           |
| Net unrealized gains reported as accumulated other comprehensive income                                             | \$ 244,280       | \$ 686,807           |

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 98% of our fixed maturity portfolio rated investment grade at June 30, 2013 and December 31, 2012.

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, 2013  |               | December 31, 2012 |               |
|------------------------|----------------|---------------|-------------------|---------------|
|                        | Amortized Cost | Fair Value    | Amortized Cost    | Fair Value    |
| (Dollars in thousands) |                |               |                   |               |
| 1                      | \$ 15,440,564  | \$ 16,049,276 | \$ 13,737,381     | \$ 15,250,560 |
| 2                      | 8,878,184      | 9,028,631     | 7,838,186         | 8,533,121     |
| 3                      | 475,652        | 457,918       | 398,294           | 387,222       |
| 4                      | 68,807         | 69,502        | 53,879            | 56,151        |
| 5                      | —              | —             | —                 | —             |
| 6                      | 2,050          | 1,565         | 5,375             | 6,603         |

\$24,865,257   \$25,606,892   \$22,033,115   \$24,233,657

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 803 and 198 securities, respectively) have been in a continuous unrealized loss position, at June 30, 2013 and December 31, 2012:

|                                                      | Less than 12 months    |                   | 12 months or more |                   | Total       |                   |
|------------------------------------------------------|------------------------|-------------------|-------------------|-------------------|-------------|-------------------|
|                                                      | Fair Value             | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value  | Unrealized Losses |
|                                                      | (Dollars in thousands) |                   |                   |                   |             |                   |
| June 30, 2013                                        |                        |                   |                   |                   |             |                   |
| Fixed maturity securities:                           |                        |                   |                   |                   |             |                   |
| Available for sale:                                  |                        |                   |                   |                   |             |                   |
| United States Government full faith and credit       | \$984                  | \$(36 )           | \$—               | \$—               | \$984       | \$(36 )           |
| United States Government sponsored agencies          | 1,126,107              | (46,847 )         | —                 | —                 | 1,126,107   | (46,847 )         |
| United States municipalities, states and territories | 407,748                | (24,701 )         | —                 | —                 | 407,748     | (24,701 )         |
| Foreign government obligations                       | 27,269                 | (2,525 )          | —                 | —                 | 27,269      | (2,525 )          |
| Corporate securities:                                |                        |                   |                   |                   |             |                   |
| Finance, insurance and real estate                   | 1,295,619              | (67,115 )         | 84,262            | (7,814 )          | 1,379,881   | (74,929 )         |
| Manufacturing, construction and mining               | 2,631,633              | (135,270 )        | 12,079            | (1,797 )          | 2,643,712   | (137,067 )        |
| Utilities and related sectors                        | 1,334,828              | (64,359 )         | 29,728            | (3,728 )          | 1,364,556   | (68,087 )         |
| Wholesale/retail trade                               | 301,898                | (17,027 )         | —                 | —                 | 301,898     | (17,027 )         |
| Services, media and other                            | 747,156                | (39,559 )         | —                 | —                 | 747,156     | (39,559 )         |
| Residential mortgage backed securities               | 293,301                | (13,905 )         | 58,100            | (2,488 )          | 351,401     | (16,393 )         |
| Commercial mortgage backed securities                | 1,064,758              | (83,053 )         | —                 | —                 | 1,064,758   | (83,053 )         |
| Other asset backed securities                        | 426,195                | (16,816 )         | 22,823            | (3,347 )          | 449,018     | (20,163 )         |
|                                                      | \$9,657,496            | \$(511,213 )      | \$206,992         | \$(19,174 )       | \$9,864,488 | \$(530,387 )      |
| Held for investment:                                 |                        |                   |                   |                   |             |                   |
| Corporate security:                                  |                        |                   |                   |                   |             |                   |
| Insurance                                            | \$—                    | \$—               | \$61,250          | \$(14,920 )       | \$61,250    | \$(14,920 )       |
| December 31, 2012                                    |                        |                   |                   |                   |             |                   |
| Fixed maturity securities:                           |                        |                   |                   |                   |             |                   |
| Available for sale:                                  |                        |                   |                   |                   |             |                   |
| United States Government sponsored agencies          | \$973,728              | \$(3,468 )        | \$—               | \$—               | \$973,728   | \$(3,468 )        |
| United States municipalities, states and territories | 24,393                 | (125 )            | —                 | —                 | 24,393      | (125 )            |
| Corporate securities:                                |                        |                   |                   |                   |             |                   |
| Finance, insurance and real estate                   | 177,962                | (4,126 )          | 85,709            | (8,438 )          | 263,671     | (12,564 )         |
| Manufacturing, construction and mining               | 426,120                | (4,303 )          | 21,975            | (1,281 )          | 448,095     | (5,584 )          |
| Utilities and related sectors                        | 221,044                | (5,187 )          | 39,224            | (4,212 )          | 260,268     | (9,399 )          |
| Wholesale/retail trade                               | 101,790                | (784 )            | 10,250            | (208 )            | 112,040     | (992 )            |
| Services, media and other                            | 264,421                | (3,085 )          | —                 | —                 | 264,421     | (3,085 )          |
| Residential mortgage backed securities               | 220,622                | (8,679 )          | 260,226           | (19,049 )         | 480,848     | (27,728 )         |
|                                                      | 161,582                | (1,983 )          | —                 | —                 | 161,582     | (1,983 )          |

Commercial mortgage backed securities

|                               |             |             |           |             |             |             |
|-------------------------------|-------------|-------------|-----------|-------------|-------------|-------------|
| Other asset backed securities | 145,238     | (2,242 )    | 26,131    | (731 )      | 171,369     | (2,973 )    |
|                               | \$2,716,900 | \$(33,982 ) | \$443,515 | \$(33,919 ) | \$3,160,415 | \$(67,901 ) |

Held for investment:

Corporate security:

|           |     |     |          |             |          |             |
|-----------|-----|-----|----------|-------------|----------|-------------|
| Insurance | \$— | \$— | \$61,521 | \$(14,567 ) | \$61,521 | \$(14,567 ) |
|-----------|-----|-----|----------|-------------|----------|-------------|

Equity security, available for sale:

|          |     |     |         |            |         |            |
|----------|-----|-----|---------|------------|---------|------------|
| Services | \$— | \$— | \$8,722 | \$(1,403 ) | \$8,722 | \$(1,403 ) |
|----------|-----|-----|---------|------------|---------|------------|

The following is a description of the factors causing the temporary unrealized losses by investment category as of June 30, 2013:

United States Government sponsored agencies: These securities are relatively long in duration; however, they are callable in less than 12 months making the value of such securities sensitive to changes in market interest rates. The timing of when some of these securities were purchased gave rise to unrealized losses at June 30, 2013.

United States municipalities, states and territories: These securities are relatively long in duration and their fair values are sensitive to changes in market interest rates. The timing of the purchase of these securities have resulted in unrealized losses at this point in time.

Foreign government obligations: The unrealized losses on these securities are due to wider spreads on the announcement of increased capital expenditures with resulting higher leverage and greater supply.

Corporate securities: The unrealized losses in these securities are due partially to the timing of purchases in 2012 and 2013. These securities carry yields less than those available at June 30, 2013 as the result of rising interest rates in the first half of 2013. In addition, a small number of securities have seen their credit spreads remain wide due to issuer or industry specific news while some financial and industrial sector credit spreads remain wide due to continued economic uncertainty and concerns of economic instability.

Residential mortgage backed securities: At June 30, 2013, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of \$341.4 million and a fair value of \$372.5 million. Despite recent improvements in the capital markets, the fair values of RMBS with weaker borrower characteristics continue at prices below amortized cost. These RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.

Commercial mortgage backed securities: The unrealized losses in these securities are due partially to the timing of purchases in 2012 and 2013. A number of purchases made in the middle of the fourth quarter 2012 were at yields lower than what could be executed at the end of this quarter due to the increase in the treasury yield since the time of purchase. Yield spreads for commercial mortgage backed securities have narrowed but remain attractive.

Other asset backed securities: The unrealized losses in these securities are predominantly assigned to financial sector capital trust securities which have longer maturity dates and have declined in price due to prolonged stress in the financial sector. Only one security in an unrealized loss position is rated below investment grade.

Approximately 95% and 75% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2013 and December 31, 2012, respectively, are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the 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, 2013 and 2012 are as follows:

|                                                                         | Three Months Ended<br>June 30,<br>2013 |   | 2012       | Six Months Ended<br>June 30,<br>2013 |           | 2012       |   |
|-------------------------------------------------------------------------|----------------------------------------|---|------------|--------------------------------------|-----------|------------|---|
|                                                                         | (Dollars in thousands)                 |   |            |                                      |           |            |   |
| Fixed maturity securities held for investment carried at amortized cost | \$ (964                                | ) | \$ 1,690   | \$ (353                              | )         | \$ 11,879  |   |
| Investments carried at fair value:                                      |                                        |   |            |                                      |           |            |   |
| Fixed maturity securities, available for sale                           | \$ (1,339,484                          | ) | \$ 603,462 | \$ (1,458,554                        | )         | \$ 388,374 |   |
| Equity securities, available for sale                                   | (10,168                                | ) | (787       | )                                    | (7,949    | ) 3,637    |   |
|                                                                         | (1,349,652                             | ) | 602,675    | (1,466,503                           | )         | 392,011    |   |
| Adjustment for effect on other balance sheet accounts:                  |                                        |   |            |                                      |           |            |   |
| Deferred policy acquisition costs and deferred sales inducements        | 707,525                                |   | (339,408   | )                                    | 785,693   | (203,330   | ) |
| Deferred income tax asset/liability                                     | 224,744                                |   | (92,142    | )                                    | 238,283   | (66,038    | ) |
|                                                                         | 932,269                                |   | (431,550   | )                                    | 1,023,976 | (269,368   | ) |
| Change in net unrealized gains on investments carried at fair value     | \$ (417,383                            | ) | \$ 171,125 | \$ (442,527                          | )         | \$ 122,643 |   |

Proceeds from sales of available for sale securities for the six months ended June 30, 2013 and 2012 were \$820.2 million and \$165.2 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the six months ended June 30, 2013 and 2012 were \$1.6 billion and \$1.4 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 (losses) on investments, excluding net OTTI losses for the three and six months ended June 30, 2013 and 2012 are as follows:

|                                               | Three Months Ended<br>June 30,<br>2013 |   | June 30,<br>2012 |   | Six Months Ended<br>June 30,<br>2013 |   | June 30,<br>2012 |   |
|-----------------------------------------------|----------------------------------------|---|------------------|---|--------------------------------------|---|------------------|---|
|                                               | (Dollars in thousands)                 |   |                  |   |                                      |   |                  |   |
| Available for sale fixed maturity securities: |                                        |   |                  |   |                                      |   |                  |   |
| Gross realized gains                          | \$7,628                                |   | \$4,030          |   | \$20,643                             |   | \$5,048          |   |
| Gross realized losses                         | (823                                   | ) | (59              | ) | (3,010                               | ) | (355             | ) |
|                                               | 6,805                                  |   | 3,971            |   | 17,633                               |   | 4,693            |   |
| Equity securities:                            |                                        |   |                  |   |                                      |   |                  |   |
| Gross realized gains                          | 9,571                                  |   | —                |   | 9,571                                |   | 562              |   |
| Other investments:                            |                                        |   |                  |   |                                      |   |                  |   |
| Gain on sale of real estate                   | 715                                    |   | 1,450            |   | 1,304                                |   | 2,895            |   |
| Loss on sale of real estate                   | —                                      |   | —                |   | (466                                 | ) | —                |   |
| Impairment losses on real estate              | (145                                   | ) | (1,669           | ) | (145                                 | ) | (2,643           | ) |
|                                               | 570                                    |   | (219             | ) | 693                                  |   | 252              |   |
| Mortgage loans on real estate:                |                                        |   |                  |   |                                      |   |                  |   |
| Increase in allowance for credit losses       | (1,257                                 | ) | (4,363           | ) | (1,623                               | ) | (12,194          | ) |
|                                               | \$15,689                               |   | \$(611           | ) | \$26,274                             |   | \$(6,687         | ) |

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 in place 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;
- 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 market 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. In any event, this period does not exceed 18 months from the date of impairment for perpetual preferred securities for which there is evidence of deterioration in credit of the issuer and common equity securities. For perpetual preferred securities absent evidence of a deterioration in credit of the issuer we apply an impairment model, including an anticipated recovery period, similar to a debt security.

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.

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.

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, 2013 and 2012, 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, 2013 |         |               |       |              |      |               |      |   |  |
| Prime                          | 2003    | 5.1           | % 5.1 | % 2          | % 2  | % 30          | % 30 | % |  |
|                                | 2005    | 6.5           | % 7.7 | % 8          | % 17 | % 50          | % 50 | % |  |
|                                | 2006    | 6.0           | % 6.9 | % 9          | % 16 | % 50          | % 50 | % |  |
|                                | 2007    | 6.5           | % 6.7 | % 12         | % 25 | % 40          | % 60 | % |  |
|                                | 2008    | 6.6           | % 6.6 | % 16         | % 16 | % 45          | % 45 | % |  |
| Alt-A                          | 2005    | 5.6           | % 8.7 | % 15         | % 25 | % 5           | % 65 | % |  |
|                                | 2007    | 6.2           | % 6.9 | % 38         | % 52 | % 60          | % 65 | % |  |
| Six months ended June 30, 2012 |         |               |       |              |      |               |      |   |  |
| Prime                          | 2005    | 6.5           | % 7.7 | % 9          | % 13 | % 50          | % 50 | % |  |
|                                | 2006    | 5.8           | % 7.4 | % 9          | % 19 | % 40          | % 55 | % |  |
|                                | 2007    | 6.2           | % 7.3 | % 11         | % 38 | % 40          | % 60 | % |  |
| Alt-A                          | 2005    | 5.6           | % 7.7 | % 12         | % 27 | % 5           | % 50 | % |  |

|      |     |       |      |      |      |      |   |
|------|-----|-------|------|------|------|------|---|
| 2006 | 6.0 | % 6.0 | % 32 | % 46 | % 55 | % 60 | % |
| 2007 | 6.2 | % 7.0 | % 31 | % 55 | % 55 | % 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.

The following table summarizes other than temporary impairments for the three and six months ended June 30, 2013 and 2012, by asset type:

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Number<br>of<br>Securities             | Total OTTI<br>Losses | Portion of OTTI<br>Losses<br>Recognized<br>from Other<br>Comprehensive<br>Income | Net OTTI<br>Losses<br>Recognized<br>in Operations |              |   |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|----------------------|----------------------------------------------------------------------------------|---------------------------------------------------|--------------|---|
| (Dollars in thousands)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                        |                      |                                                                                  |                                                   |              |   |
| Three months ended June 30, 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                        |                      |                                                                                  |                                                   |              |   |
| Fixed maturity securities, available for sale:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| United States Government sponsored agencies                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 2                                      | \$(2,775             | ) \$ —                                                                           | \$(2,775                                          | )            |   |
| Three months ended June 30, 2012                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |                                        |                      |                                                                                  |                                                   |              |   |
| Fixed maturity securities, available for sale:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| Residential mortgage backed securities                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 7                                      | \$(375               | ) \$ (603                                                                        | ) \$(978                                          | )            |   |
| Six months ended June 30, 2013                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| Fixed maturity securities, available for sale:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| United States Government sponsored agencies                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | 2                                      | \$(2,775             | ) \$ —                                                                           | \$(2,775                                          | )            |   |
| Corporate securities:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                                        |                      |                                                                                  |                                                   |              |   |
| Industrial                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 1                                      | (1,761               | ) —                                                                              | (1,761                                            | )            |   |
| Residential mortgage backed securities                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 5                                      | —                    | (1,048                                                                           | ) (1,048                                          | )            |   |
| Equity security, available for sale:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                        |                      |                                                                                  |                                                   |              |   |
| Industrial                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 1                                      | (428                 | ) —                                                                              | (428                                              | )            |   |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 9                                      | \$(4,964             | ) \$ (1,048                                                                      | ) \$(6,012                                        | )            |   |
| Six months ended June 30, 2012                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| Fixed maturity securities, available for sale:                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                                        |                      |                                                                                  |                                                   |              |   |
| Residential mortgage backed securities                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 22                                     | \$(2,156             | ) \$ (1,703                                                                      | ) \$(3,859                                        | )            |   |
| Other than temporary impairments during the three and six months ended June 30, 2013 on United States Government sponsored agencies were recognized as we had the intent to sell these securities as of June 30, 2013. The other than temporary impairments were determined based on the market values of the underlying securities at June 30, 2013. 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<br>June 30,<br>2013 |                      | Six Months Ended<br>June 30,<br>2013                                             |                                                   |              |   |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | 2012                                   |                      | 2012                                                                             |                                                   |              |   |
| (Dollars in thousands)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                        |                      |                                                                                  |                                                   |              |   |
| Cumulative credit loss at beginning of period                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                        | \$(129,813           | ) \$(121,976                                                                     | ) \$(134,027                                      | ) \$(119,095 | ) |
| Credit losses on securities for which OTTI has not previously been recognized                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                        | (2,775               | ) (47                                                                            | ) (4,536                                          | ) (47        | ) |
| Additional credit losses on securities for which OTTI has previously been recognized                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                                        | —                    | (931                                                                             | ) (1,048                                          | ) (3,812     | ) |

|                                                                          |            |              |              |                |
|--------------------------------------------------------------------------|------------|--------------|--------------|----------------|
| Accumulated losses on securities that were disposed of during the period | 4,075      | —            | 11,098       | —              |
| Cumulative credit loss at end of period                                  | \$(128,513 | ) \$(122,954 | ) \$(128,513 | ) \$(122,954 ) |

20

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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, 2013 and December 31, 2012:

|                                                 | Amortized<br>Cost | OTTI<br>Recognized in<br>Other<br>Comprehensive<br>Income | Change in Fair<br>Value Since<br>OTTI was<br>Recognized | Fair Value |
|-------------------------------------------------|-------------------|-----------------------------------------------------------|---------------------------------------------------------|------------|
| (Dollars in thousands)                          |                   |                                                           |                                                         |            |
| June 30, 2013                                   |                   |                                                           |                                                         |            |
| Fixed maturity securities, available for sale:  |                   |                                                           |                                                         |            |
| Corporate securities                            | \$—               | \$—                                                       | \$24                                                    | \$24       |
| Residential mortgage backed securities          | 764,746           | (176,557 )                                                | 236,236                                                 | 824,425    |
| Equity securities, available for sale:          |                   |                                                           |                                                         |            |
| Finance, insurance and real estate and services | 1,415             | —                                                         | 605                                                     | 2,020      |
|                                                 | \$766,161         | \$(176,557 )                                              | \$236,865                                               | \$826,469  |
| December 31, 2012                               |                   |                                                           |                                                         |            |
| Fixed maturity securities, available for sale:  |                   |                                                           |                                                         |            |
| Corporate securities                            | \$10,599          | \$(2,151 )                                                | \$5,676                                                 | \$14,124   |
| Residential mortgage backed securities          | 855,915           | (177,604 )                                                | 171,514                                                 | 849,825    |
| Equity securities, available for sale:          |                   |                                                           |                                                         |            |
| Finance, insurance and real estate              | 9,976             | —                                                         | 9,668                                                   | 19,644     |
|                                                 | \$876,490         | \$(179,755 )                                              | \$186,858                                               | \$883,593  |

#### 4. Mortgage Loans on Real Estate

Our mortgage loan portfolio, summarized in the following table, totaled \$2.6 billion at June 30, 2013 and December 31, 2012, with commitments outstanding of \$93.8 million at June 30, 2013.

|                          | June 30, 2013<br>(Dollars in thousands) | December 31, 2012 |
|--------------------------|-----------------------------------------|-------------------|
| Principal outstanding    | \$2,616,179                             | \$2,658,883       |
| Loan loss allowance      | (31,676 )                               | (34,234 )         |
| Deferred prepayment fees | (800 )                                  | (709 )            |
| Carrying value           | \$2,583,703                             | \$2,623,940       |

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, 2013          |         |   | December 31, 2012 |         |   |
|----------------------------|------------------------|---------|---|-------------------|---------|---|
|                            | Principal              | Percent |   | Principal         | Percent |   |
|                            | Outstanding            |         |   | Outstanding       |         |   |
|                            | (Dollars in thousands) |         |   |                   |         |   |
| Geographic distribution    |                        |         |   |                   |         |   |
| East                       | \$760,025              | 29.1    | % | \$732,762         | 27.5    | % |
| Middle Atlantic            | 147,167                | 5.6     | % | 155,094           | 5.8     | % |
| Mountain                   | 359,436                | 13.7    | % | 387,599           | 14.6    | % |
| New England                | 23,131                 | 0.9     | % | 26,385            | 1.0     | % |
| Pacific                    | 322,519                | 12.3    | % | 320,982           | 12.1    | % |
| South Atlantic             | 459,052                | 17.6    | % | 458,802           | 17.3    | % |
| West North Central         | 369,363                | 14.1    | % | 370,168           | 13.9    | % |
| West South Central         | 175,486                | 6.7     | % | 207,091           | 7.8     | % |
|                            | \$2,616,179            | 100.0   | % | \$2,658,883       | 100.0   | % |
| Property type distribution |                        |         |   |                   |         |   |
| Office                     | \$643,747              | 24.6    | % | \$666,467         | 25.1    | % |
| Medical Office             | 137,746                | 5.3     | % | 136,764           | 5.1     | % |
| Retail                     | 680,618                | 26.0    | % | 677,951           | 25.5    | % |
| Industrial/Warehouse       | 666,935                | 25.5    | % | 692,637           | 26.1    | % |
| Hotel                      | 83,363                 | 3.2     | % | 94,045            | 3.5     | % |
| Apartment                  | 233,609                | 8.9     | % | 219,335           | 8.2     | % |
| Mixed use/other            | 170,161                | 6.5     | % | 171,684           | 6.5     | % |
|                            | \$2,616,179            | 100.0   | % | \$2,658,883       | 100.0   | % |

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve 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. 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.

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 have a population of mortgage loans that we have been carrying with workout terms (e.g. interest only periods, period of suspended payments, etc.) and a population of mortgage loans that have been in a delinquent status (i.e. more than 60 days past due). It is from this population that we have been recognizing some impairment loss due to nonpayment and, in some cases, eventual satisfaction of the loan by taking ownership of the collateral real estate. In most cases the fair value of the collateral less estimated costs to sell such collateral has been less than the outstanding principal amount of the mortgage loan.

Our general loan loss allowance for the period ended June 30, 2012 was calculated utilizing a group of loans which had a debt service coverage ratio (DSCR) of less than 1.0. The DSCR is calculated by dividing the net operating income of the mortgaged property by the contractual principal and interest payment due for the corresponding period.

We developed the loss rates to apply to this group of loans by dividing the specific impairment loss for the most recent 4 quarters by the principal outstanding of the loans with a DSCR of less than 1.0.

Currently, we rate 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 general loan loss allowance at June 30, 2013. We began this process in the third quarter of 2012.

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

|                             | Three Months Ended<br>June 30, 2013 |                      | Three Months Ended<br>June 30, 2012 |                      |
|-----------------------------|-------------------------------------|----------------------|-------------------------------------|----------------------|
|                             | Specific<br>Allowance               | General<br>Allowance | Specific<br>Allowance               | General<br>Allowance |
|                             | (Dollars in thousands)              |                      |                                     |                      |
| Beginning allowance balance | \$ (22,631                          | ) \$ (10,400         | ) \$ (29,595                        | ) \$ (10,300         |
| Charge-offs                 | 2,612                               | —                    | 7,613                               | —                    |
| Recoveries                  | —                                   | —                    | —                                   | —                    |
| Provision for credit losses | (1,157                              | ) (100               | ) (3,463                            | ) (900               |
| Ending allowance balance    | \$ (21,176                          | ) \$ (10,500         | ) \$ (25,445                        | ) \$ (11,200         |
|                             | Six Months Ended<br>June 30, 2013   |                      | Six Months Ended<br>June 30, 2012   |                      |
|                             | Specific<br>Allowance               | General<br>Allowance | Specific<br>Allowance               | General<br>Allowance |
|                             | (Dollars in thousands)              |                      |                                     |                      |
| Beginning allowance balance | \$ (23,134                          | ) \$ (11,100         | ) \$ (23,664                        | ) \$ (9,300          |
| Charge-offs                 | 4,181                               | —                    | 8,513                               | —                    |
| Recoveries                  | —                                   | —                    | —                                   | —                    |
| Provision for credit losses | (2,223                              | ) 600                | (10,294                             | ) (1,900             |
| Ending allowance balance    | \$ (21,176                          | ) \$ (10,500         | ) \$ (25,445                        | ) \$ (11,200         |

The specific allowance is a total of credit loss allowances on loans which are individually evaluated for impairment. The general allowance is 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, 2013          | December 31, 2012 |
|---------------------------------------|------------------------|-------------------|
|                                       | (Dollars in thousands) |                   |
| Individually evaluated for impairment | \$46,707               | \$53,110          |
| Collectively evaluated for impairment | 2,569,472              | 2,605,773         |
| Total loans evaluated for impairment  | \$2,616,179            | \$2,658,883       |

The amount of charge-offs include the amount of allowance that has been established for loans that were satisfied by taking ownership of the collateral. When the property is taken it is recorded at its fair value 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. There could be other situations that develop where we have established a larger specific loan loss allowance than is needed based on increases in the fair value of collateral supporting collateral dependent loans, or improvements in the financial position of a borrower so that a loan would become reliant on cash flows from debt service instead of dependent upon sale of the collateral. Charge-offs of the allowance would be recognized in those situations as well. 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.

During the second quarter of 2013, no mortgage loans were satisfied by taking ownership of any real estate serving as collateral and during the six months ended June 30, 2013, one mortgage loan was satisfied by taking ownership of the real estate serving as collateral compared to four and six mortgage loans for the same periods in 2012. The following table summarizes the activity in the real estate owned which was obtained in satisfaction of mortgage loans on real estate:

| Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|--------------------------------|------|------------------------------|------|
| 2013                           | 2012 | 2013                         | 2012 |



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|                                                        | (Dollars in thousands) |          |          |          |
|--------------------------------------------------------|------------------------|----------|----------|----------|
| Real estate owned at beginning of period               | \$28,764               | \$35,824 | \$33,172 | \$36,821 |
| Real estate acquired in satisfaction of mortgage loans | —                      | 8,683    | 844      | 11,985   |
| Additions                                              | 480                    | 117      | 480      | 117      |
| Sales                                                  | (2,333)                | ) (4,283 | ) (7,413 | ) (7,366 |
| Impairments                                            | (145)                  | ) (1,669 | ) (145   | ) (2,643 |
| Depreciation                                           | (157)                  | ) (282   | ) (329   | ) (524   |
| Real estate owned at end of period                     | \$26,609               | \$38,390 | \$26,609 | \$38,390 |

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, 2013<br>(Dollars in thousands) | December 31, 2012 |
|--------------------------------------|-----------------------------------------|-------------------|
| Credit Exposure--By Payment Activity |                                         |                   |
| Performing                           | \$2,572,527                             | \$2,597,440       |
| In workout                           | 28,326                                  | 26,723            |
| Collateral dependent                 | 15,326                                  | 34,720            |
|                                      | \$2,616,179                             | \$2,658,883       |

Mortgage loans are considered delinquent when they become 60 days past due. 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 a non-accrual status at June 30, 2013 and December 31, 2012 totaled \$15.3 million and \$34.7 million, respectively.

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<br>Days        | 60 - 89<br>Days | 90 Days<br>and Over | Total Past<br>Due | Current | Collateral<br>Dependent<br>Receivables | Total<br>Financing<br>Receivables |
|--|------------------------|-----------------|---------------------|-------------------|---------|----------------------------------------|-----------------------------------|
|  | (Dollars in thousands) |                 |                     |                   |         |                                        |                                   |

#### Commercial Mortgage Loans

|                   |     |     |     |     |             |          |             |
|-------------------|-----|-----|-----|-----|-------------|----------|-------------|
| June 30, 2013     | \$— | \$— | \$— | \$— | \$2,600,853 | \$15,326 | \$2,616,179 |
| December 31, 2012 | \$— | \$— | \$— | \$— | \$2,624,163 | \$34,720 | \$2,658,883 |

Financing receivables 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 more than 60 days 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<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|------------------------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
|                                          | (Dollars in thousands) |                                |                      |                                   |                                  |
| June 30, 2013                            |                        |                                |                      |                                   |                                  |
| Mortgage loans with an allowance         | \$25,531               | \$46,707                       | \$(21,176)           | \$27,923                          | \$885                            |
| Mortgage loans with no related allowance | 18,699                 | 18,699                         | —                    | 18,760                            | 531                              |
|                                          | \$44,230               | \$65,406                       | \$(21,176)           | \$46,683                          | \$1,416                          |

December 31, 2012

|                                          |          |          |            |            |         |
|------------------------------------------|----------|----------|------------|------------|---------|
| Mortgage loans with an allowance         | \$29,976 | \$53,110 | \$(23,134) | ) \$37,480 | \$1,946 |
| Mortgage loans with no related allowance | 27,765   | 27,765   | —          | 27,696     | 1,664   |
|                                          | \$57,741 | \$80,875 | \$(23,134) | ) \$65,176 | \$3,610 |

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, original interest rate and maturity date have not been modified and we have not forgiven any principal amounts.

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.

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, 2013 and December 31, 2012 that we determined to be TDRs are as follows:

| Geographic Region  | Number of TDRs | Principal Balance Outstanding<br>(Dollars in thousands) | Specific Loan Loss Allowance | Net Carrying Amount |
|--------------------|----------------|---------------------------------------------------------|------------------------------|---------------------|
| June 30, 2013      |                |                                                         |                              |                     |
| East               | 1              | \$3,712                                                 | \$(949)                      | ) \$2,763           |
| Mountain           | 8              | 23,019                                                  | (1,172)                      | ) 21,847            |
| South Atlantic     | 7              | 17,249                                                  | (5,898)                      | ) 11,351            |
| East North Central | 2              | 3,697                                                   | (1,029)                      | ) 2,668             |
| West North Central | 1              | 1,938                                                   | —                            | 1,938               |
| West South Central | 1              | 1,458                                                   | (255)                        | ) 1,203             |
|                    | 20             | \$51,073                                                | \$(9,303)                    | ) \$41,770          |
| December 31, 2012  |                |                                                         |                              |                     |
| East               | 1              | \$4,208                                                 | \$(1,425)                    | ) \$2,783           |
| Mountain           | 10             | 28,786                                                  | (1,702)                      | ) 27,084            |
| South Atlantic     | 9              | 23,358                                                  | (5,047)                      | ) 18,311            |
| East North Central | 1              | 2,232                                                   | (467)                        | ) 1,765             |
| West North Central | 3              | 9,466                                                   | (2,328)                      | ) 7,138             |

|    |          |           |            |
|----|----------|-----------|------------|
| 24 | \$68,050 | \$(10,969 | ) \$57,081 |
|----|----------|-----------|------------|

25

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## 5. Derivative Instruments

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. 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,<br>2013       | December 31,<br>2012 |
|----------------------------------------------|------------------------|----------------------|
|                                              | (Dollars in thousands) |                      |
| Assets                                       |                        |                      |
| Derivative instruments                       |                        |                      |
| Call options                                 | \$629,135              | \$415,258            |
| Other assets                                 |                        |                      |
| 2015 notes hedges                            | 71,400                 | 43,105               |
| Interest rate caps                           | 5,565                  | 3,247                |
| Interest rate swap                           | 274                    | —                    |
|                                              | \$706,374              | \$461,610            |
| Liabilities                                  |                        |                      |
| Policy benefit reserves - annuity products   |                        |                      |
| Fixed index annuities - embedded derivatives | \$3,747,052            | \$3,337,556          |
| Other liabilities                            |                        |                      |
| 2015 notes embedded derivatives              | 71,400                 | 43,105               |
| Interest rate swap                           | —                      | 4,261                |
|                                              | \$3,818,452            | \$3,384,922          |

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

|                                               | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |             |
|-----------------------------------------------|--------------------------------|--------------|------------------------------|-------------|
|                                               | 2013                           | 2012         | 2013                         | 2012        |
|                                               | (Dollars in thousands)         |              |                              |             |
| Change in fair value of derivatives:          |                                |              |                              |             |
| Call options                                  | \$58,200                       | \$(122,241)  | ) \$402,854                  | \$119,279   |
| 2015 notes hedges                             | 197                            | (24,163)     | ) 28,295                     | (7,412)     |
| Interest rate swap                            | 3,802                          | (4,038)      | ) 4,535                      | (3,148)     |
| Interest rate caps                            | 1,841                          | (405)        | ) 2,318                      | (405)       |
|                                               | \$64,040                       | \$(150,847)  | ) \$438,002                  | \$108,314   |
| Change in fair value of embedded derivatives: |                                |              |                              |             |
| 2015 notes embedded derivatives               | \$197                          | \$(24,163)   | ) \$28,295                   | \$(7,412)   |
| Fixed index annuities                         | (408,606)                      | ) (56,826)   | ) (73,432)                   | ) 285,489   |
|                                               | \$(408,409)                    | ) \$(80,989) | ) \$(45,137)                 | ) \$278,077 |

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

|                        |                        |                            | June 30, 2013      |            | December 31, 2012  |            |
|------------------------|------------------------|----------------------------|--------------------|------------|--------------------|------------|
| Counterparty           | Credit Rating<br>(S&P) | Credit Rating<br>(Moody's) | Notional<br>Amount | Fair Value | Notional<br>Amount | Fair Value |
| (Dollars in thousands) |                        |                            |                    |            |                    |            |
| Bank of America        | A                      | A3                         | \$1,075,595        | \$39,162   | \$568,786          | \$16,533   |
| Barclays               | A                      | A2                         | 3,617,125          | 131,476    | 3,463,777          | 103,929    |
| BNP Paribas            | A+                     | A2                         | 1,895,967          | 68,448     | 2,207,097          | 60,301     |
| Citibank, N.A.         | A                      | A3                         | 1,501,845          | 64,812     | 2,878,588          | 67,592     |
| Credit Suisse          | A                      | A1                         | 2,922,641          | 78,855     | 936,625            | 21,518     |
| Deutsche Bank          | A                      | A2                         | 874,245            | 42,587     | 886,688            | 20,787     |
| HSBC                   | AA-                    | A1                         | 301,678            | 14,010     | 295,520            | 6,539      |
| J.P. Morgan            | A+                     | Aa3                        | 643,078            | 20,635     | 735,016            | 21,940     |
| Morgan Stanley         | A-                     | Baa1                       | 1,961,040          | 70,329     | 1,590,505          | 40,113     |
| Wells Fargo            | AA-                    | Aa3                        | 2,374,518          | 98,821     | 2,060,903          | 56,006     |
|                        |                        |                            | \$17,167,732       | \$629,135  | \$15,623,505       | \$415,258  |

As of June 30, 2013 and December 31, 2012, we held \$572.2 million and \$328.7 million, 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 \$78.4 million and \$93.7 million at June 30, 2013 and December 31, 2012, 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, 2012 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 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 | Receive Rate | Pay     | Counterparty | June 30, 2013                        | December 31, 2012 |
|----------------|----------|--------------|---------|--------------|--------------------------------------|-------------------|
|                | Amount   |              | Rate    |              | Fair Value<br>(Dollars in thousands) | Fair Value        |
| March 15, 2021 | \$85,500 | *LIBOR       | 2.415 % | SunTrust     | \$274                                | \$(4,261)         |

\* - three month London Interbank Offered Rate

Details regarding the interest rate caps are as follows:

| Maturity Date | Notional | Floating Rate | Cap  | Counterparty | June 30, 2013 | December 31, 2012 |
|---------------|----------|---------------|------|--------------|---------------|-------------------|
|               | Amount   |               | Rate |              | Fair Value    | Fair Value        |



|               |          |        |      |            | (Dollars in thousands) |         |
|---------------|----------|--------|------|------------|------------------------|---------|
| July 7, 2021  | \$40,000 | *LIBOR | 2.50 | % SunTrust | \$2,804                | \$1,634 |
| July 8, 2021  | 12,000   | *LIBOR | 2.50 | % SunTrust | 841                    | 490     |
| July 29, 2021 | 27,000   | *LIBOR | 2.50 | % SunTrust | 1,920                  | 1,123   |
|               | \$79,000 |        |      |            | \$5,565                | \$3,247 |

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\* - three month London Interbank Offered Rate

The interest rate swap has a forward starting date beginning in March 2014 and converts floating rates to fixed rates for seven years. The interest rate caps have a forward starting date beginning in July 2014 and cap our interest rates for seven years. As of June 30, 2013, we held \$6.4 million of cash and cash equivalents from the counterparty for derivative collateral related to the swap and caps, which is included in other liabilities on our consolidated balance sheets.

#### 6. Notes Payable

The convertible senior notes included in notes payable are accounted for separately as a liability component and an equity component in the consolidated balance sheets. The liability component and equity component are as follows:

|                                                          | June 30, 2013           |                        | December 31, 2012       |                        |                        |
|----------------------------------------------------------|-------------------------|------------------------|-------------------------|------------------------|------------------------|
|                                                          | September<br>2015 Notes | December<br>2029 Notes | September<br>2015 Notes | December<br>2029 Notes | December<br>2024 Notes |
|                                                          | (Dollars in thousands)  |                        |                         |                        |                        |
| Notes payable:                                           |                         |                        |                         |                        |                        |
| Principal amount of liability component                  | \$200,000               | \$115,839              | \$200,000               | \$115,839              | \$28,243               |
| Unamortized discount                                     | (18,285)                | (9,428)                | (21,944)                | (12,269)               | —                      |
| Net carrying amount of liability component               | \$181,715               | \$106,411              | \$178,056               | \$103,570              | \$28,243               |
| Additional paid-in capital:                              |                         |                        |                         |                        |                        |
| Carrying amount of equity component                      |                         | \$15,586               |                         | \$15,586               | \$22,637               |
| Amount by which the if-converted value exceeds principal | \$54,179                | \$77,831               | \$—                     | \$30,382               | \$—                    |

The discount is being amortized over the expected lives of the notes, which is December 15, 2014 for the 2029 notes and September 15, 2015 for the 2015 notes. The effective interest rates during the discount amortization periods are 8.9% and 11.9% on the 2015 notes and the 2029 notes, respectively. The interest cost recognized in operations for the convertible notes, inclusive of the coupon and amortization of the discount and debt issue costs, was \$6.8 million and \$14.0 million for the three and six months ended June 30, 2013, respectively, and \$7.1 million and \$14.1 million for the same periods in 2012.

We are required to include the dilutive effect of the 2029 notes in our diluted earnings per share calculation. Because these notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the fair value of our common stock at the end of the reporting period exceeds the conversion price per share of \$9.57. At June 30, 2013 and 2012, the conversion premium of the 2029 notes was dilutive and the effect has been included in diluted earnings per share for the three and six months ended June 30, 2013 and 2012. The 2015 notes and the 2015 notes hedges are excluded from the dilutive effect in our diluted earnings per share calculation as they are currently to be settled only in cash. The 2015 warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock exceeds the strike price of the 2015 warrants.

On March 25, 2013, notice of mandatory redemption was issued for our 2024 notes. \$25.8 million principal amount of the convertible notes exercised their conversion rights prior to the April 30, 2013 mandatory redemption date. The holders of these notes received the principal amount of their notes in cash and the conversion premium in shares of our common stock, for which 216,729 shares were issued. The balance of the convertible notes (\$2.5 million principal amount) was redeemed for cash.

In 2011, we entered into a three year \$160 million revolving line of credit agreement with seven banks. The interest rate is floating at a rate based on our election that will be equal to the alternate base rate (as defined in the credit agreement) plus the applicable margin or the adjusted LIBOR rate (as defined in the credit agreement) plus the applicable margin. We also pay a commitment fee on the available unused portion of the credit facility. The applicable margin and commitment fee rate are based on our credit rating and can change throughout the period of the credit facility. Based upon our current credit rating, the applicable margin is 2.00% for alternate base rate borrowings and 3.00% for adjusted LIBOR rate borrowings and the commitment fee is 0.50%. Under this agreement, we are required to maintain a minimum risk-based capital ratio at American Equity Life, a maximum ratio of debt to total capital, a minimum cash coverage ratio, and a minimum level of statutory surplus at American Equity Life. At June 30, 2013,

\$15.0 million was outstanding. No amount was outstanding at December 31, 2012.

As part of our investment strategy, we enter into securities repurchase agreements (short-term collateralized borrowings). The maximum amount borrowed during the six months ended June 30, 2013 was \$160.4 million. We had no borrowings under repurchase agreements during the six months ended June 30, 2012. 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 \$10.0 million and \$5.0 million for the three and six months ended June 30, 2013, respectively. The weighted average interest rate on amounts due under repurchase agreements was 0.32% for both the three and six months ended June 30, 2013.

## 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 SEC, FINRA, 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. We recorded an estimated litigation liability of \$17.5 million during the third quarter of 2012 based on developments in the mediation of the matter discussed below.

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in a purported class action, McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation (complaint filed September 7, 2005) (the "Los Angeles Case"), involving allegations of improper sales practices and similar claims as described below.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us; however, no class has yet been certified. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek rescission and injunctive relief including restitution and disgorgement of profits on behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. On July 30, 2013, the parties entered into a settlement agreement and stipulated to certification of the case as a class action for settlement purposes only. Based upon the terms of the settlement agreement, the \$17.5 million litigation liability referred to above represents our best estimate of probable loss with respect to this litigation; however, the settlement is contingent upon court approval which has not yet been granted. Additionally, other factors could potentially result in a change in this estimate as further developments take place. In particular, part of the settlement involves a claims process for individual class members, and it is difficult to predict the amount of the liabilities that will ultimately result from that process. In light of the inherent uncertainties involved in the pending purported class action lawsuit, there can be no assurance that such litigation, or any other 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, 2013 to private equity limited partnerships of \$31.5 million and to secured bank loans of \$29.3 million.

## 8. Earnings Per Share

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

|                                                                             | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|-----------------------------------------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                                                             | 2013                           | 2012       | 2013                         | 2012       |
| (Dollars in thousands, except per share data)                               |                                |            |                              |            |
| Numerator:                                                                  |                                |            |                              |            |
| Net income - numerator for earnings per common share                        | \$ 120,113                     | \$ 18,759  | \$ 146,144                   | \$ 29,230  |
| Interest on convertible subordinated debentures (net of income tax benefit) | —                              | 257        | —                            | 515        |
| Numerator for earnings per common share - assuming dilution                 | \$ 120,113                     | \$ 19,016  | \$ 146,144                   | \$ 29,745  |
| Denominator:                                                                |                                |            |                              |            |
| Weighted average common shares outstanding (1)                              | 64,254,387                     | 59,943,337 | 63,786,577                   | 59,821,937 |
| Effect of dilutive securities:                                              |                                |            |                              |            |
| Convertible subordinated debentures                                         | —                              | 2,637,176  | —                            | 2,678,508  |
| Convertible senior notes                                                    | 5,009,622                      | 1,158,686  | 5,082,208                    | 1,158,686  |
| Stock options and deferred compensation agreements                          | 1,118,056                      | 514,429    | 1,013,455                    | 570,525    |
| Denominator for earnings per common share - assuming dilution               | 70,382,065                     | 64,253,628 | 69,882,240                   | 64,229,656 |
| Earnings per common share                                                   | \$ 1.87                        | \$ 0.31    | \$ 2.29                      | \$ 0.49    |
| Earnings per common share - assuming dilution                               | \$ 1.71                        | \$ 0.30    | \$ 2.09                      | \$ 0.46    |

(1) Weighted average common shares outstanding include shares vested under the NMO Deferred Compensation Plan and exclude unallocated shares held by the ESOP.

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 per share because the options' exercise price was greater than the average market price of the common shares are as follows:

| Period                           | Number of<br>Shares | Range of<br>Exercise Prices |         |
|----------------------------------|---------------------|-----------------------------|---------|
|                                  |                     | Minimum                     | Maximum |
| Three months ended June 30, 2013 | —                   | \$—                         | \$—     |
| Six months ended June 30, 2013   | —                   | \$—                         | \$—     |
| Three months ended June 30, 2012 | 1,502,900           | \$11.88                     | \$14.34 |
| Six months ended June 30, 2012   | 1,502,900           | \$11.88                     | \$14.34 |

## 9. Subsequent Event

On July 16, 2013, we issued \$400 million aggregate principal amount of senior unsecured notes due 2021 which will bear interest at 6.625% per year and will mature on July 15, 2021. We intend to use the net proceeds (i) to pay the cash consideration required to purchase our 5.25% Contingent Convertible Senior Notes due 2029 (the "2029 Notes") tendered in connection with an offer to exchange any and all of our outstanding 2029 Notes for cash and newly issued shares of common stock if we commence such an offer, depending on market conditions and other factors, including the payment of any applicable accrued and unpaid interest on our 2029 Notes, (ii) to pay the cash consideration required to purchase our 3.5% Convertible Senior Notes due 2015 (the "2015 Notes") tendered in connection with an offer to exchange any and all of our outstanding 2015 Notes for cash and newly issued shares of common stock if we commence such an offer, depending on market conditions and other factors, including the payment of any applicable accrued and unpaid interest on our 2015 Notes, (iii) to repay all amounts outstanding under our existing revolving

credit facility (we repaid all amounts outstanding on July 17, 2013) and (iv) to pay related fees and expenses. Any proceeds we are unable to use in the manner described above, due to market conditions or otherwise, or any excess proceeds after those uses may be used to tender for, redeem or repurchase any of the 2029 Notes or 2015 Notes that remain outstanding and/or for general corporate purposes.

## 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, 2013, and the unaudited consolidated results of operations for the three and six month periods ended June 30, 2013 and 2012, 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, 2012.

### 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, 2012.

### Overview

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a 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 and other charges deducted from the account balances of policyholders, 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), 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 operating income while maintaining a high quality investment portfolio that will not experience significant losses from impairments of invested assets. Growth in invested assets is predicated on a continuation of our high sales achievements of the last four years while at the same time maintaining a high level of retention of the funds received. The economic and personal investing environments continue 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. We are committed to maintaining a high quality investment portfolio with limited exposure to below investment grade securities and

other riskier assets.

31

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Annuity deposits by product type collected during the three and six months ended June 30, 2013 and 2012, were as follows:

| Product Type                       | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |             |
|------------------------------------|--------------------------------|-----------|------------------------------|-------------|
|                                    | 2013                           | 2012      | 2013                         | 2012        |
| (Dollars in thousands)             |                                |           |                              |             |
| Fixed index annuities:             |                                |           |                              |             |
| Index strategies                   | \$764,437                      | \$533,633 | \$1,369,078                  | \$1,021,760 |
| Fixed strategy                     | 285,416                        | 281,206   | 528,545                      | 570,560     |
|                                    | 1,049,853                      | 814,839   | 1,897,623                    | 1,592,320   |
| Fixed rate annuities:              |                                |           |                              |             |
| Single-year rate guaranteed        | 20,404                         | 21,141    | 40,314                       | 55,628      |
| Multi-year rate guaranteed         | 48,291                         | 39,232    | 95,547                       | 160,897     |
| Single premium immediate annuities | 16,824                         | 42,137    | 31,804                       | 87,949      |
|                                    | 85,519                         | 102,510   | 167,665                      | 304,474     |
| Total before coinsurance ceded     | 1,135,372                      | 917,349   | 2,065,288                    | 1,896,794   |
| Coinsurance ceded                  | 44,572                         | 32,668    | 87,179                       | 131,447     |
| Net after coinsurance ceded        | \$1,090,800                    | \$884,681 | \$1,978,109                  | \$1,765,347 |

Annuity deposits before coinsurance ceded increased 24% during the second quarter of 2013 and 9% during the six months ended June 30, 2013 compared to the same periods in 2012. We attribute the continuing significant sales of our products to factors including the highly competitive rates of our products, our continued strong relationships with our national marketing organizations and field force of licensed, independent insurance agents, the increased attractiveness of safe money products in volatile markets, lower interest rates on competing products such as bank certificates of deposit and product enhancements including a new generation of guaranteed income withdrawal benefit riders. The extent to which this trend will be sustained in future periods is uncertain.

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<br>June 30, |       | Six Months Ended<br>June 30, |       |
|----------------------------------|--------------------------------|-------|------------------------------|-------|
|                                  | 2013                           | 2012  | 2013                         | 2012  |
| Average yield on invested assets | 4.94%                          | 5.34% | 4.98%                        | 5.47% |
| Aggregate cost of money          | 2.24%                          | 2.64% | 2.28%                        | 2.66% |
| Aggregate investment spread      | 2.70%                          | 2.70% | 2.70%                        | 2.81% |

Impact of:

|                                                 |       |         |       |       |
|-------------------------------------------------|-------|---------|-------|-------|
| Investment yield - additional prepayment income | 0.05% | 0.03%   | 0.06% | 0.05% |
| Cost of money benefit of over (under) hedging   | 0.06% | (0.01)% | 0.04% | —%    |

Our investment spread for the three and six months ended June 30, 2013 and 2012 has been impacted by shortfalls in investment income from excess liquidity resulting from a lag in the reinvestment of proceeds of government agency bonds called for redemption. The callable government agency securities have been a cornerstone of our investment portfolio since our formation. Through the years they have provided very acceptable yields that met our spread requirements without any risk-based capital charges. We have been through several cycles of calls on these securities and each time we have reinvested a portion of the call redemption proceeds into new callable government agency securities. This kept cash balances low but perpetuated the call risk. However, in the current interest rate environment, we have been reluctant to reinvest the call redemption proceeds in government agency securities and only purchased \$948.9 million in 2012 compared to \$4.3 billion in calls. Consequently, we have been managing excess cash and other short-term investments throughout 2012 and into the second quarter of 2013. We ended the second quarter of 2013 with \$815.9 million in excess cash and other short-term investments compared to \$1.3 billion at the end of the first

quarter of 2013 and \$2.2 billion at the end of 2012. We expect to be in a fully invested position by the end of the third quarter of 2013. See Results of Operations - Net investment income for additional information regarding our excess liquidity.

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, 2012. 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 or early termination 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, 2012.

As reported in previous filings, in response to the continuing 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 2013 and 2012 periods reflect the benefit from these reductions; however, the reductions in cost of money were offset by lower yields available on investments including those purchased with reinvestment of proceeds from bonds called for redemption. We expect to continue to manage policyholder crediting rates with the objective of restoring our investment spread to our 3.00% target. We have approximately 0.60% of room to reduce rates before we would reach minimum guaranteed rates on our entire book of business.

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.

Results of Operations for the Three and Six Months Ended June 30, 2013 and 2012

Net income, 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 liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 14% to \$29.0 billion during second quarter of 2013 and increased 13% to \$28.5 billion for the six months ended June 30, 2013 compared to \$25.5 billion and \$25.2 billion for the same periods in 2012. Our investment spread measured in dollars was \$168.0 million during the second quarter of 2013 and \$329.1 million for the six months ended June 30, 2013 compared to \$146.6 million and \$301.5 million during the same periods in 2012. As previously mentioned, our investment spread has been negatively impacted by both the extended low interest rate environment and our excess liquidity due to calls of our United States government agency securities (see Net investment income). In addition, net income for the three and six months ended June 30, 2013 has been positively impacted by decreases in the change in fair value of embedded derivatives due to an increase in the discount rate used to estimate our liability for policy growth (see Change in fair value of embedded derivatives).

Operating income (a non-GAAP financial measure) increased 11% to \$30.3 million in the second quarter of 2013 and increased 12% to \$63.7 million compared to \$27.4 million and \$57.1 million for the same periods in 2012.

In addition to net income, we have consistently utilized operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains (losses) on investments including net other than temporary impairment ("OTTI") losses recognized in operations, fair value changes in derivatives and embedded derivatives, losses on extinguishment of debt and changes in litigation reserves. Because these items fluctuate from year to year in a manner unrelated to core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and evaluation of operating income together with net income provides information that may enhance an investor's understanding of our underlying results and profitability.

Operating income is not a substitute for net income determined in accordance with GAAP. The adjustments made to derive operating income are important to understanding our overall results from operations and, if evaluated without proper context, 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 and board of directors also separately review net realized investment gains (losses) 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 and board of directors examine net income as part of their review of our overall financial results.

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The adjustments made to net income to arrive at operating income for the three and six months ended June 30, 2013 and 2012 are set forth in the table that follows:

|                                                                                | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|----------|
|                                                                                | 2013                           | 2012     | 2013                         | 2012     |
|                                                                                | (Dollars in thousands)         |          |                              |          |
| Reconciliation of net income to operating income:                              |                                |          |                              |          |
| Net income                                                                     | \$120,113                      | \$18,759 | \$146,144                    | \$29,230 |
| Net realized (gains) losses and net OTTI losses on investments, net of offsets | (3,574                         | ) 861    | (6,378                       | ) 4,408  |
| Net effect of derivatives and embedded derivatives, net of offsets             | (84,653                        | ) 7,736  | (74,416                      | ) 23,478 |
| Extinguishment of debt, net of income taxes                                    | 345                            | —        | 345                          | —        |
| Litigation reserve, net of offsets                                             | (1,969                         | ) —      | (1,969                       | ) —      |
| Operating income                                                               | \$30,262                       | \$27,356 | \$63,726                     | \$57,116 |

Net realized gains/losses on investments and net impairment losses recognized in operations fluctuate from period to period based upon changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. The amounts disclosed in the reconciliation above are net of related adjustments in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

Amounts attributable to the fair value accounting for fixed index annuity derivatives and embedded derivatives fluctuate from year to year based upon changes in the fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in the interest rates used to discount the embedded derivative liability. The amounts disclosed in the reconciliation above are net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs and income taxes. The significant changes in the impact from the item disclosed in the reconciliation above relate primarily to a change in the discount rate used to estimate our embedded derivative liabilities which increased during the three and six months ended June 30, 2013 as a result of an increase in the general level of interest rates during the second quarter of 2013.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 7% to \$23.5 million in the second quarter of 2013 and increased 9% to \$45.0 million for the six months ended June 30, 2013 compared to \$21.9 million and \$41.3 million for the same periods in 2012. The components of annuity product charges are set forth in the table that follows:

|                                                                                | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |             |
|--------------------------------------------------------------------------------|--------------------------------|-------------|------------------------------|-------------|
|                                                                                | 2013                           | 2012        | 2013                         | 2012        |
|                                                                                | (Dollars in thousands)         |             |                              |             |
| Surrender charges                                                              | \$11,292                       | \$12,135    | \$22,794                     | \$23,797    |
| Lifetime income benefit riders (LIBR) fees                                     | 12,219                         | 9,773       | 22,198                       | 17,504      |
|                                                                                | \$23,511                       | \$21,908    | \$44,992                     | \$41,301    |
| Withdrawals from annuity policies subject to surrender charges                 | \$81,305                       | \$88,012    | \$159,310                    | \$177,790   |
| Average surrender charge collected on withdrawals subject to surrender charges | 13.9                           | % 13.8      | % 14.3                       | % 13.4      |
|                                                                                |                                |             |                              | %           |
| Fund values on policies subject to LIBR fees                                   | \$2,423,891                    | \$1,999,310 | \$4,311,461                  | \$3,508,994 |
| Weighted average per policy LIBR fee                                           | 0.50                           | % 0.49      | % 0.52                       | % 0.50      |
|                                                                                |                                |             |                              | %           |

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. See Interest sensitive and index product benefits below for corresponding expense recognized on lifetime income benefit riders. Decreases in surrender charges were primarily attributable to reductions in withdrawals subject to a surrender charge. The lower amount of withdrawals was influenced by the continuing low interest rate environment.

Net investment income increased 5% to \$336.1 million in the second quarter of 2013 and 3% to \$665.8 million for the six months ended June 30, 2013 compared to \$320.3 million and \$647.2 million for the same periods in 2012. This increase was principally attributable to the growth in our annuity business and a corresponding increase in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 14% to \$27.3 billion for the second quarter of 2013 and 13% to \$26.8 billion for the six months ended June 30, 2013 compared to \$24.0 billion and \$23.7 billion for the same periods in 2012. The average yield earned on average invested assets was 4.94% for the second quarter of 2013 and 4.98% for the six months ended June 30, 2013 compared to 5.34% and 5.47% for the same periods in 2012.

The decrease in yield earned on average invested assets was attributable to lower yields on investments purchased in 2012 and the six months ended June 30, 2013. In addition, net investment income and average yield were negatively

impacted by a lag in reinvestment of proceeds from bonds called for redemption during the periods into new assets causing excess liquidity held in low yielding cash and other short-term investments. The average balance held in cash and short-term investments was \$1.7 billion and \$1.8 billion for the three and six months ended June 30, 2013 compared to \$1.4 billion and \$1.1 billion for the same periods in 2012, respectively. We ended the second quarter of 2013 with \$815.9 million in excess cash and other short-term investments. The average yield on our cash and short-term investments for the three and six months ended June 30, 2013 was 0.47% and 0.40% compared to 0.14% and 0.13% for the same periods in 2012, respectively. Additionally, net investment income and average yield was positively impacted by prepayment and fee income received resulting in additional net investment income of \$3.1 million and \$8.0 million for the three and six months ended June 30, 2013 compared to \$1.8 million and \$5.6 million for the same periods in 2012, respectively.

Change in fair value of derivatives (principally call options purchased to fund annual index credits on fixed index annuities) is affected by the performance of the indices upon which our options are based and the aggregate cost of options purchased. The components of change in fair value of derivatives are as follows:

|                                  | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |            |
|----------------------------------|--------------------------------|-------------|------------------------------|------------|
|                                  | 2013                           | 2012        | 2013                         | 2012       |
|                                  | (Dollars in thousands)         |             |                              |            |
| Call options:                    |                                |             |                              |            |
| Gain (loss) on option expiration | \$150,874                      | \$(49,147)  | ) \$209,700                  | \$(75,300) |
| Change in unrealized gain/loss   | (92,674)                       | ) (73,094)  | ) 193,154                    | 194,579    |
| 2015 notes hedges                | 197                            | (24,163)    | ) 28,295                     | (7,412)    |
| Interest rate swaps              | 3,802                          | (4,038)     | ) 4,535                      | (3,148)    |
| Interest rate caps               | 1,841                          | (405)       | ) 2,318                      | (405)      |
|                                  | \$64,040                       | \$(150,847) | ) \$438,002                  | \$108,314  |

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, 2013 and 2012 is as follows:

|                                      | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |              |
|--------------------------------------|--------------------------------|--------------|------------------------------|--------------|
|                                      | 2013                           | 2012         | 2013                         | 2012         |
| S&P 500 Index                        |                                |              |                              |              |
| Point-to-point strategy              | 1.5% - 11.5%                   | 0.0% - 6.8%  | 1.5% - 11.5%                 | 0.0% - 7.0%  |
| Monthly average strategy             | 0.0% - 11.7%                   | 0.0% - 18.1% | 0.0% - 11.7%                 | 0.0% - 18.1% |
| Monthly point-to-point strategy      | 0.0% - 19.0%                   | 0.0% - 0.2%  | 0.0% - 19.0%                 | 0.0% - 3.3%  |
| Fixed income (bond index) strategies | 0.0% - 8.0%                    | 4.0% - 10.0% | 0.0% - 8.0%                  | 4.0% - 10.0% |

The change in fair value of derivatives is also influenced by the aggregate costs 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, 2012.

Concurrently with the issuance of the 2015 notes, we entered into hedge transactions (the "2015 notes hedges") to provide the cash needed to meet our cash obligations in excess of the principal amount of the 2015 notes upon conversion of the 2015 notes. The fair value of the 2015 notes hedges changes based upon changes in the price of our common stock, interest rates, stock price volatility, dividend yield and the time to expiration of the 2015 notes hedges. Similarly, the fair value of the conversion option obligation to the holders of the 2015 notes changes based upon these same factors and the conversion option obligation is accounted for as an embedded derivative liability with changes in fair value reported in the Change in fair value of embedded derivatives. The amount for the change in fair value of the 2015 notes hedges equals the amount for the change in the related embedded derivative liabilities and there is an offsetting expense in the change in fair value of embedded derivatives. See Note 9 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 for a discussion of the 2015 notes hedges.

Net realized gains (losses) 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. The components of net realized gains (losses) on investments are set forth in the table that follows:

|                                               | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |           |
|-----------------------------------------------|--------------------------------|---------|------------------------------|-----------|
|                                               | 2013                           | 2012    | 2013                         | 2012      |
|                                               | (Dollars in thousands)         |         |                              |           |
| Available for sale fixed maturity securities: |                                |         |                              |           |
| Gross realized gains                          | \$7,628                        | \$4,030 | \$20,643                     | \$5,048   |
| Gross realized losses                         | (823)                          | (59)    | (3,010)                      | (355)     |
|                                               | 6,805                          | 3,971   | 17,633                       | 4,693     |
| Equity securities:                            |                                |         |                              |           |
| Gross realized gains                          | 9,571                          | —       | 9,571                        | 562       |
| Other investments:                            |                                |         |                              |           |
| Gain on sale of real estate                   | 715                            | 1,450   | 1,304                        | 2,895     |
| Loss on sale of real estate                   | —                              | —       | (466)                        | —         |
| Impairment losses on real estate              | (145)                          | (1,669) | (145)                        | (2,643)   |
|                                               | 570                            | (219)   | 693                          | 252       |
| Mortgage loans on real estate:                |                                |         |                              |           |
| Increase in allowance for credit losses       | (1,257)                        | (4,363) | (1,623)                      | (12,194)  |
|                                               | \$15,689                       | \$(611) | \$26,274                     | \$(6,687) |

See Financial Condition - Investments for additional discussion of allowance for credit losses on mortgage loans on real estate.

Net OTTI losses recognized in operations increased to \$2.8 million in the second quarter of 2013 and \$6.0 million for the six months ended June 30, 2013 compared to \$1.0 million and \$3.9 million for the same periods in 2012. See Financial Condition - Investments and note 3 to our consolidated financial statements for additional discussion of write downs of securities for other than temporary impairments.

Interest sensitive and index product benefits increased to \$336.0 million in the second quarter of 2013 and to \$561.8 million for the six months ended June 30, 2013 compared to \$142.7 million and \$281.9 million for the same periods in 2012. The components of interest credited to account balances are summarized as follows:

|                                                                                                | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|------------------------------------------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                                                | 2013                           | 2012      | 2013                         | 2012      |
|                                                                                                | (Dollars in thousands)         |           |                              |           |
| Index credits on index policies                                                                | \$241,801                      | \$50,682  | \$377,142                    | \$101,340 |
| Interest credited (including changes in minimum guaranteed interest for fixed index annuities) | 81,600                         | 81,949    | 161,218                      | 162,461   |
| Living income benefit rider                                                                    | 12,624                         | 10,102    | 23,474                       | 18,055    |
|                                                                                                | \$336,025                      | \$142,733 | \$561,834                    | \$281,856 |

The amount of 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 \$244.8 million and \$380.0 million for the three and six months ended June 30, 2013, compared to \$50.0 million and \$100.9 million for the same periods in 2012. The decrease in interest credited was due to a decrease in the average rate credited to the annuity liabilities outstanding receiving a fixed rate of interest. The average amount of annuity



liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 14% to \$29.0 billion during second quarter of 2013 and increased 13% to \$28.5 billion for the six months ended June 30, 2013 compared to \$25.5 billion and \$25.2 billion for the same periods in 2012. The increases in benefits recognized for living income benefit rider were due to increases in the number of policies with lifetime income benefit riders and correlates to the increase in fees discussed in Annuity product charges.

Amortization of deferred sales inducements increased 365% to \$120.5 million in the second quarter of 2013 and 250% to \$149.4 million for the six months ended June 30, 2013 compared to \$25.9 million and \$42.7 million for the same periods in 2012. In general, amortization of deferred sales inducements 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 97% of our net annuity deposits during the three and six months ended June 30, 2013 compared to 97% during the same periods in 2012. The anticipated increase in amortization from these factors has

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 exceeds ten years. Amortization of deferred sales inducements is summarized as follows:

|                                                                                         | Three Months Ended<br>June 30,<br>2013 |          | Six Months Ended<br>June 30,<br>2013 |           |
|-----------------------------------------------------------------------------------------|----------------------------------------|----------|--------------------------------------|-----------|
|                                                                                         | 2012                                   |          | 2012                                 |           |
|                                                                                         | (Dollars in thousands)                 |          |                                      |           |
| Amortization of deferred sales inducements before gross profit adjustments              | \$37,953                               | \$33,141 | \$74,231                             | \$66,609  |
| Gross profit adjustments:                                                               |                                        |          |                                      |           |
| Fair value accounting for derivatives and embedded derivatives                          | 79,558                                 | (7,217 ) | 70,787                               | (22,637 ) |
| Net realized gains (losses) on investments and net OTTI losses recognized in operations | 3,025                                  | 16       | 4,349                                | (1,322 )  |
| Amortization of deferred sales inducements after gross profit adjustments               | \$120,536                              | \$25,940 | \$149,367                            | \$42,650  |

Change in fair value of embedded derivatives primarily relates to fixed index annuity embedded derivatives and 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 these index credits discussed above in change in fair value of derivatives; (ii) changes in discount rates used in estimating our liability for policy growth; and (iii) the growth in the host component of the policy liability. 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, 2012. The primary reasons for the decrease in the change in fair value of the fixed index annuity embedded derivatives during the three and six months ended June 30, 2013 was an increase in the discount rate used in estimating our liability for policy growth and decreases in the expected index credits that resulted from decreases in the fair value of the call options acquired to fund these index credits. The discount rates used in estimating our liability for policy growth increased as a result of the increase in the general level of interest rates during the second quarter of 2013. The changes for the three and six months ended June 30, 2013 also include increases of \$0.2 million and \$28.3 million, respectively, compared to decreases of \$24.2 million and \$7.4 million for the same periods in 2012, respectively, in the fair value of the 2015 notes embedded conversion derivative. As discussed previously, these amounts were offset by comparable increases in the fair value of the 2015 notes hedges.

Interest expense on subordinated debentures decreased 15% to \$3.0 million in the second quarter of 2013 and 16% to \$6.0 million for the six months ended June 30, 2013 compared to \$3.6 million and \$7.1 million for the same periods in 2012. The decrease is primarily attributable to the redemption of \$22 million principal amount of our 8% Convertible Junior Subordinated Debentures in July 2012. \$169.6 million principal amount of the subordinated debentures has floating rates of interest based upon the three month London Interbank Offered Rate plus an applicable margin. See Financial Condition - Liabilities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

Amortization of deferred policy acquisition costs increased 277% to \$169.3 million in the second quarter of 2013 and 172% to \$215.5 million for the six months ended June 30, 2013 compared to \$44.8 million and \$79.1 million for the same periods in 2012. In general, amortization of deferred policy acquisition costs 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 anticipated increase in amortization from these factors has 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 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<br>June 30,<br>2013 |          | Six Months Ended<br>June 30,<br>2013 |           |
|-----------------------------------------------------------------------------------------|----------------------------------------|----------|--------------------------------------|-----------|
|                                                                                         | 2012                                   |          | 2012                                 |           |
|                                                                                         | (Dollars in thousands)                 |          |                                      |           |
| Amortization of deferred policy acquisition costs before gross profit adjustments       | \$57,701                               | \$54,457 | \$113,631                            | \$110,096 |
| Gross profit adjustments:                                                               |                                        |          |                                      |           |
| Fair value accounting for derivatives and embedded derivatives                          | 107,174                                | (9,342 ) | 95,705                               | (28,585 ) |
| Net realized gains (losses) on investments and net OTTI losses recognized in operations | 4,395                                  | (267 )   | 6,164                                | (2,379 )  |
| Amortization of deferred policy acquisition costs after gross profit adjustments        | \$169,270                              | \$44,848 | \$215,500                            | \$79,132  |

Other operating costs and expenses increased 31% to \$24.9 million in the second quarter of 2013 and 9% to \$44.4 million for the six months ended June 30, 2013 compared to \$18.9 million and \$40.6 million for the same periods in 2012. The increase for both the three and six month periods ended June 30, 2013 was primarily due to \$8.5 million of guaranty fund assessments related to the insolvency of Executive Life Insurance Company of New York which was offset by a \$3.2 million decrease in a litigation reserve associated with a previous lawsuit settlement that represents undistributed settlement awards due to contractholders and beneficiaries that could not be located or did not come forward to claim such awards during the agreed upon time period, which expired during the second quarter of 2013.

Income tax expense increased to \$64.6 million in the second quarter of 2013 and to \$78.1 million for the six months ended June 30, 2013 compared to \$9.9 million and \$15.6 million for the same periods in 2012. The change in income tax expense was primarily due to changes in income before income taxes. Income tax expense and the resulting effective tax rate are based upon two components of income before income taxes ("pretax income") that are taxed at different tax rates. Life insurance income is generally taxed at an effective rate of approximately 35.6% reflecting the absence of state income taxes for substantially all of the states that the life insurance subsidiaries do business in. The income for the parent company and other non-life insurance subsidiaries is generally taxed at an effective tax rate of 41.5% reflecting the combined federal / state income tax rates. The effective 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 tax rate for the three and six months ended June 30, 2013 was 35.0% and 34.8%, respectively, and 34.5% and 34.7% for the same periods in 2012, respectively.

#### 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 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, 2013          |         | December 31, 2012 |         |   |
|------------------------------------------------------|------------------------|---------|-------------------|---------|---|
|                                                      | Carrying Amount        | Percent | Carrying Amount   | Percent |   |
|                                                      | (Dollars in thousands) |         |                   |         |   |
| Fixed maturity securities:                           |                        |         |                   |         |   |
| United States Government full faith and credit       | \$4,938                | —       | % \$5,154         | —       | % |
| United States Government sponsored agencies          | 1,199,847              | 4.1     | % 1,772,025       | 6.5     | % |
| United States municipalities, states and territories | 3,543,158              | 12.2    | % 3,578,323       | 13.0    | % |
| Foreign government obligations                       | 92,811                 | 0.3     | % 105,259         | 0.4     | % |
| Corporate securities                                 | 16,075,497             | 55.3    | % 14,542,860      | 52.8    | % |
| Residential mortgage backed securities               | 2,488,057              | 8.6     | % 2,888,113       | 10.5    | % |
| Commercial mortgage backed securities                | 1,222,689              | 4.2     | % 357,982         | 1.3     | % |
| Other asset backed securities                        | 994,815                | 3.5     | % 998,508         | 3.6     | % |
| Total fixed maturity securities                      | 25,621,812             | 88.2    | % 24,248,224      | 88.1    | % |
| Equity securities                                    | 9,790                  | —       | % 53,422          | 0.2     | % |
| Mortgage loans on real estate                        | 2,583,703              | 8.9     | % 2,623,940       | 9.5     | % |

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|                        |              |       |   |              |       |   |
|------------------------|--------------|-------|---|--------------|-------|---|
| Derivative instruments | 629,135      | 2.2   | % | 415,258      | 1.5   | % |
| Other investments      | 208,635      | 0.7   | % | 196,366      | 0.7   | % |
|                        | \$29,053,075 | 100.0 | % | \$27,537,210 | 100.0 | % |

38

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## 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. Historically, we have had a high percentage of our fixed maturity securities in U.S. Government sponsored agency securities (for the most part Federal Home Loan Mortgage Corporation and Federal National Mortgage Association). While U.S. Government sponsored agency securities are of high credit quality, the call features have resulted in our excess cash position. These calls resulted from the low interest rate and tight agency spread environment. Since 2007, when we had almost 80% of our fixed maturity portfolio invested in callable agencies, we have reallocated a significant portion of our fixed maturities from the callable agency securities to other highly rated, long-term securities. The largest portion of our fixed maturity securities are now in investment grade (NAIC designation 1 or 2) publicly traded or privately placed corporate securities. We have also built a portfolio of residential mortgage backed securities ("RMBS") that provide our investment portfolio a source of regular cash flow and higher yielding assets than our agency securities. In addition, we have acquired a portfolio of taxable bonds issued by municipalities, states and territories of the United States that provide us with attractive yields while being consistent with our credit risk parameters. Beginning in 2012, we have increased our position in other asset backed securities as well as establishing a position in commercial mortgage backed securities.

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

| Rating Agency Rating         | June 30, 2013          |                                      | December 31, 2012 |                                      |   |
|------------------------------|------------------------|--------------------------------------|-------------------|--------------------------------------|---|
|                              | Carrying Amount        | Percent of Fixed Maturity Securities | Carrying Amount   | Percent of Fixed Maturity Securities |   |
|                              | (Dollars in thousands) |                                      |                   |                                      |   |
| Aaa/Aa/A                     | \$15,432,442           | 60.2                                 | % \$14,613,775    | 60.3                                 | % |
| Baa                          | 8,676,435              | 33.9                                 | % 8,190,220       | 33.8                                 | % |
| Total investment grade       | 24,108,877             | 94.1                                 | % 22,803,995      | 94.1                                 | % |
| Ba                           | 471,089                | 1.8                                  | % 365,102         | 1.5                                  | % |
| B                            | 107,823                | 0.4                                  | % 79,789          | 0.3                                  | % |
| Caa and lower                | 760,254                | 3.0                                  | % 862,650         | 3.5                                  | % |
| In or near default           | 173,769                | 0.7                                  | % 136,688         | 0.6                                  | % |
| Total below investment grade | 1,512,935              | 5.9                                  | % 1,444,229       | 5.9                                  | % |
|                              | \$25,621,812           | 100.0                                | % \$24,248,224    | 100.0                                | % |

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

| NAIC Designation | NRSRO Equivalent Rating |
|------------------|-------------------------|
| 1                | Aaa/Aa/A                |
| 2                | Baa                     |
| 3                | Ba                      |
| 4                | B                       |
| 5                | Caa and lower           |
| 6                | In or near default      |

Since 2009, the NAIC has utilized a process to assess non-agency RMBS that does not rely on NRSRO ratings. The NAIC retained the services of PIMCO Advisory to model each non-agency RMBS owned by U.S. insurers at year-end 2012 and 2011. PIMCO Advisory has provided 5 prices for each security for life insurance companies to utilize in determining the NAIC designation for each RMBS based on each insurer's statutory book value price. This process is used to determine the level of RBC requirements for non-agency RMBS. In 2010, the NAIC retained the services of

BlackRock Solutions to model each non-agency CMBS to determined the level of RBC requirements for non-agency CMBS in a manner similar to that utilized by PIMCO Advisory for RMBS.

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

| NAIC Designation | June 30, 2013          |              |                 |                                  | December 31, 2012      |              |                 |                                  |  |  |
|------------------|------------------------|--------------|-----------------|----------------------------------|------------------------|--------------|-----------------|----------------------------------|--|--|
|                  | 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                | \$15,440,564           | \$16,049,276 | \$16,049,276    | 62.7 %                           | \$13,737,381           | \$15,250,560 | \$15,250,560    | 62.9 %                           |  |  |
| 2                | 8,878,184              | 9,028,631    | 9,028,631       | 35.2 %                           | 7,838,186              | 8,533,121    | 8,533,121       | 35.2 %                           |  |  |
| 3                | 475,652                | 457,918      | 472,838         | 1.8 %                            | 398,294                | 387,222      | 401,789         | 1.7 %                            |  |  |
| 4                | 68,807                 | 69,502       | 69,502          | 0.3 %                            | 53,879                 | 56,151       | 56,151          | 0.2 %                            |  |  |
| 5                | —                      | —            | —               | — %                              | —                      | —            | —               | — %                              |  |  |
| 6                | 2,050                  | 1,565        | 1,565           | — %                              | 5,375                  | 6,603        | 6,603           | — %                              |  |  |
|                  | \$24,865,257           | \$25,606,892 | \$25,621,812    | 100.0 %                          | \$22,033,115           | \$24,233,657 | \$24,248,224    | 100.0 %                          |  |  |

A summary of our RMBS by collateral type and split by NAIC designation, as well as a separate summary of securities for which we have recognized OTTI and those which we have not recognized any OTTI is as follows as of June 30, 2013:

| Collateral Type              | Principal Amount<br>(Dollars in thousands) | Amortized Cost | Fair Value  |
|------------------------------|--------------------------------------------|----------------|-------------|
| OTTI has not been recognized |                                            |                |             |
| Government agency            | \$943,971                                  | \$887,172      | \$932,517   |
| Prime                        | 683,014                                    | 648,610        | 693,299     |
| Alt-A                        | 36,427                                     | 36,872         | 37,816      |
|                              | \$1,663,412                                | \$1,572,654    | \$1,663,632 |
| OTTI has been recognized     |                                            |                |             |
| Prime                        | \$531,924                                  | \$460,258      | \$489,691   |
| Alt-A                        | 385,961                                    | 304,487        | 334,734     |
|                              | \$917,885                                  | \$764,745      | \$824,425   |
| Total by collateral type     |                                            |                |             |
| Government agency            | \$943,971                                  | \$887,172      | \$932,517   |
| Prime                        | 1,214,938                                  | 1,108,868      | 1,182,990   |
| Alt-A                        | 422,388                                    | 341,359        | 372,550     |
|                              | \$2,581,297                                | \$2,337,399    | \$2,488,057 |
| Total by NAIC designation    |                                            |                |             |
| 1                            | \$2,185,965                                | \$1,984,119    | \$2,116,730 |
| 2                            | 305,145                                    | 274,662        | 287,908     |
| 3                            | 57,961                                     | 50,979         | 54,389      |
| 4                            | 29,110                                     | 25,589         | 27,489      |
| 6                            | 3,116                                      | 2,050          | 1,541       |
|                              | \$2,581,297                                | \$2,337,399    | \$2,488,057 |

The amortized cost and fair value of fixed maturity securities at June 30, 2013, by contractual maturity, are presented in Note 3 to our consolidated financial statements in this form 10-Q, which is incorporated by reference in this Item 2.



## Unrealized Losses

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

|                                                      | Number of<br>Securities | Amortized<br>Cost<br>(Dollars in thousands) | Unrealized<br>Losses | Fair Value    |
|------------------------------------------------------|-------------------------|---------------------------------------------|----------------------|---------------|
| June 30, 2013                                        |                         |                                             |                      |               |
| Fixed maturity securities, available for sale:       |                         |                                             |                      |               |
| United States Government full faith and credit       | 2                       | \$1,020                                     | \$(36                | ) \$984       |
| United States Government sponsored agencies          | 13                      | 1,172,954                                   | (46,847              | ) 1,126,107   |
| United States municipalities, states and territories | 102                     | 432,449                                     | (24,701              | ) 407,748     |
| Foreign government obligations                       | 3                       | 29,794                                      | (2,525               | ) 27,269      |
| Corporate securities:                                |                         |                                             |                      |               |
| Finance, insurance and real estate                   | 95                      | 1,454,810                                   | (74,929              | ) 1,379,881   |
| Manufacturing, construction and mining               | 196                     | 2,780,779                                   | (137,067             | ) 2,643,712   |
| Utilities and related sectors                        | 124                     | 1,432,643                                   | (68,087              | ) 1,364,556   |
| Wholesale/retail trade                               | 30                      | 318,925                                     | (17,027              | ) 301,898     |
| Services, media and other                            | 61                      | 786,715                                     | (39,559              | ) 747,156     |
| Residential mortgage backed securities               | 48                      | 367,794                                     | (16,393              | ) 351,401     |
| Commercial mortgage backed securities                | 98                      | 1,147,811                                   | (83,053              | ) 1,064,758   |
| Other asset backed securities                        | 30                      | 469,181                                     | (20,163              | ) 449,018     |
|                                                      | 802                     | \$10,394,875                                | \$(530,387           | ) \$9,864,488 |
| Fixed maturity securities, held for investment:      |                         |                                             |                      |               |
| Corporate security:                                  |                         |                                             |                      |               |
| Insurance                                            | 1                       | \$76,170                                    | \$(14,920            | ) \$61,250    |
| December 31, 2012                                    |                         |                                             |                      |               |
| Fixed maturity securities, available for sale:       |                         |                                             |                      |               |
| United States Government sponsored agencies          | 6                       | \$977,196                                   | \$(3,468             | ) \$973,728   |
| United States municipalities, states and territories | 8                       | 24,518                                      | (125                 | ) 24,393      |
| Corporate securities:                                |                         |                                             |                      |               |
| Finance, insurance and real estate                   | 19                      | 276,235                                     | (12,564              | ) 263,671     |
| Manufacturing, construction and mining               | 34                      | 453,679                                     | (5,584               | ) 448,095     |
| Utilities and related sectors                        | 20                      | 269,667                                     | (9,399               | ) 260,268     |
| Wholesale/retail trade                               | 11                      | 113,032                                     | (992                 | ) 112,040     |
| Services, media and other                            | 19                      | 267,506                                     | (3,085               | ) 264,421     |
| Residential mortgage backed securities               | 56                      | 508,576                                     | (27,728              | ) 480,848     |
| Commercial mortgage backed securities                | 12                      | 163,565                                     | (1,983               | ) 161,582     |
| Other asset backed securities                        | 11                      | 174,342                                     | (2,973               | ) 171,369     |
|                                                      | 196                     | \$3,228,316                                 | \$(67,901            | ) \$3,160,415 |
| Fixed maturity securities, held for investment:      |                         |                                             |                      |               |
| Corporate security:                                  |                         |                                             |                      |               |
| Insurance                                            | 1                       | \$76,088                                    | \$(14,567            | ) \$61,521    |

## Equity securities, available for sale:

Finance, insurance and real estate 1 \$10,125 \$(1,403 ) \$8,722

Unrealized losses increased \$461.4 million from \$83.9 million at December 31, 2012 to \$545.3 million at June 30, 2013. Unrealized losses primarily increased due to a rise in ten-year treasury yields during the six months ended June 30, 2013.



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

| NAIC Designation  | Carrying Value<br>of<br>Securities with<br>Gross<br>Unrealized<br>Losses<br>(Dollars in thousands) | Percent of<br>Total | Gross<br>Unrealized<br>Losses | Percent of<br>Total |   |
|-------------------|----------------------------------------------------------------------------------------------------|---------------------|-------------------------------|---------------------|---|
| June 30, 2013     |                                                                                                    |                     |                               |                     |   |
| 1                 | \$5,623,683                                                                                        | 56.6                | % \$(304,980                  | ) 55.9              | % |
| 2                 | 4,024,112                                                                                          | 40.5                | % (212,677                    | ) 39.0              | % |
| 3                 | 259,939                                                                                            | 2.6                 | % (25,217                     | ) 4.6               | % |
| 4                 | 31,383                                                                                             | 0.3                 | % (1,924                      | ) 0.4               | % |
| 5                 | —                                                                                                  | —                   | % —                           | —                   | % |
| 6                 | 1,541                                                                                              | —                   | % (509                        | ) 0.1               | % |
|                   | \$9,940,658                                                                                        | 100.0               | % \$(545,307                  | ) 100.0             | % |
| December 31, 2012 |                                                                                                    |                     |                               |                     |   |
| 1                 | \$1,992,406                                                                                        | 61.5                | % \$(38,125                   | ) 46.2              | % |
| 2                 | 1,071,009                                                                                          | 33.1                | % (23,969                     | ) 29.1              | % |
| 3                 | 157,464                                                                                            | 4.9                 | % (19,410                     | ) 23.5              | % |
| 4                 | 13,812                                                                                             | 0.4                 | % (299                        | ) 0.4               | % |
| 5                 | —                                                                                                  | —                   | % —                           | —                   | % |
| 6                 | 1,812                                                                                              | 0.1                 | % (665                        | ) 0.8               | % |
|                   | \$3,236,503                                                                                        | 100.0               | % \$(82,468                   | ) 100.0             | % |

Our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 803 and 198 securities, respectively) have been in a continuous unrealized loss position at June 30, 2013 and December 31, 2012, along with a description of the factors causing the unrealized losses is presented in Note 3 to our consolidated financial statements in this Form 10-Q, which is incorporated by reference in the Item 2.

The amortized cost and fair value of fixed maturity securities and equity 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 considered investment grade) were as follows:

|                                                | Number of<br>Securities | Amortized<br>Cost      | Fair Value  | Gross<br>Unrealized<br>Losses |
|------------------------------------------------|-------------------------|------------------------|-------------|-------------------------------|
|                                                |                         | (Dollars in thousands) |             |                               |
| June 30, 2013                                  |                         |                        |             |                               |
| Fixed maturity securities:                     |                         |                        |             |                               |
| Investment grade:                              |                         |                        |             |                               |
| Less than six months                           | 699                     | \$8,956,989            | \$8,498,026 | \$(458,963 )                  |
| Six months or more and less than twelve months | 39                      | 1,054,493              | 1,006,258   | (48,235 )                     |
| Twelve months or greater                       | 12                      | 140,513                | 128,433     | (12,080 )                     |
| Total investment grade                         | 750                     | 10,151,995             | 9,632,717   | (519,278 )                    |
| Below investment grade:                        |                         |                        |             |                               |
| Less than six months                           | 40                      | 157,228                | 153,213     | (4,015 )                      |
| Six months or more and less than twelve months | —                       | —                      | —           | —                             |
| Twelve months or greater                       | 13                      | 161,822                | 139,808     | (22,014 )                     |
| Total below investment grade                   | 53                      | 319,050                | 293,021     | (26,029 )                     |
|                                                | 803                     | \$10,471,045           | \$9,925,738 | \$(545,307 )                  |
| December 31, 2012                              |                         |                        |             |                               |
| Fixed maturity securities:                     |                         |                        |             |                               |
| Investment grade:                              |                         |                        |             |                               |
| Less than six months                           | 106                     | \$2,464,476            | \$2,440,131 | \$(24,345 )                   |
| Six months or more and less than twelve months | 4                       | 40,054                 | 39,151      | (903 )                        |
| Twelve months or greater                       | 14                      | 165,718                | 155,618     | (10,100 )                     |
| Total investment grade                         | 124                     | 2,670,248              | 2,634,900   | (35,348 )                     |
| Below investment grade:                        |                         |                        |             |                               |
| Less than six months                           | 23                      | 110,435                | 108,531     | (1,904 )                      |
| Six months or more and less than twelve months | 9                       | 135,915                | 129,086     | (6,829 )                      |
| Twelve months or greater                       | 41                      | 387,806                | 349,419     | (38,387 )                     |
| Total below investment grade                   | 73                      | 634,156                | 587,036     | (47,120 )                     |
| Equity securities:                             |                         |                        |             |                               |
| Less than six months                           | —                       | —                      | —           | —                             |
| Six months or more and less than twelve months | 1                       | 10,125                 | 8,722       | (1,403 )                      |
| Twelve months or greater                       | —                       | —                      | —           | —                             |
| Total equity securities                        | 1                       | 10,125                 | 8,722       | (1,403 )                      |
|                                                | 198                     | \$3,314,529            | \$3,230,658 | \$(83,871 )                   |

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 and equity securities that had unrealized losses greater than 20% and the number of months in a continuous unrealized loss position were as follows:

|                                                | Number of<br>Securities | Amortized<br>Cost      | Fair<br>Value | Gross<br>Unrealized<br>Losses |
|------------------------------------------------|-------------------------|------------------------|---------------|-------------------------------|
|                                                |                         | (Dollars in thousands) |               |                               |
| June 30, 2013                                  |                         |                        |               |                               |
| Investment grade:                              |                         |                        |               |                               |
| Less than six months                           | 4                       | \$31,644               | \$24,249      | \$(7,395)                     |
| Six months or more and less than twelve months | —                       | —                      | —             | —                             |
| Twelve months or greater                       | 1                       | 20,000                 | 14,565        | (5,435)                       |
| Total investment grade                         | 5                       | 51,644                 | 38,814        | (12,830)                      |
| Below investment grade:                        |                         |                        |               |                               |
| Less than six months                           | 3                       | 81,170                 | 65,215        | (15,955)                      |
| Six months or more and less than twelve months | —                       | —                      | —             | —                             |
| Twelve months or greater                       | 2                       | 2,050                  | 1,541         | (509)                         |
| Total below investment grade                   | 5                       | 83,220                 | 66,756        | (16,464)                      |
|                                                | 10                      | \$134,864              | \$105,570     | \$(29,294)                    |
| December 31, 2012                              |                         |                        |               |                               |
| Investment grade:                              |                         |                        |               |                               |
| Less than six months                           | —                       | \$—                    | \$—           | \$—                           |
| Six months or more and less than twelve months | 1                       | 20,000                 | 15,379        | (4,621)                       |
| Twelve months or greater                       | —                       | —                      | —             | —                             |
| Total investment grade                         | 1                       | 20,000                 | 15,379        | (4,621)                       |
| Below investment grade:                        |                         |                        |               |                               |
| Less than six months                           | 1                       | 1,416                  | 1,131         | (285)                         |
| Six months or more and less than twelve months | —                       | —                      | —             | —                             |
| Twelve months or greater                       | 3                       | 9,324                  | 7,148         | (2,176)                       |
| Total below investment grade                   | 4                       | 10,740                 | 8,279         | (2,461)                       |
|                                                | 5                       | \$30,740               | \$23,658      | \$(7,082)                     |

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, 2013                            |                        |             |                     |            |
| Due in one year or less                  | \$—                    | \$—         | \$—                 | \$—        |
| Due after one year through five years    | 22,522                 | 22,106      | —                   | —          |
| Due after five years through ten years   | 4,217,818              | 4,027,854   | —                   | —          |
| Due after ten years through twenty years | 2,461,129              | 2,343,870   | —                   | —          |
| Due after twenty years                   | 1,708,620              | 1,605,481   | 76,170              | 61,250     |
|                                          | 8,410,089              | 7,999,311   | 76,170              | 61,250     |
| Residential mortgage backed securities   | 367,794                | 351,401     | —                   | —          |
| Commercial mortgage backed securities    | 1,147,811              | 1,064,758   | —                   | —          |
| Other asset backed securities            | 469,181                | 449,018     | —                   | —          |
|                                          | \$10,394,875           | \$9,864,488 | \$76,170            | \$61,250   |
| December 31, 2012                        |                        |             |                     |            |
| Due in one year or less                  | \$—                    | \$—         | \$—                 | \$—        |
| Due after one year through five years    | 22,160                 | 21,059      | —                   | —          |
| Due after five years through ten years   | 623,802                | 617,848     | —                   | —          |
| Due after ten years through twenty years | 1,319,250              | 1,302,283   | —                   | —          |
| Due after twenty years                   | 416,621                | 405,426     | 76,088              | 61,521     |
|                                          | 2,381,833              | 2,346,616   | 76,088              | 61,521     |
| Residential mortgage backed securities   | 508,576                | 480,848     | —                   | —          |
| Commercial mortgage backed securities    | 163,565                | 161,582     | —                   | —          |
| Other asset backed securities            | 174,342                | 171,369     | —                   | —          |
|                                          | \$3,228,316            | \$3,160,415 | \$76,088            | \$61,521   |

#### International Exposure

We hold fixed maturity securities with international exposure. As of June 30, 2013, 15% 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. All of these securities are denominated in U.S. dollars and all are investment grade (NAIC designation of either 1 or 2), except for thirteen securities with a total fair value of \$74.7 million which are all NAIC 3 and one security (fair value of \$2.3 million) which has an NAIC 4 designation. 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, 2013

|                  | Amortized Cost         | Carrying Amount/Fair Value | Percent of Total Carrying Amount |
|------------------|------------------------|----------------------------|----------------------------------|
|                  | (Dollars in thousands) |                            |                                  |
| GIIPS (1)        | \$238,434              | \$243,285                  | 0.9%                             |
| Asia/Pacific     | 174,344                | 172,967                    | 0.7%                             |
| Non-GIIPS Europe | 1,782,259              | 1,802,949                  | 7.0%                             |
| Latin America    | 195,506                | 190,749                    | 0.8%                             |

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|                         |             |             |       |
|-------------------------|-------------|-------------|-------|
| Non-U.S. North America  | 722,194     | 736,819     | 2.9%  |
| Australia & New Zealand | 372,489     | 377,527     | 1.5%  |
| Other                   | 367,820     | 386,423     | 1.5%  |
|                         | \$3,853,046 | \$3,910,719 | 15.3% |

(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.

### 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 RMBS as we monitor all of our RMBS 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, 2013, the amortized cost and fair value of securities on the watch list are as follows:

| General Description                  | Number of Securities | Amortized Cost | Unrealized Losses | Fair Value | Months in Continuous Unrealized Loss Position | Months Unrealized Losses Greater Than 20% |
|--------------------------------------|----------------------|----------------|-------------------|------------|-----------------------------------------------|-------------------------------------------|
| (Dollars in thousands)               |                      |                |                   |            |                                               |                                           |
| Investment grade                     |                      |                |                   |            |                                               |                                           |
| Corporate fixed maturity securities: |                      |                |                   |            |                                               |                                           |
| Finance                              | 3                    | \$49,530       | \$(6,998)         | ) \$42,532 | 1 - 31                                        | 0 - 20                                    |
| Industrial                           | 3                    | 28,875         | (5,516)           | ) 23,359   | 8 - 34                                        | 0 - 1                                     |
| Industrial                           | 1                    | 9,365          | 22                | 9,387      |                                               |                                           |
|                                      | 7                    | \$87,770       | \$(12,492)        | ) \$75,278 |                                               |                                           |
| Below investment grade               |                      |                |                   |            |                                               |                                           |
| Corporate fixed maturity securities: |                      |                |                   |            |                                               |                                           |
| Industrial                           | 1                    | 20,606         | (2,491)           | ) 18,115   | 25                                            | —                                         |
|                                      | 8                    | \$108,376      | (14,983)          | ) \$93,393 |                                               |                                           |

A majority of the investment grade securities on the watch list have Eurozone exposure that has contributed to their depressed fair values. Our analysis of all of the securities on the watch list that we have determined are temporarily impaired and their credit performance at June 30, 2013 is as follows:

**Finance:** The decline in value of these securities which are rated investment grade is due to the continued wide spreads as a result of the ongoing concerns relating to capital, asset quality and earnings stability due to the financial events of the past three years and the ongoing events in the Eurozone, specifically the sovereign debt crisis. While these issuers have had their financial position and profitability weakened by the credit and liquidity crisis, we have determined that these securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of each individual issuer.

**Industrial:** The decline in value of these securities relates to ongoing operational issues or recent corporate actions. These issues have caused the price for these securities to decline; however, the companies have strong liquidity and ample time to strengthen their credit profile. We have determined that these securities were not other than temporarily impaired due to the issuers' very strong market positions, restructuring actions that are expected to favorably impact future profitability and a history of strong reliable operating performance, improving economic conditions and rising security prices.

### Other Than Temporary Impairments



We have a policy and process in place 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, 2012.

We recognized other than temporary impairments and additional credit losses on a number of securities for which we have previously recognized OTTI. 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.

Several factors led us to believe that full recovery of amortized cost will not be expected. A discussion of these factors and our policy and process in place to identify securities that could potentially have impairment that is other than temporary is 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, adjusted for amortization of premiums and accrual of discounts net of valuation allowances. At June 30, 2013 and December 31, 2012 the largest principal amount outstanding for any single mortgage loan was \$14.7 million and \$15.0 million, respectively, and the average loan size was \$2.5 million and \$2.4 million as of June 30, 2013 and December 31, 2012, respectively. We have the contractual ability to pursue full personal recourse on 11.0% of the loans and partial personal recourse on 31.4% of the loans. In addition, the average loan to value ratio for the overall portfolio was 54.6% and 53.5% at June 30, 2013 and December 31, 2012, 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 current appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type in Note 4 - Mortgage Loans on Real Estate in our unaudited consolidated financial statements.

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At June 30, 2013, we had commitments to fund commercial mortgage loans totaling \$93.8 million, with fixed interest rates ranging from 3.80% to 4.55%. During 2012 and 2013, 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, 2013, we received \$224.3 million in cash for loans being paid in full compared to \$165.4 million for the six months ended June 30, 2012. 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 for a presentation of our specific and general loan loss allowances, foreclosure activity and troubled debt restructure analysis.

We recorded impairment losses of \$1.2 million on three mortgage loan with outstanding principal due totaling \$5.9 million and impairment losses of \$2.2 million on four mortgage loans with outstanding principal due totaling \$9.5 million during the three and six months ended June 30, 2013, respectively. We recorded impairment losses of \$3.5 million on five mortgage loan with outstanding principal due totaling \$13.6 million and impairment losses of \$10.3 million on sixteen mortgage loans with outstanding principal due totaling \$45.6 million during the same periods in 2012.

In 2012, we initiated 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 follows:

|                                                | June 30, 2013            |                                              | December 31, 2012        |                                              |   |
|------------------------------------------------|--------------------------|----------------------------------------------|--------------------------|----------------------------------------------|---|
|                                                | Principal<br>Outstanding | Percent of Total<br>Principal<br>Outstanding | Principal<br>Outstanding | Percent of Total<br>Principal<br>Outstanding |   |
|                                                | (Dollars in thousands)   |                                              |                          |                                              |   |
| Debt Service Coverage Ratio:                   |                          |                                              |                          |                                              |   |
| Greater than or equal to 1.5                   | \$1,596,745              | 61.0                                         | % \$1,517,840            | 57.1                                         | % |
| Greater than or equal to 1.2 and less than 1.5 | 542,745                  | 20.8                                         | % 604,512                | 22.7                                         | % |
| Greater than or equal to 1.0 and less than 1.2 | 225,451                  | 8.6                                          | % 262,165                | 9.9                                          | % |
| Less than 1.0                                  | 251,238                  | 9.6                                          | % 274,366                | 10.3                                         | % |
|                                                | \$2,616,179              | 100.0                                        | % \$2,658,883            | 100.0                                        | % |

At June 30, 2013, we have six mortgages that are in the process of being satisfied by our taking ownership of the real estate serving as collateral. These loans have an outstanding principal balance of \$15.3 million and we have recorded

specific loan loss allowances totaling \$5.4 million, of which \$0.6 million was recognized during the three and six months ended June 30, 2013. We also have eleven commercial mortgage loans at June 30, 2013 with an outstanding principal balance of \$28.3 million that have been given "workout" terms which generally allow for interest only payments or the capitalization of interest for a specified period of time and we have recorded specific loan loss allowances on four of these loans (principal balance of \$10.6 million) of \$3.5 million. At June 30, 2013, we had no commercial mortgage loans that were delinquent (60 days or more past due at the reporting date). The total outstanding principal balance of these seventeen loans is \$43.6 million, which represents less than 2% of our total mortgage loan portfolio.

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, 2013          | December 31, 2012 |
|-----------------------------------------------|------------------------|-------------------|
|                                               | (Dollars in thousands) |                   |
| Mortgage loans with allowances                | \$46,707               | \$53,110          |
| Mortgage loans with no allowance for losses   | 18,699                 | 27,765            |
| Allowance for probable loan losses            | (21,176)               | (23,134)          |
| Net carrying value of impaired mortgage loans | \$44,230               | \$57,741          |

#### 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.

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. 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. 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 \$1.2 billion for the six months ended June 30, 2013 compared to \$1.0 billion for the six months ended June 30, 2012, with the increase attributable to a \$181.0 million increase in net annuity deposits after coinsurance and a \$14.6 million (after coinsurance) decrease 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. As discussed above under Overview, we have been through several cycles of calls of our United States Government callable agency securities that has resulted in excess cash and other short-term investments beginning in 2010.

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, including the convertible 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 to us to meet our current and reasonably foreseeable future obligations and we expect they will be adequate to fund our parent company cash flow requirements for the rest of 2013.

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 2013, up to \$165.6 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 \$783.9 million of statutory earned surplus at June 30, 2013.

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. Given recent economic events that have affected the insurance industry, 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, 2013, 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.M. Best modifies its rating criteria and, given the current market conditions, 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 December 31, 2010, 2) 50% of the statutory net income for each fiscal quarter ending after December 31, 2010, and 3) 50% of all capital contributed to American Equity Life after September 30, 2010. American Equity Life's risk-based capital ratio was 332% at December 31, 2012. Under this agreement we are also required to maintain a maximum ratio of adjusted debt to total adjusted capital of 0.35 and a minimum cash coverage ratio of 1.0.

Cash and cash equivalents of the parent holding company at June 30, 2013, was \$26.6 million. In addition, we have a \$160 million line of credit, with \$15.0 million outstanding, available through January 2014 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 July 16, 2013, we issued \$400 million aggregate principal amount of senior unsecured notes due 2021 which will bear interest at 6.625% per year and will mature on July 15, 2021. We intend to use the net proceeds (i) to pay the cash consideration required to purchase our 5.25% Contingent Convertible Senior Notes due 2029 (the "2029 Notes") tendered in connection with an offer to exchange any and all of our outstanding 2029 Notes for cash and newly issued shares of common stock if we commence such an offer, depending on market conditions and other factors, including the payment of any applicable accrued and unpaid interest on our 2029 Notes, (ii) to pay the cash consideration required to purchase our 3.5% Convertible Senior Notes due 2015 (the "2015 Notes") tendered in connection with an offer to exchange any and all of our outstanding 2015 Notes for cash and newly issued shares of common stock if we commence such an offer, depending on market conditions and other factors, including the payment of any applicable accrued and unpaid interest on our 2015 Notes, (iii) to repay all amounts outstanding under our existing revolving credit facility (we repaid all amounts outstanding on July 17, 2013) and (iv) to pay related fees and expenses. Any proceeds we are unable to use in the manner described above, due to market conditions or otherwise, or any excess proceeds after those uses may be used to tender for, redeem or repurchase any of the 2029 Notes or 2015 Notes that remain outstanding and/or for general corporate purposes.

On March 25, 2013, notice of mandatory redemption was issued for our 2024 notes. \$25.8 million principal amount of the convertible notes exercised their conversion rights prior to the April 30, 2013 mandatory redemption date. The holders of these notes received the principal amount of their notes in cash and the conversion premium in shares of our common stock, for which 216,729 shares were issued. The balance of the convertible notes (\$2.5 million principal amount) was redeemed for cash.

#### New Accounting Pronouncements

See Note 1 - Significant Accounting Policies to the Consolidated Financial Statements, which is incorporated by reference in this Item 2, for new accounting pronouncement disclosures that supplements the disclosure in Note 1 - Significant Accounting Policies to the Consolidated Financial Statements of our 2012 Annual Report on Form 10-K.

#### 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. An OTTI shall be considered to have occurred when we have an intention to sell

available for sale securities in an unrealized loss position. If we do not intend to sell a debt security, we consider all available evidence to make an assessment of whether it is more likely than not that we will be required to sell the security before the recovery of its amortized cost basis. If it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, an OTTI will be considered to have occurred.

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 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 \$169.6 million at June 30, 2013, of which \$85.5 million has been swapped to a fixed rate and \$79.0 million has been capped for a term of seven years beginning March or 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 computer 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% (35 basis points) from levels at June 30, 2013, we estimate that the fair value of our fixed maturity securities would decrease by approximately \$780.9 million. 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 \$227.6 million in accumulated other comprehensive income and a decrease in stockholders' equity. The computer 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, 2012.

At June 30, 2013, 30% of our fixed income securities have call features of which 5% (\$1.3 billion) will become subject to call redemption during the next twelve months. During the six months ended June 30, 2013 and 2012, we received \$1.0 billion and \$2.8 billion, respectively, in redemption proceeds related to the exercise of such call options. 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, 2013, 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. For the six months ended June 30, 2013 and 2012, the annual index credits to policyholders on their anniversaries were \$377.1 million and \$101.3 million, respectively. Proceeds received at expiration of these options related to such credits were \$380.0 million and \$100.9 million for the six months ended June 30, 2013 and 2012, respectively.

Within our hedging process we purchase options out of the money to the extent of anticipated minimum guaranteed interest on index policies. 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.

#### Item 4. Controls and Procedures

##### Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15 and 15d-15, 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, 2013 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 during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

## PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

See Note 7 - Commitments and Contingencies to the Consolidated Financial Statements, which is incorporated by reference in this Item 1, for litigation and regulatory disclosures that supplements the disclosure in Note 13 - Commitments and Contingencies to the Consolidated Financial Statements of our 2012 Annual Report on Form 10-K.

Item 1A. Risk Factors

Our 2012 Annual Report on Form 10-K described our Risk Factors. There have been no material changes to the Risk Factors during the six months ended June 30, 2013.

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, 2013.

We have a Rabbi Trust, the NMO Deferred Compensation Trust, which purchases our common shares to fund the amount of shares earned by our agents under the NMO Deferred Compensation Plan. At June 30, 2013, all shares earned and vested by agents have been purchased and contributed to the Rabbi Trust.

In addition, we have a share repurchase program under which we are authorized to purchase up to 10,000,000 shares of our common stock. As of June 30, 2013, no shares of our common stock had been repurchased under this program.

Item 6. Exhibits

| Number | Name                                                                                                                                                                                                                                    | Method of Filing                                                              |
|--------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| 4.2    | First Supplemental Indenture, dated July 17, 2013, among American Equity Investment Life Holding Company, U.S. Bank National Association, and Wells Fargo Bank, National Association.                                                   | Incorporated by reference to Exhibit 4.2 to Form 8-K filed on July 17, 2013   |
| 4.3    | Second Supplemental Indenture, dated July 17, 2013, between American Equity Investment Life Holding Company and Wells Fargo Bank, National Association.                                                                                 | Incorporated by reference to Exhibit 4.2 to Form 8-K filed on July 17, 2013   |
| 10.1   | First Amendment, dated July 12, 2013, to the Credit Agreement dated January 28, 2011 among American Equity Investment Life Holding Company, JPMorgan Chase Bank, National Association, SunTrust Bank and Deutsche Bank Securities, Inc. | Incorporated by reference to Exhibit 10.1 to Form 8-K filed on July 17, 2013  |
| 10.2   | American Equity Investment Life Holding Company Short-Term Performance Incentive Plan adopted April 15, 2013, as amended and restated.                                                                                                  | Incorporated by reference to Exhibit 10.1 to Form 8-K filed on April 15, 2013 |
| 10.3   | Form of Change in Control Agreement between American Equity Investment Life Holding Company and Scott A. Samuelson                                                                                                                      | Filed herewith                                                                |
| 10.4   | 2013 Director Equity and Incentive Plan                                                                                                                                                                                                 | Filed herewith                                                                |
| 12.1   | Ratio of Earnings to Fixed Charges                                                                                                                                                                                                      | Filed herewith                                                                |
| 31.1   | 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                                                                                       | Filed herewith                                                                |
| 31.2   | 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                                                                                            | Filed herewith                                                                |

2002

32.1 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 Filed herewith

32.2 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 Filed herewith

101.INS XBRL Instance Document \*

101.SCH XBRL Taxonomy Extension Schema Document \*

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document \*

101.DEF XBRL Taxonomy Extension Definition Linkbase Document \*

101.LAB XBRL Taxonomy Extension Label Linkbase Document \*

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document \*

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities and Exchange Act of 1934, as amended and otherwise are not subject to liability under those sections.

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, 2013

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 - Controller  
(Principal Accounting Officer)