AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
November 09, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2015
OR

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

For the transition period from ________ to ________
Commission File Number : 001-31911
American Equity Investment Life Holding Company
(Exact name of registrant as specified in its charter)

Iowa	42-1447959
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6000 Westown Parkway
West Des Moines, Iowa 50266
(Address of principal executive offices, including zip code)
(515) 221-0002
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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 x No o

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 the definitions of “large accelerated filer," “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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:

As of November 2, 2015, there were 81,548,649 shares of the registrant's common stock, $1 par value, outstanding.

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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 share and per share data)

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2015 - $34,058,330; 2014 - $30,205,046)	$35,389,842	$32,445,202
Held for investment, at amortized cost (fair value: 2015 - $62,000; 2014 - $75,838)	76,574	76,432
Equity securities, available for sale, at fair value (cost: 2015 - $7,514; 2014 - $7,509)	7,833	7,805
Mortgage loans on real estate	2,452,402	2,434,580
Derivative instruments	180,649	731,113
Other investments	284,994	286,726
Total investments	38,392,294	35,981,858
Cash and cash equivalents	523,614	701,514
Coinsurance deposits	3,062,924	3,044,342
Accrued investment income	375,522	326,559
Deferred policy acquisition costs	2,591,327	2,058,556
Deferred sales inducements	1,981,209	1,587,257
Deferred income taxes	129,948	—
Income taxes recoverable	4,693	9,252
Other assets	66,890	280,396
Total assets	$47,128,421	$43,989,734
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	$43,582,521	$39,802,861
Other policy funds and contract claims	335,185	365,819
Notes payable	400,000	421,679
Subordinated debentures	246,397	246,243
Deferred income taxes	—	3,895
Other liabilities	414,409	1,009,361
Total liabilities	44,978,512	41,849,858
Stockholders' equity:		
Preferred stock, par value $1 per share, 2,000,000 shares authorized, 2015 and 2014 - no shares issued and outstanding	—	—
Common stock, par value $1 per share, 200,000,000 shares authorized; issued and outstanding:	81,191	76,062

2015 - 81,190,936 shares (excluding 3,536,875 treasury shares);		
2014 - 76,062,407 shares (excluding 4,126,167 treasury shares)		
Additional paid-in capital	626,914	513,218
Accumulated other comprehensive income	426,555	721,401
Retained earnings	1,015,249	829,195
Total stockholders' equity	2,149,909	2,139,876
Total liabilities and stockholders' equity	$47,128,421	$43,989,734

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Premiums and other considerations	$8,335	$6,043	$25,369	$22,497
Annuity product charges	37,975	31,958	99,066	86,477
Net investment income	436,085	386,931	1,253,930	1,127,818
Change in fair value of derivatives	(351,360)	39,218	(405,484)	358,594
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	1,159	(3,190)	10,362	(6,134)
OTTI losses on investments:				
Total OTTI losses	(10,000)	—	(10,132)	—
Portion of OTTI losses recognized in (from) other comprehensive income	4,771	(564)	3,943	(2,063)
Net OTTI losses recognized in operations	(5,229)	(564)	(6,189)	(2,063)
Loss on extinguishment of debt	—	—	—	(10,551)
Total revenues	126,965	460,396	977,054	1,576,638
Benefits and expenses:				
Insurance policy benefits and change in future policy benefits	10,959	9,109	32,629	30,191
Interest sensitive and index product benefits	213,465	429,415	802,431	1,114,381
Amortization of deferred sales inducements	65,807	40,661	152,278	96,676
Change in fair value of embedded derivatives	(414,724)	(195,206)	(583,112)	(21,652)
Interest expense on notes payable	7,283	8,741	21,976	28,126
Interest expense on subordinated debentures	3,075	3,044	9,138	9,076
Amortization of deferred policy acquisition costs	67,885	39,671	186,871	113,949
Other operating costs and expenses	24,497	20,616	70,487	60,588
Total benefits and expenses	(21,753)	356,051	692,698	1,431,335
Income before income taxes	148,718	104,345	284,356	145,303
Income tax expense	51,412	36,530	98,302	50,497
Net income	$97,306	$67,815	$186,054	$94,806
Earnings per common share	$1.22	$0.90	$2.39	$1.28
Earnings per common share - assuming dilution	$1.19	$0.85	$2.33	$1.19
Weighted average common shares outstanding (in thousands):				
Earnings per common share	79,676	75,083	77,995	74,030
Earnings per common share - assuming dilution	81,559	79,467	79,977	79,477

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$97,306	$67,815	$186,054	$94,806
Other comprehensive income (loss):				
Change in net unrealized investment gains/losses (1)	60,402	(15,590)	(453,582)	768,414
Noncredit component of OTTI losses (1)	(2,381)	9	(1,968)	703
Reclassification of unrealized investment gains/losses to net income (1)	96	(18)	1,940	(294)
Other comprehensive income (loss) before income tax	58,117	(15,599)	(453,610)	768,823
Income tax effect related to other comprehensive income (loss)	(20,341)	5,459	158,764	(269,088)
Other comprehensive income (loss)	37,776	(10,140)	(294,846)	499,735
Comprehensive income (loss)	$135,082	$57,675	$(108,792)	$594,541

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

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands, except share data)
(Unaudited)

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2014	$76,062	$513,218	$—	$ 721,401	$829,195	$2,139,876
Net income for period	—	—	—	—	186,054	186,054
Other comprehensive loss	—	—	—	(294,846)	—	(294,846)
Share-based compensation, including excess income tax benefits	—	7,567	—	—	—	7,567
Issuance of common stock via public offering	4,300	100,179	—	—	—	104,479
Issuance of 828,529 shares of common stock under compensation plans, including excess income tax benefits	829	5,950	—	—	—	6,779
Balance at September 30, 2015	$81,191	$626,914	$—	$ 426,555	$1,015,249	$2,149,909
Balance at December 31, 2013	$70,535	$550,400	$(631)	$ 46,196	$718,187	$1,384,687
Net income for period	—	—	—	—	94,806	94,806
Other comprehensive income	—	—	—	499,735	—	499,735
Allocation of 58,618 shares of common stock by ESOP, including excess income tax benefits	—	721	631	—	—	1,352
Share-based compensation, including excess income tax benefits	—	4,548	—	—	—	4,548
Issuance of 1,290,732 shares of common stock under compensation plans, including excess income tax benefits	1,291	9,653	—	—	—	10,944
Extinguishment of convertible senior notes, net of tax, including 2,443,457 shares of common stock issued upon conversion	2,444	7,015	—	—	—	9,459
Warrants reclassified to embedded derivative liability to be settled in cash	—	(30,455)	—	—	—	(30,455)
Balance at September 30, 2014	$74,270	$541,882	$—	$ 545,931	$812,993	$1,975,076

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
Operating activities		
Net income	$186,054	$94,806
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	802,431	1,114,381
Amortization of deferred sales inducements	152,278	96,676
Annuity product charges	(99,066)	(86,477)
Change in fair value of embedded derivatives	(583,112)	(21,652)
Increase in traditional life and accident and health insurance reserves	3,024	396
Policy acquisition costs deferred	(464,451)	(312,070)
Amortization of deferred policy acquisition costs	186,871	113,949
Provision for depreciation and other amortization	3,733	7,578
Amortization of discounts and premiums on investments	(10,730)	(12,500)
Realized gains/losses on investments and net OTTI losses recognized in operations	(4,173)	8,197
Change in fair value of derivatives	404,085	(359,626)
Deferred income taxes	23,640	(39,823)
Loss on extinguishment of debt	—	10,551
Share-based compensation	5,332	1,142
Change in accrued investment income	(48,963)	(38,574)
Change in income taxes recoverable/payable	4,794	(6,384)
Change in other assets	1,053	(2,359)
Change in other policy funds and contract claims	(36,876)	(47,257)
Change in collateral held for derivatives	(469,752)	10,048
Change in other liabilities	24,766	(40,310)
Other	(9,843)	(3,339)
Net cash provided by operating activities	71,095	487,353
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	1,280,927	1,233,408
Mortgage loans on real estate	354,391	316,841
Derivative instruments	563,125	886,556
Other investments	11,716	16,515
Acquisition of investments:		
Fixed maturity securities - available for sale	(5,041,263)	(3,998,902)
Mortgage loans on real estate	(362,123)	(227,244)
Derivative instruments	(427,763)	(355,473)
Other investments	(5,206)	(68,891)
Purchases of property, furniture and equipment	(913)	(777)
Net cash used in investing activities	(3,627,109)	(2,197,967)

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Dollars in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2015	2014
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	$4,913,473	$3,016,856
Coinsurance deposits	21,623	41,740
Return of annuity policyholder account balances	(1,638,598)	(1,410,682)
Financing fees incurred and deferred	—	(100)
Repayment of notes payable	(48,152)	(119,677)
Net proceeds from settlement of notes hedges and warrants	25,775	10,401
Proceeds from amounts due under repurchase agreements	—	81,189
Acquisition of common stock	(16)	—
Excess tax benefits realized from share-based compensation plans	3,281	4,312
Proceeds from issuance of common stock	111,274	10,038
Change in checks in excess of cash balance	(10,546)	(32,192)
Net cash provided by financing activities	3,378,114	1,601,885
Decrease in cash and cash equivalents	(177,900)	(108,729)
Cash and cash equivalents at beginning of period	701,514	897,529
Cash and cash equivalents at end of period	$523,614	$788,800
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$36,136	$39,090
Income taxes	66,541	91,675
Non-cash operating activity:		
Deferral of sales inducements	346,410	241,277
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	—	11,755
Non-cash financing activities:		
Common stock issued in extinguishment of debt	—	56,292

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(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 nine month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015. 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, 2014.

Adopted Accounting Pronouncements

There were no accounting pronouncements that were adopted during the current period.

New Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This ASU will be effective for us on January 1, 2016, and retroactive application is required. It is not expected to have a material impact on our consolidated financial statements. Subsequently, in August 2015, the FASB issued an ASU that states that the Securities and Exchange Commission staff would not object to an entity deferring and presenting debt issuance costs related to line-of-credit arrangements as an asset and expensing those costs ratably over the term of the line of credit arrangement.

In June 2014, the FASB issued an ASU that requires that a performance target in a share-based payment arrangement that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This ASU will be effective for us on January 1, 2016, and early adoption is permitted, but it is not expected to have a material impact on our consolidated financial statements.

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2. Fair Values of Financial Instruments

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

	September 30, 2015		December 31, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$35,389,842	$35,389,842	$32,445,202	$32,445,202
Held for investment	76,574	62,000	76,432	75,838
Equity securities, available for sale	7,833	7,833	7,805	7,805
Mortgage loans on real estate	2,452,402	2,492,283	2,434,580	2,493,901
Derivative instruments	180,649	180,649	731,113	731,113
Other investments	275,300	282,277	266,488	273,004
Cash and cash equivalents	523,614	523,614	701,514	701,514
Coinsurance deposits	3,062,924	2,750,361	3,044,342	2,698,552
Interest rate caps	1,492	1,492	2,778	2,778
2015 notes hedges	—	—	30,291	30,291
Counterparty collateral	30,880	30,880	206,096	206,096
Liabilities				
Policy benefit reserves	43,240,623	36,871,234	39,463,987	33,078,978
Single premium immediate annuity (SPIA) benefit reserves	334,921	346,930	365,440	377,654
Notes payable	400,000	421,500	421,679	503,349
Subordinated debentures	246,397	204,817	246,243	244,437
2015 notes embedded conversion derivative	—	—	30,291	30,291
Interest rate swap	4,528	4,528	2,644	2,644

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

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

Level 1— Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.

Level 2— Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.

Level 3— Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The

inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant would use in determining fair value.

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

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Our assets and liabilities which are measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
September 30, 2015				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$37,681	$5,549	$32,132	$—
United States Government sponsored agencies	1,314,748	—	1,314,748	—
United States municipalities, states and territories	3,760,888	—	3,760,888	—
Foreign government obligations	216,987	—	216,987	—
Corporate securities	23,459,748	20	23,459,728	—
Residential mortgage backed securities	1,556,308	—	1,556,308	—
Commercial mortgage backed securities	3,941,863	—	3,941,863	—
Other asset backed securities	1,101,619	—	1,101,619	—
Equity securities, available for sale: finance, insurance and real estate	7,833	—	7,833	—
Derivative instruments	180,649	—	180,649	—
Cash and cash equivalents	523,614	523,614	—	—
Interest rate caps	1,492	—	1,492	—
Counterparty collateral	30,880	—	30,880	—
	$36,134,310	$529,183	$35,605,127	$—
Liabilities				
Interest rate swap	$4,528	$—	$4,528	$—
Fixed index annuities - embedded derivatives	5,731,117	—	—	5,731,117
	$5,735,645	$—	$4,528	$5,731,117
December 31, 2014				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$138,460	$4,255	$134,205	$—
United States Government sponsored agencies	1,393,890	—	1,393,890	—
United States municipalities, states and territories	3,723,309	—	3,723,309	—
Foreign government obligations	193,803	—	193,803	—
Corporate securities	21,490,292	11	21,490,281	—
Residential mortgage backed securities	1,751,345	—	1,750,970	375
Commercial mortgage backed securities	2,807,620	—	2,807,620	—
Other asset backed securities	946,483	—	946,483	—
Equity securities, available for sale: finance, insurance and real estate	7,805	—	7,805	—
Derivative instruments	731,113	—	731,113	—
Cash and cash equivalents	701,514	701,514	—	—
Interest rate caps	2,778	—	2,778	—

2015 notes hedges	30,291	—	30,291	—
Counterparty collateral	206,096	—	206,096	—
	$34,124,799	$705,780	$33,418,644	$375
Liabilities				
2015 notes embedded conversion derivative	$30,291	$—	$30,291	$—
Interest rate swap	2,644	—	2,644	—
Fixed index annuities - embedded derivatives	5,574,653	—	—	5,574,653
	$5,607,588	$—	$32,935	$5,574,653

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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 multiple broker quotes and take the average of the broker prices received. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of September 30, 2015 and December 31, 2014.

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 value of our equity method investments qualify as Level 3 fair values and were determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread and a liquidity discount. The risk spread and liquidity discount are rates determined by our investment professionals and are unobservable market inputs. The fair value of our COLI approximates the cash surrender value of the policies and whose fair values fall within Level 2 of the fair value hierarchy.

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Cash and cash equivalents
Amounts reported in the consolidated balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.
Interest rate swap and caps
The fair values of our pay fixed/receive variable interest rate swap and our interest rate caps are obtained from third parties and are determined by discounting expected future cash flows using projected LIBOR rates for the term of the swap and caps.
2015 notes hedges
The fair value of these call options was 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.
Counterparty collateral
Amounts reported in other assets on the consolidated balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.
Policy benefit reserves, coinsurance deposits and SPIA benefit reserves
The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. For period-certain annuity benefit contracts, the fair value is determined by discounting the benefits at the interest rates currently in effect for newly 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 values of our senior unsecured notes and convertible senior notes are based upon pricing matrices developed by a third party pricing service when quoted market prices are not available and are categorized as Level 2 within the fair value hierarchy. 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 conversion derivative
The fair value of this embedded derivative was determined by pricing the call options that hedge this potential liability. The terms of the conversion option 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.

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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 nine months ended September 30, 2015 and 2014:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$26	$668	$375	$1,376
Principal returned	(2)	(68)	(23)	(260)
Amortization of premium/accretion of discount	(28)	1	(494)	(164)
Total gains (losses) (realized/unrealized):				
Included in other comprehensive income (loss)	4	127	280	(19)
Included in operations	—	(202)	(138)	(407)
Ending balance	$—	$526	$—	$526

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives				
Beginning balance	$5,984,007	$5,119,823	$5,574,653	$4,406,163
Premiums less benefits	207,141	496,295	1,020,853	1,294,024
Change in fair value, net	(460,031)	(354,564)	(864,389)	(438,633)
Ending balance	$5,731,117	$5,261,554	$5,731,117	$5,261,554

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

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

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at September 30, 2015, were to increase by 100 basis points, the fair value of the embedded derivatives would decrease by $383.9 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of $269.2 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 $429.3 million recorded through operations as an increase in the change in fair value of embedded derivatives and there would be a corresponding increase of $223.8 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.

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3. Investments

At September 30, 2015 and December 31, 2014, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
September 30, 2015				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$36,355	$1,437	$(111)	$37,681
United States Government sponsored agencies	1,286,586	35,864	(7,702)	1,314,748
United States municipalities, states and territories	3,405,519	363,590	(8,221)	3,760,888
Foreign government obligations	210,941	16,199	(10,153)	216,987
Corporate securities	22,738,792	1,135,974	(415,018)	23,459,748
Residential mortgage backed securities	1,431,656	126,485	(1,833)	1,556,308
Commercial mortgage backed securities	3,881,487	90,536	(30,160)	3,941,863
Other asset backed securities	1,066,994	45,295	(10,670)	1,101,619
	$34,058,330	$1,815,380	$(483,868)	$35,389,842
Held for investment:				
Corporate security	$76,574	$—	$(14,574)	$62,000
Equity securities, available for sale:				
Finance, insurance, and real estate	$7,514	$319	$—	$7,833
December 31, 2014				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$137,710	$765	$(15)	$138,460
United States Government sponsored agencies	1,364,424	43,399	(13,933)	1,393,890
United States municipalities, states and territories	3,293,551	430,469	(711)	3,723,309
Foreign government obligations	181,128	16,628	(3,953)	193,803
Corporate securities	19,984,747	1,628,941	(123,396)	21,490,292
Residential mortgage backed securities	1,616,846	136,704	(2,205)	1,751,345
Commercial mortgage backed securities	2,720,294	90,649	(3,323)	2,807,620
Other asset backed securities	906,346	48,022	(7,885)	946,483
	$30,205,046	$2,395,577	$(155,421)	$32,445,202
Held for investment:				
Corporate security	$76,432	$—	$(594)	$75,838
Equity securities, available for sale:				
Finance, insurance, and real estate	$7,509	$296	$—	$7,805

At September 30, 2015, 33% of our fixed income securities have call features, of which 2.0% ($0.7 billion) were subject to call redemption and another 0.4% ($0.1 billion) will become subject to call redemption during the next twelve months. Approximately 66% of our fixed income securities that have call features are not callable until within six months of their stated maturities.

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The amortized cost and fair value of fixed maturity securities at September 30, 2015, 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	$134,699	$138,612	$—	$—
Due after one year through five years	1,818,945	1,969,759	—	—
Due after five years through ten years	9,951,489	10,005,018	—	—
Due after ten years through twenty years	8,419,743	8,976,207	—	—
Due after twenty years	7,353,317	7,700,456	76,574	62,000
	27,678,193	28,790,052	76,574	62,000
Residential mortgage backed securities	1,431,656	1,556,308	—	—
Commercial mortgage backed securities	3,881,487	3,941,863	—	—
Other asset backed securities	1,066,994	1,101,619	—	—
	$34,058,330	$35,389,842	$76,574	$62,000

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:

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	$1,331,831	$2,240,452
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(710,260)	(1,165,271)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax expense	(217,550)	(376,314)
Net unrealized gains reported as accumulated other comprehensive income	$426,555	$721,401

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 both September 30, 2015 and December 31, 2014.

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

	September 30, 2015		December 31, 2014	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$21,918,272	$23,171,086	$19,223,151	$20,941,634
2	11,432,147	11,581,162	10,432,593	10,981,618
3	745,289	679,289	602,191	583,313
4	31,042	17,256	22,888	14,089
5	—	—	—	—
6	8,154	3,049	655	386

$34,134,904	$35,451,842	$30,281,478	$32,521,040

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The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 855 and 402 securities, respectively) have been in a continuous unrealized loss position, at September 30, 2015 and December 31, 2014:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
September 30, 2015						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$7,431	$(111)	$—	$—	$7,431	$(111)
United States Government sponsored agencies	589,545	(7,702)	—	—	589,545	(7,702)
United States municipalities, states and territories	217,954	(8,115)	2,894	(106)	220,848	(8,221)
Foreign government obligations	43,821	(898)	15,400	(9,255)	59,221	(10,153)
Corporate securities:						
Finance, insurance and real estate	1,552,033	(38,683)	51,196	(13,569)	1,603,229	(52,252)
Manufacturing, construction and mining	2,735,903	(155,795)	319,447	(77,062)	3,055,350	(232,857)
Utilities and related sectors	1,681,159	(74,879)	67,812	(9,995)	1,748,971	(84,874)
Wholesale/retail trade	335,950	(13,414)	41,296	(6,234)	377,246	(19,648)
Services, media and other	692,146	(24,241)	33,986	(1,146)	726,132	(25,387)
Residential mortgage backed securities	51,190	(1,180)	7,110	(653)	58,300	(1,833)
Commercial mortgage backed securities	1,283,393	(30,043)	4,768	(117)	1,288,161	(30,160)
Other asset backed securities	166,719	(3,140)	48,641	(7,530)	215,360	(10,670)
	$9,357,244	$(358,201)	$592,550	$(125,667)	$9,949,794	$(483,868)
Held for investment:						
Corporate security:						
Insurance	$62,000	$(14,574)	$—	$—	$62,000	$(14,574)
December 31, 2014						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$—	$—	$498	$(15)	$498	$(15)
United States Government sponsored agencies	—	—	610,339	(13,933)	610,339	(13,933)
United States municipalities, states and territories	—	—	27,947	(711)	27,947	(711)
Foreign government obligations	14,194	(1,068)	11,542	(2,885)	25,736	(3,953)
Corporate securities:						
Finance, insurance and real estate	253,439	(2,586)	399,874	(16,277)	653,313	(18,863)
Manufacturing, construction and mining	1,078,089	(35,151)	694,088	(35,926)	1,772,177	(71,077)
Utilities and related sectors	373,952	(8,185)	344,313	(10,153)	718,265	(18,338)

Wholesale/retail trade	88,766	(2,290)	99,427	(3,122)	188,193	(5,412)
Services, media and other	131,940	(1,567)	277,296	(8,139)	409,236	(9,706)
Residential mortgage backed securities	22,115	(1,219)	20,427	(986)	42,542	(2,205)
Commercial mortgage backed securities	241,637	(1,344)	187,241	(1,979)	428,878	(3,323)
Other asset backed securities	142,094	(3,519)	58,958	(4,366)	201,052	(7,885)
	$2,346,226	$(56,929)	$2,731,950	$(98,492)	$5,078,176	$(155,421)
Held for investment:						
Corporate security:						
Insurance	$—	$—	$75,838	$(594)	$75,838	$(594)

Based on the results of our process for evaluating available for sale securities in unrealized loss positions for other-than-temporary-impairments, which is discussed in detail later in this footnote, we have determined that the unrealized losses on the securities in the preceding table are temporary. The unrealized losses at September 30, 2015 are principally related to timing of the purchases of these securities, which carry less yield than those available at September 30, 2015. In addition, a general widening of credit spreads has occurred in risk asset classes and some financial and industrial sector credit spreads remain wide due to continued economic uncertainty and concerns of prolonged economic weakness.

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At September 30, 2015, 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 34 securities with a total amortized cost basis of $215.4 million and a fair value of $238.8 million.

Approximately 82% and 78% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2015 and December 31, 2014, respectively, are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized gains on investments for the three and nine months ended September 30, 2015 and 2014 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Fixed maturity securities held for investment carried at amortized cost	$(3,753)	$4,883	$(13,980)	$10,527
Investments carried at fair value:				
Fixed maturity securities, available for sale	$118,345	$(54,291)	$(908,644)	$1,639,619
Equity securities, available for sale	(30)	(7)	23	(26)
	118,315	(54,298)	(908,621)	1,639,593
Adjustment for effect on other balance sheet accounts:				
Deferred policy acquisition costs and deferred sales inducements	(60,198)	38,699	455,011	(870,770)
Deferred income tax asset/liability	(20,341)	5,459	158,764	(269,088)
	(80,539)	44,158	613,775	(1,139,858)
Change in net unrealized gains on investments carried at fair value	$37,776	$(10,140)	$(294,846)	$499,735

Proceeds from sales of available for sale securities for the nine months ended September 30, 2015 and 2014 were $269.7 million and $141.8 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the nine months ended September 30, 2015 and 2014 were $1.0 billion and $1.1 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 nine months ended September 30, 2015 and 2014, are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$283	$179	$4,783	$1,536
Gross realized losses	(97)	(148)	(897)	(910)
	186	31	3,886	626
Other investments:				
Gain on sale of real estate	2,245	455	3,278	1,493
Loss on sale of real estate	—	—	(575)	(231)
Impairment losses on real estate	(570)	(1,436)	(1,199)	(2,235)
	1,675	(981)	1,504	(973)
Mortgage loans on real estate:				

Decrease (increase) in allowance for credit losses	(702)	(2,240)	597	(5,787)
Recovery of specific allowance	—	—	4,375	—
	(702)	(2,240)	4,972	(5,787)
	$1,159	$(3,190)	$10,362	$(6,134)

Losses on available for sale fixed maturity securities were realized primarily due to strategies to reposition the fixed maturity security portfolio that result in improved net investment income, risk or duration profiles as they pertain to our asset liability management.

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.

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

- the length of time and the extent to which the fair value has been less than amortized cost or cost;
- whether the issuer is current on all payments and all contractual payments have been made as agreed;
- the remaining payment terms and the financial condition and near-term prospects of the issuer;
- the lack of ability to refinance due to liquidity problems in the credit market;
- the fair value of any underlying collateral;
- the existence of any credit protection available;
- our intent to sell and whether it is more likely than not we would be required to sell prior to recovery for debt securities;
- our assessment in the case of equity securities including perpetual preferred stocks with credit deterioration that the security cannot recover to cost in a reasonable period of time;
- our intent and ability to retain equity securities for a period of time sufficient to allow for recovery;
- consideration of rating agency actions; and
- changes in estimated cash flows of mortgage and asset backed securities.

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

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

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

The determination of the credit loss component of a mortgage or asset 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.

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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 nine months ended September 30, 2015 and 2014, which are all senior level tranches within the structure of the securities:

		Discount Rate		Default Rate		Loss Severity	
Sector	Vintage	Min	Max	Min	Max	Min	Max
Nine months ended September 30, 2015							
Prime	2006	6.5 %	6.5 %	14 %	14 %	40 %	40 %
	2007	5.8 %	7.0 %	15 %	21 %	45 %	55 %
Alt-A	2005	5.6 %	5.6 %	99 %	99 %	2 %	2 %
Nine months ended September 30, 2014							
Prime	2005	7.5 %	7.5 %	15 %	15 %	50 %	50 %
	2006	6.5 %	7.4 %	11 %	12 %	50 %	50 %
	2007	7.0 %	7.0 %	14 %	14 %	55 %	55 %
Alt-A	2005	5.6 %	6.4 %	87 %	89 %	2 %	2 %

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 in net income and amortized cost is written down to fair value. 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.

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The following table summarizes other than temporary impairments for the three and nine months ended September 30, 2015 and 2014, by asset type:

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized in (from) Other Comprehensive Income	Net OTTI Losses Recognized in Operations
		(Dollars in thousands)		
Three months ended September 30, 2015				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	3	$—	$(354)	$(354)
Other asset backed securities	1	(10,000)	5,125	(4,875)
	4	$(10,000)	$4,771	$(5,229)
Three months ended September 30, 2014				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	3	$—	$(564)	$(564)
Nine months ended September 30, 2015				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	7	$(132)	$(1,182)	$(1,314)
Other asset backed securities	1	(10,000)	5,125	(4,875)
	8	$(10,132)	$3,943	$(6,189)
Nine months ended September 30, 2014				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	6	$—	$(2,063)	$(2,063)

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Cumulative credit loss at beginning of period	$(128,010)	$(127,459)	$(127,050)	$(125,960)
Credit losses on securities for which OTTI has not previously been recognized	(4,876)	—	(5,008)	—
Additional credit losses on securities for which OTTI has previously been recognized	(353)	(564)	(1,181)	(2,063)
Accumulated losses on securities that were disposed of during the period	761	—	761	—
Cumulative credit loss at end of period	$(132,478)	$(128,023)	$(132,478)	$(128,023)

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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 (loss), by major type of security, for securities that are part of our investment portfolio at September 30, 2015 and December 31, 2014:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
September 30, 2015				
Fixed maturity securities, available for sale:				
Corporate securities	$—	$—	$20	$20
Residential mortgage backed securities	495,278	(171,632)	205,140	528,786
Other asset backed securities	8,154	(5,125)	—	3,029
	$503,432	$(176,757)	$205,160	$531,835
December 31, 2014				
Fixed maturity securities, available for sale:				
Corporate securities	$—	$—	$11	$11
Residential mortgage backed securities	569,508	(173,494)	215,625	611,639
	$569,508	$(173,494)	$215,636	$611,650

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio, summarized in the following table, totaled $2.5 billion at September 30, 2015 and $2.4 billion December 31, 2014, respectively, with commitments outstanding of $64.3 million at September 30, 2015.

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Principal outstanding	$2,470,456	$2,457,721
Loan loss allowance	(17,518)	(22,633)
Deferred prepayment fees	(536)	(508)
Carrying value	$2,452,402	$2,434,580

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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:

	September 30, 2015		December 31, 2014	
	Principal	Percent	Principal	Percent
	(Dollars in thousands)			
Geographic distribution				
East	$720,522	29.2 %	$701,638	28.5 %
Middle Atlantic	160,946	6.5 %	166,249	6.8 %
Mountain	255,454	10.3 %	279,075	11.4 %
New England	13,267	0.5 %	12,280	0.5 %
Pacific	359,231	14.6 %	302,307	12.3 %
South Atlantic	451,123	18.3 %	471,849	19.2 %
West North Central	311,774	12.6 %	349,028	14.2 %
West South Central	198,139	8.0 %	175,295	7.1 %
	$2,470,456	100.0 %	$2,457,721	100.0 %
Property type distribution				
Office	$417,122	16.9 %	$484,585	19.7 %
Medical Office	84,843	3.4 %	88,275	3.6 %
Retail	768,210	31.1 %	711,775	29.0 %
Industrial/Warehouse	688,336	27.9 %	649,425	26.4 %
Hotel	3,412	0.1 %	30,640	1.3 %
Apartment	362,809	14.7 %	335,087	13.6 %
Mixed use/other	145,724	5.9 %	157,934	6.4 %
	$2,470,456	100.0 %	$2,457,721	100.0 %

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

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

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

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

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

	Three Months Ended September 30, 2015		Three Months Ended September 30, 2014	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	$(9,316)	$(7,500)	$(17,282)	$(9,300)
Charge-offs	—	—	958	—
Change in provision for credit losses	(1,302)	600	(1,040)	(1,200)
Ending allowance balance	$(10,618)	$(6,900)	$(17,364)	$(10,500)

	Nine Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	$(12,333)	$(10,300)	$(16,847)	$(9,200)
Charge-offs	143	—	3,715	—
Recoveries	4,375	—	255	—
Change in provision for credit losses	(2,803)	3,400	(4,487)	(1,300)
Ending allowance balance	$(10,618)	$(6,900)	$(17,364)	$(10,500)

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

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Individually evaluated for impairment	$27,244	$29,116
Collectively evaluated for impairment	2,443,212	2,428,605
Total loans evaluated for impairment	$2,470,456	$2,457,721

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

During the three and nine months ended September 30, 2015, no mortgage loans were satisfied by taking ownership of any real estate serving as collateral compared to one and six mortgage loans for the same periods in 2014. The following table summarizes the activity in the real estate owned, included in Other investments, which was obtained in satisfaction of mortgage loans on real estate:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Real estate owned at beginning of period	$12,958	$24,606	$20,238	$22,844
Real estate acquired in satisfaction of mortgage loans	—	1,748	—	11,755

Additions	120	—	120	—
Sales	(2,761)	(2,431)	(9,241)	(9,579)
Impairments	(570)	(1,436)	(1,199)	(2,235)
Depreciation	(53)	(153)	(224)	(451)
Real estate owned at end of period	$9,694	$22,334	$9,694	$22,334

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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.

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Credit Exposure--By Payment Activity		
Performing	$2,443,679	$2,451,760
In workout	10,739	—
Delinquent	—	—
Collateral dependent	16,038	5,961
	$2,470,456	$2,457,721

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

Mortgage loans are considered delinquent when they become 60 days or more past due. In general, when loans become 90 days past due, become collateral dependent or enter a period with no debt service payments required we place them on non-accrual status and discontinue recognizing interest income. If payments are received on a delinquent loan, interest income is recognized to the extent it would have been recognized if normal principal and interest would have been received timely. If payments are received to bring a delinquent loan back to current we will resume accruing interest income on that loan. Outstanding principal of loans in a non-accrual status at September 30, 2015 and December 31, 2014 totaled $16.0 million and $6.0 million, respectively.

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

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

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

	30 - 59 Days	60 - 89 Days	90 Days and Over	Total Past Due	Current	Collateral Dependent Receivables	Total Financing Receivables
	(Dollars in thousands)						

Commercial Mortgage Loans							
September 30, 2015	$—	$—	$—	$—	$2,454,418	$16,038	$2,470,456
December 31, 2014	$—	$—	$—	$—	$2,451,760	$5,961	$2,457,721

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance
	(Dollars in thousands)		
September 30, 2015			
Mortgage loans with an allowance	$16,626	$27,244	$(10,618)
Mortgage loans with no related allowance	13,396	13,396	—
	$30,022	$40,640	$(10,618)
December 31, 2014			
Mortgage loans with an allowance	$16,783	$29,116	$(12,333)
Mortgage loans with no related allowance	2,656	2,656	—
	$19,439	$31,772	$(12,333)

	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)	
Three months ended September 30, 2015		
Mortgage loans with an allowance	$17,336	$44
Mortgage loans with no related allowance	13,414	176
	$30,750	$220
Three months ended September 30, 2014		
Mortgage loans with an allowance	$22,157	$539
Mortgage loans with no related allowance	2,656	—
	$24,813	$539
Nine months ended September 30, 2015		
Mortgage loans with an allowance	$17,649	$866
Mortgage loans with no related allowance	13,432	595
	$31,081	$1,461
Nine months ended September 30, 2014		
Mortgage loans with an allowance	$23,580	$1,696
Mortgage loans with no related allowance	2,656	—
	$26,236	$1,696

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.

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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 September 30, 2015 and December 31, 2014 that we determined to be TDRs are as follows:

Geographic Region	Number of TDRs	Principal Balance Outstanding	Specific Loan Loss Allowance	Net Carrying Amount
		(Dollars in thousands)		
September 30, 2015				
South Atlantic	6	$10,878	$(2,992)	$7,886
East North Central	2	3,345	(467)	2,878
West North Central	2	7,790	(1,046)	6,744
	10	$22,013	$(4,505)	$17,508
December 31, 2014				
South Atlantic	7	$14,475	$(4,244)	$10,231
East North Central	1	2,177	(467)	1,710
West North Central	1	1,881	(1,047)	834
	9	$18,533	$(5,758)	$12,775

5. Derivative Instruments

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

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Assets		
Derivative instruments		
Call options	$180,649	$731,113
Other assets		
2015 notes hedges	—	30,291
Interest rate caps	1,492	2,778
	$182,141	$764,182
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$5,731,117	$5,574,653
Other liabilities		
2015 notes embedded conversion derivative	—	30,291
Interest rate swap	4,528	2,644
	$5,735,645	$5,607,588

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Change in fair value of derivatives:				
Call options	$(347,038)	$45,931		