AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
August 10, 2009

FORM 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended June 30, 2009

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 of Incorporation)	(I.R.S. Employer Identification No.)

5000 Westown Parkway, Suite 440	
West Des Moines, Iowa	**50266**
(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 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 504 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 o No o

Indicate by check mark whether the registrant is a large accelerated filed, 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 o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Shares of common stock outstanding at July 31, 2009: 58,162,259

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

(Unaudited)

	June 30, 2009	December 31, 2008 (As Adjusted)
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2009 - $10,072,671; 2008 - $7,159,286)	$ 9,486,107	$ 6,629,046
Held for investment, at amortized cost (fair value: 2009 - $2,110,396; 2008 - $3,588,114)	2,143,403	3,604,149
Equity securities, available for sale, at fair value (cost: 2009 - $104,484; 2008 - $125,157)	93,492	99,552
Mortgage loans on real estate	2,374,028	2,329,824
Derivative instruments	159,439	56,588
Other investments	3,700	446
Total investments	14,260,169	12,719,605
Cash and cash equivalents	134,550	214,862
Coinsurance deposits	1,458,994	1,528,981
Accrued investment income	111,928	91,756
Deferred policy acquisition costs	1,717,707	1,579,871
Deferred sales inducements	999,098	843,377
Deferred income taxes	156,138	82,409
Other assets	27,130	20,879
Total assets	$ 18,865,714	$ 17,081,740

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

(Unaudited)

	June 30, 2009	December 31, 2008 (As Adjusted)
Liabilities and Stockholders Equity		
Liabilities:		
Policy benefit reserves:		
Traditional life and accident and health insurance products	$ 129,193	$ 121,914
Annuity products	17,249,801	15,687,625
Other policy funds and contract claims	110,132	111,205
Notes payable	262,874	247,750
Subordinated debentures	268,277	268,209
Income taxes payable	38,474	14,133
Other liabilities	194,237	134,060
Total liabilities	18,252,988	16,584,896
Stockholders equity:		
Common stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding: 2009 - 56,066,008 shares (excluding 5,941,547 treasury shares); 2008 - 50,739,355 shares (excluding 6,263,700 treasury shares)	56,066	50,739
Additional paid-in capital	403,730	376,782
Unallocated common stock held by ESOP; 2009 - 588,312 shares; 2008 - 588,312 shares	(6,066)	(6,336)
Accumulated other comprehensive loss	(124,766)	(147,376)
Retained earnings	283,762	223,035
Total stockholders equity	612,726	496,844
Total liabilities and stockholders equity	$ 18,865,714	$ 17,081,740

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008 (As Adjusted)	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 (As Adjusted)
Revenues:				
Traditional life and accident and health insurance premiums	$ 2,867	$ 2,880	$ 6,353	$ 6,196
Annuity product charges	16,615	11,845	31,666	23,943
Net investment income	226,803	202,080	447,457	397,568
Change in fair value of derivatives	30,494	(73,313)	(13,329)	(230,678)
Net realized gains on investments, excluding other than temporary impairment (OTTI) losses	4,317	255	5,077	1,085
OTTI losses on investments:				
Total OTTI losses	(22,061)	(30,274)	(77,452)	(33,523)
Portion of OTTI losses recognized in other comprehensive income	16,418		58,371	
Net OTTI losses recognized in operations	(5,643)	(30,274)	(19,081)	(33,523)
Gain (loss) on extinguishment of debt	3,098	(196)	3,098	(1,328)
Total revenues	278,551	113,277	461,241	163,263
Benefits and expenses:				
Insurance policy benefits and change in future policy benefits	1,974	2,321	4,173	4,930
Interest sensitive and index product benefits	71,977	49,469	131,740	103,645
Amortization of deferred sales inducements	12,184	(4,479)	25,895	27,433
Change in fair value of embedded derivatives	140,716	17,745	154,899	(200,869)
Interest expense on notes payable	3,642	4,981	7,918	10,113
Interest expense on subordinated debentures	4,029	4,649	8,237	9,880
Interest expense on amounts due under repurchase agreements	2	2,024	244	4,996
Amortization of deferred policy acquisition costs	13,266	18,620	47,910	99,310
Other operating costs and expenses	16,880	12,550	31,344	25,001
Total benefits and expenses	264,670	107,880	412,360	84,439
Income before income taxes	13,881	5,397	48,881	78,824
Income tax expense	4,869	1,745	13,394	27,112
Net income	$ 9,012	$ 3,652	$ 35,487	$ 51,712
Earnings per common share	$ 0.16	$ 0.07	$ 0.66	$ 0.95
Earnings per common share - assuming dilution	$ 0.16	$ 0.07	$ 0.63	$ 0.91

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2008, as adjusted	$ 50,739	$ 376,782	$ (6,336)	$ (147,376)	$ 223,035	$ 496,844
Cumulative effect of FSP FAS 115-2, net				(20,094)	25,240	5,146
Other comprehensive income:						
Net income for period					35,487	35,487
Change in net unrealized investment gains/losses				80,645		80,645
Noncredit component of OTTI losses, available for sale securities, net				(37,941)		(37,941)
Other comprehensive income						78,191
Acquisition of 12,362 shares of common stock	(12)	(40)				(52)
Allocation of 25,047 shares of common stock by ESOP, including excess income tax benefits		(86)	270			184
Share-based compensation, including excess income tax benefits		1,163				1,163
Issuance of 5,000,000 shares of common stock in exchange for notes payable	5,000	26,250				31,250
Issuance of 339,015 shares of common stock under compensation plans	339	(339)				
Balance at June 30, 2009	$ 56,066	$ 403,730	$ (6,066)	$ (124,766)	$ 283,762	$ 612,726
Balance at December 31, 2007	$ 53,556	$ 387,302	$ (6,781)	$ (38,929)	$ 216,487	$ 611,635
Retrospective application of FSP APB 14-1		15,355			(5,888)	9,467
Other comprehensive income:						
Net income for period, as adjusted					51,712	51,712
Change in net unrealized investment gains/losses				(49,496)		(49,496)
Other comprehensive income, as adjusted						2,216
Acquisition of 2,829,438 shares of common stock	(2,829)	(22,103)				(24,932)
Allocation of 29,337 shares of common stock by ESOP, including excess income tax benefits		(17)	206			189
Share-based compensation, including excess income tax benefits		1,670				1,670
Issuance of 870,048 shares of common stock under compensation plans,	870	(751)				119

including excess income tax benefits						
Conversion of $10 of subordinated debentures	1	9				10
Balance at June 30, 2008, as adjusted	$ 51,598	$ 381,465	$ (6,575)	$ (88,425)	$ 262,311	$ 600,374

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 (As Adjusted)
Operating activities		
Net income	$ 35,487	$ 51,712
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	131,740	103,645
Amortization of deferred sales inducements	25,895	27,433
Annuity product charges	(31,666)	(23,943)
Change in fair value of embedded derivatives	154,899	(200,869)
Increase in traditional life and accident and health insurance reserves	3,040	688
Policy acquisition costs deferred	(203,508)	(132,447)
Amortization of deferred policy acquisition costs	47,910	99,310
Provision for depreciation and other amortization	2,967	3,464
Amortization of discount and premiums on investments	(109,763)	(129,952)
Net realized gains on investments, excluding OTTI losses	(5,077)	(1,085)
Net OTTI losses recognized in operations	19,081	33,523
Change in fair value of derivatives	12,504	230,408
Deferred income taxes	(52,308)	32,323
Loss (gain) on extinguishment of debt	(3,098)	1,328
Share-based compensation	1,531	1,528
Change in accrued investment income	(20,172)	(7,539)
Change in income taxes payable	24,342	(5,387)
Change in other assets	(1,202)	(99)
Change in other policy funds and contract claims	(1,073)	(4,469)
Change in other liabilities	64,371	29,777
Other	111	(402)
Net cash provided by operating activities	96,011	108,947
Investing Activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	1,932,460	980,278
Fixed maturity securities - held for investment	1,517,475	826,794
Equity securities - available for sale	200	7,388
Mortgage loans on real estate	54,325	55,331
Derivative instruments	5,503	23,983
Policy loans		5
Acquisition of investments:		
Fixed maturity securities - available for sale	(4,671,914)	(2,274,737)
Equity securities - available for sale		(83,014)
Mortgage loans on real estate	(102,753)	(314,985)
Derivative instruments	(120,619)	(147,860)
Policy loans	(30)	
Purchases of property, furniture and equipment	(741)	(96)
Net cash used in investing activities	(1,386,094)	(926,913)

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008 (As Adjusted)
Financing activities		
Receipts credited to annuity policyholder account balances	$ 1,797,631	$ 1,163,163
Coinsurance deposits	90,178	85,975
Return of annuity policyholder account balances	(685,963)	(648,991)
Financing fees incurred and deferred	(320)	
Proceeds from notes payable	50,000	20,000
Repayments of notes payable	(2,055)	(32,825)
Increase in amounts due under repurchase agreements		242,022
Acquisition of common stock	(34)	(19,373)
Excess tax benefits realized from share-based compensation plans	47	176
Proceeds from issuance of common stock		94
Change in checks in excess of cash balance	(39,713)	2,275
Net cash provided by financing activities	1,209,771	812,516
Decrease in cash and cash equivalents	(80,312)	(5,450)
Cash and cash equivalents at beginning of period	214,862	18,888
Cash and cash equivalents at end of period	$ 134,550	$ 13,438
Supplemental disclosures of cash flow information:		
Cash paid during period for:		
Interest expense	$ 15,279	$ 22,478
Income taxes	44,300	
Non-cash operating activity:		
Deferral of sales inducements	179,599	96,094
Non-cash financing activity:		
Conversion of subordinated debentures		10
Stock acquired in satisfaction of obligations		5,559
Stock issued in extinguishment of debt	31,250	

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

(Unaudited)

1. Organization and 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 month and six month periods ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. 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, 2008.

Reclassifications have been made to prior period financial statements to conform with the June 30, 2009 presentation. See Adopted Accounting Pronouncements for impact of new accounting guidance on prior period financial statements.

Adopted Accounting Pronouncements

On January 1, 2009, we adopted Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement 133* (SFAS 161). SFAS 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how an entity uses derivative instruments and how derivative instruments and related hedged items are accounted for and affect an entity s financial position, financial performance and cash flows. The adoption of SFAS 161 did not have a material impact on our financial position or results of operations as it impacts financial statement disclosure only.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other Than Temporary Impairments* (FSP FAS 115-2). FSP FAS 115-2 amends the other than temporary impairment guidance in GAAP for debt securities only to make the guidance more operational and to expand the presentation and disclosure of other than temporary impairments on debt and equity securities in the financial statements. FSP FAS 115-2 requires management to determine cash flows expected to be collected on each debt security for which an other than temporary impairment is being recognized. In accordance with FSP FAS 115-2, the reporting entity shall allocate its other than temporary impairments on debt securities between credit and noncredit components with the noncredit portion of the other than temporary impairments recognized as a component of other comprehensive income (loss) and the credit loss portion included in operations. Credit loss is defined as the amount that the amortized cost basis of the impaired security exceeds the present value of cash flows expected to be collected. FSP FAS 115-2 also requires a cumulative effect adjustment to the opening balance of retained earnings and accumulated other comprehensive income (loss) in the period of adoption for other than temporary impairments on debt securities recognized in prior periods which are still held as investments at the date of adoption. FSP FAS 115-2 is effective for interim and annual reporting periods ending after June 15, 2009; however, early application is permitted. We elected to adopt FSP FAS 115-2 effective January 1, 2009. The cumulative effect adjustment as of January 1, 2009 increased retained earnings by $25.2 million and increased accumulated other comprehensive loss by $20.1 million.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased, as well as guidance on identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively, with early adoption permitted. We elected to adopt FSP FAS 157-4 as of January 1, 2009, and it did not have a material impact on our consolidated financial statements.

On January 1, 2009, we adopted FSP No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1) and applied it retrospectively to all periods presented as required.

FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) do not fall within the scope of paragraph 12 of Accounting Principles Board Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, and specifies that issuers of such instruments should separately account for the liability component and the equity component represented by the embedded conversion option in a manner that will reflect the issuer s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon settlement, the issuer shall allocate consideration transferred and transaction costs incurred to the extinguishment of the liability component and the reacquisition of the equity component.

In December 2004, we issued $260 million of contingent convertible senior notes with a fixed rate of 5.25% and a maturity date of December 6, 2024. FSP APB 14-1 requires on the date of issuance bifurcation of these notes into a debt component and an equity component. The difference between the fair value of the debt component at the date of issuance and the initial proceeds at the date of issuance is recorded as a component of equity. The fair value of the notes without the embedded conversion option (liability component) at the date of issuance was $221.4 million. The fair value of the embedded conversion option (equity component) at the date of issuance was $39.1 million. The fair value of the equity component at issuance has been recorded as a debt discount to the notes, with a corresponding increase to additional paid-in capital, net of income tax. The debt discount is being amortized over the expected life of the debt.

The following summarizes the effects of the retrospective adoption of FSP APB 14-1 on the balance sheet, statements of operations and earnings per share:

	December 31, 2008		
	As Originally Reported	Adjustments	As Adjusted
		(Dollars in thousands)	
Deferred income taxes	$ 85,700	$ (3,291)	$ 82,409
Other assets	23,661	(2,782)	20,879
Total assets	17,087,813	(6,073)	17,081,740
Notes payable	258,462	(10,712)	247,750
Total liabilities	16,595,608	(10,712)	16,584,896
Additional paid-in capital	361,427	15,355	376,782
Retained earnings	233,751	(10,716)	223,035
Total stockholders equity	492,205	4,639	496,844

	Three Months Ended June 30, 2008			Six Months Ended June 30, 2008		
	As Originally Reported	Adjustments	As Adjusted	As Originally Reported	Adjustments	As Adjusted
	(Dollars in thousands, except per share data)					
Gain (loss) on extinguishment of debt (1)	$ 450	$ (646)	$ (196)	$ 183	$ (1,511)	$ (1,328)
Interest expense on notes payable	3,722	1,259	4,981	7,851	2,262	10,113
Income tax expense	2,535	(790)	1,745	28,678	(1,566)	27,112
Net income	4,767	(1,115)	3,652	53,919	(2,207)	51,712
Earnings per common share	$ 0.09	$ (0.02)	$ 0.07	$ 0.99	$ (0.04)	$ 0.95
Earnings per common share - assuming dilution	$ 0.09	$ (0.02)	$ 0.07	$ 0.95	$ (0.04)	$ 0.91

(1) the gain on extinguishment of debt was originally reported as part of other operating costs and expenses in the unaudited consolidated statements of operations for the three and six months ended June 30, 2008.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165). SFAS 165 requires reporting entities to recognize in their financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing those financial statements. In addition, a reporting entity shall disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. SFAS 165 is effective for periods ending after June 15, 2009. We adopted SFAS 165 effective June 30, 2009 and it did not have a material effect on our consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and Accounting Principles Board Opinion (APB) 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1). FSP FAS 107-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (SFAS 107) to require disclosures about fair value of financial instruments within the scope of SFAS 107 for interim reporting periods as well as in annual financial statements. FSP FAS 107-1 also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim and annual basis and to highlight any changes from prior periods. FSP FAS 107-1 is effective for financial statements issued for interim and annual periods ending after June 15, 2009. We adopted FSP FAS 107-1 as of and for the periods ended June 30, 2009.

New Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets* (SFAS 166). SFAS 166 is an amendment to SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140). SFAS 166 removes the concept of a qualifying special-purpose entity (QSPE) from SFAS 140 and removes the exception of QSPE s from consolidation requirements. Additionally, SFAS 166 creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies the derecognition criteria, revises how retained interests are initially measured and removes the guaranteed mortgage securitization recharacterization provisions, in addition to requiring additional disclosures. SFAS 166 must be applied as of the beginning of our first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently assessing the impact of this SFAS.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167). SFAS 167 is an amendment to FASB Interpretation No. FIN 46(R), *Consolidation of Variable Interest Entities* (FIN 46(R)). SFAS 167 replaces the quantitative-based risks and rewards calculation of FIN 46(R) for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with a primarily qualitative approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impacts the entity s economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. SFAS 167 is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently assessing the impact of this SFAS.

2. Other Comprehensive Income (Loss)

Other comprehensive income (loss) is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
Net income	$ 9,012	$ 3,652	$ 35,487	$ 51,712
Change in net unrealized investment gains/losses	74,223	(29,314)	80,645	(49,496)

Noncredit component of OTTI losses, available for sale securities, net	(10,671)		(37,941)	
	$ 72,564	$ (25,662)	$ 78,191	$ 2,216

3. Fair Values of Financial Instruments

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. We categorize our financial instruments into three levels of fair value hierarchy based on the priority for use of inputs in determining fair value. The highest level inputs (Level 1) are quoted prices in active markets for identical assets. Level 2 inputs are observable market data other than Level 1 inputs such as quoted prices for similar assets, quoted prices for identical or similar assets in markets that are not active and inputs other than quoted prices (interest rates, yield curves, etc.). Level 3 inputs are our own assumptions about what a market participant would use in determining fair value such as estimated future cash flows.

Our assessment of all available data when determining fair value of its investments is necessary to appropriately apply fair value accounting standards. The first step in our process of determining fair value of our investments is obtaining quotes for each individual investment from an independent broker. These quotes are non-binding, but they are determined based on observable market data. The process that the independent broker uses for determining fair value of all securities except for private placement bonds begins with obtaining prices from an independent pricing service. The broker then evaluates other observable market data to determine if that price should be modified for facts and circumstances that may have not been considered by the pricing service. Inputs used by both the broker and the pricing service include market information, such as yield data, and other factors relating to instruments or securities with similar characteristics. In the case of private placement bonds, the broker typically starts with a price of a publicly traded bond of an entity that is comparable to size and financial position of the issuer of the private bond. The broker adjusts the price for factors such as marketability and risk factors specific to each security.

We review the prices received from the independent brokers to ensure that the prices represent a reasonable estimate of fair value. This process involves quantitative and qualitative analysis and is administered by our investment department. This review process includes, but is not limited to, initial and on-going review of methodologies used by the independent broker, review of pricing statistics and trends, back testing recent trades, comparing prices to those obtained from other third party pricing services, reviewing cash flow activity in the subsequent period, monitoring credit rating upgrades and downgrades and monitoring of trading volumes. Most all of the information used by the pricing service and the independent broker can be corroborated by our procedures of investigating market data and tying that data to the facts utilized by the broker.

The fixed income markets in 2008 and early 2009 experienced a period of extreme volatility and limited market liquidity conditions, which affected a broad range of asset classes and sectors. In addition, there were credit downgrade events and an increased probability of default for many fixed income instruments. These volatile market conditions increased the difficulty of valuing certain instruments as trading was less frequent and/or market data was less observable. There were certain instruments that were in active markets with significant observable data that became illiquid due to the current financial environment or market conditions. As a result, certain valuations require greater estimation and judgment as well as valuation methods which are more complex. These values may not ultimately be realizable in a market transaction, and such values may change very rapidly as market conditions change and valuation assumptions are modified.

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: The fair values of fixed maturity securities are obtained from third parties and are based on quoted market prices when 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.

Equity securities: The fair values of equity securities are based on quoted market prices.

Mortgage loans on real estate: 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.

Derivative instruments: The fair values of our derivative instruments are based on quoted market prices from the counterparties, adjusted for the credit risk of the counterparty.

Other investments: Other investments is comprised of policy loans and real estate held for sale. We have not attempted to determine the fair values associated with our policy loans, as management believes any differences between carrying value and the fair values afforded these instruments are immaterial to our financial position and, accordingly, the cost to provide such disclosure is not worth the benefit to be derived. The fair value of our real estate held for sale was determined by estimating the net operating income of the commercial rental property and dividing that by a current market capitalization rate.

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.

Annuity policy benefit reserves and coinsurance deposits: Fair values of our 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). The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. We are not required to and have not estimated the fair value of our liabilities under other contracts.

Notes payable and amounts due under repurchase agreements: The fair value of the contingent convertible senior notes is based upon quoted market prices. Fair values for other notes payable with fixed interest rates are estimated by discounting expected cash flows using current market interest rates currently being offered for similar securities. The amounts reported in the consolidated balance sheets for short term indebtedness under repurchase agreements with variable interest rates approximate their fair values.

Subordinated debentures: The carrying amount of subordinated debentures with variable interest rates reported in the consolidated balance sheets approximates fair value. Fair values for subordinated debentures with fixed interest rates are estimated by discounting expected cash flows using current market interest rates currently being offered for similar securities.

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

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$ 9,486,107	$ 9,486,107	$ 6,629,046	$ 6,629,046
Held for investment	2,143,403	2,110,396	3,604,149	3,588,114
Equity securities, available for sale	93,492	93,492	99,552	99,552
Mortgage loans on real estate	2,374,028	2,304,537	2,329,824	2,284,583
Derivative instruments	159,439	159,439	56,588	56,588
Other investments	3,700	4,294	446	446
Cash and cash equivalents	134,550	134,550	214,862	214,862
Coinsurance deposits	1,458,994	1,304,485	1,528,981	1,366,149
Liabilities				
Annuity benefit reserves	17,378,994	14,878,846	15,809,539	13,391,244
Notes payable	262,874	234,906	247,750	193,267
Subordinated debentures	268,277	246,458	268,209	248,283
Derivative instruments	1,172	1,172		

The objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date. We categorize financial assets and financial liabilities into a three level hierarchy based on the priority of inputs used in the valuation techniques utilized to determine fair value.

Level 1 - Quoted prices are available in active markets for identical financial instruments as of the reporting date. The types of financial instruments included in Level 1 are listed equities, United States treasuries and non-interest bearing cash. 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. The types of financial instruments included in Level 2 are U.S. Government sponsored agency securities, corporate preferred securities, corporate bonds and mortgage and asset backed securities.

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 unobservable inputs using market participant assumptions to determine fair value.

We used the following valuation techniques in estimating the fair values of financial instruments:

1. Fair values of fixed maturity securities are obtained primarily from a broker who starts by obtaining a price from an independent pricing source and adjusts for observable data. These prices from the independent broker undergo evaluation by our internal investment professionals. We generally obtain one price per security, which is compared to relevant credit information, perceived market movements and sector news. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. If the issuer has had trades in similar debt outstanding but not necessarily the same rank in the capital structure, spread information is used to support fair value. If discrepancies are identified, additional quotes are obtained and the quote that best reflects a fair value exit price at the reporting date is selected.

2. Amounts reported as fair value of embedded derivatives are estimated by projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and discounting the excess of the projected contract value amounts. The projections of the policy contract values are based on best estimate assumptions for future policy growth and future policy decrements. 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 that will be purchased 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. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in the fair values of call options purchased to fund the annual index credits and changes in the discount rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values. The fair value of the embedded derivatives includes an adjustment for our non performance risk.

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.

Our assets and liabilities which are measured at fair value on a recurring basis as of June 30, 2009 and December 31, 2008 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in thousands)		
June 30, 2009				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 3,129	$ 2,553	$ 576	$
United States Government sponsored agencies	3,355,515		3,355,515	
U.S. states, territories and political subdivisions	187,262		187,262	
Corporate securities	3,360,171	88,061	3,255,058	17,052
Mortgage and asset backed securities	2,580,030		2,577,942	2,088
Equity securities, available for sale: finance, insurance and real estate	93,492	85,107	8,385	
Derivative instruments	159,439		159,439	
Cash and cash equivalents	134,550	134,550		
	$ 9,873,588	$ 310,271	$ 9,544,177	$ 19,140
Liabilities				
Derivative instruments	$ 1,172	$	$ 1,172	$
Embedded derivatives	1,050,769			1,050,769
	$ 1,051,941	$	$ 1,172	$ 1,050,769
December 31, 2008				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 22,050	$ 3,404	$ 18,646	$
United States Government sponsored agencies	3,104,853		3,104,853	
Corporate securities	1,688,869	84,946	1,586,174	17,749
Mortgage and asset backed securities	1,813,274		1,810,941	2,333
Equity securities, available for sale: finance, insurance and real estate	99,552	84,554	14,998	
Derivative instruments	56,588		56,588	
Cash and cash equivalents	214,862	214,862		
	$ 7,000,048	$ 387,766	$ 6,592,200	$ 20,082
Liabilities				
Embedded derivatives	$ 998,015	$		$ 998,015
	$ 998,015	$	$	$ 998,015

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, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$ 19,588	$	$ 20,082	$
Transfers in to or out of Level 3		27,034		27,034
Disposals	(37)		(74)	
Total gains (losses) (unrealized/realized):				
Included in other comprehensive income	(123)		(42)	
Net impairment losses recognized in operations	(288)	(7,935)	(826)	(7,935)
	$ 19,140	$ 19,099	$ 19,140	$ 19,099

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(Dollars in thousands)			
Embedded Derivatives				
Beginning balance	$ 943,386	$ 1,190,935	$ 998,015	$ 1,432,746
Premiums less benefits	11,823	26,072	(4,841)	68,985
Change in unrealized loss (gains), net	95,560	(48,957)	57,595	(333,681)
	$ 1,050,769	$ 1,168,050	$ 1,050,769	$ 1,168,050

Change in unrealized loss (gains), net for each period in our embedded derivatives are included in change in fair value of embedded derivatives in the consolidated statements of operations.

4. Investments

At June 30, 2009 and December 31, 2008, 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)		
June 30, 2009				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 2,889	$ 240	$	$ 3,129
United States Government sponsored agencies	3,461,409	5,401	(111,295)	3,355,515
U.S. states, territories and political subdivisions	184,808	3,204	(750)	187,262
Corporate securities	3,421,139	119,873	(180,841)	3,360,171
Mortgage and asset backed securities	3,002,426	13,253	(435,649)	2,580,030
	$ 10,072,671	$ 141,971	$ (728,535)	$ 9,486,107
Held for investment:				
United States Government sponsored agencies	$ 2,067,819	$ 2,962	$ (10,903)	$ 2,059,878
Corporate security	75,584		(25,066)	50,518
	$ 2,143,403	$ 2,962	$ (35,969)	$ 2,110,396
Equity securities, available for sale:				
Finance, insurance and real estate	$ 104,484	$ 9,577	$ (20,569)	$ 93,492
December 31, 2008				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 21,664	$ 515	$ (129)	$ 22,050
United States Government sponsored agencies	3,090,458	15,528	(1,133)	3,104,853
Corporate securities	1,951,308	14,939	(277,378)	1,688,869
Mortgage and asset backed securities	2,095,856	6,055	(288,637)	1,813,274
	$ 7,159,286	$ 37,037	$ (567,277)	$ 6,629,046
Held for investment:				
United States Government sponsored agencies	$ 3,528,628	$ 6,421	$ (4,984)	$ 3,530,065
Corporate security	75,521		(17,472)	58,049
	$ 3,604,149	$ 6,421	$ (22,456)	$ 3,588,114
Equity securities, available for sale:				
Finance, insurance and real estate	$ 125,157	$ 373	$ (25,978)	$ 99,552

During the six months ended June 30, 2009 and 2008, we received $3.2 billion and $1.3 billion, respectively, in net redemption proceeds related to calls of our callable United States Government sponsored agency securities, of which $1.5 billion and $0.8 billion, respectively, were classified as held for investment. We reinvested the proceeds from these redemptions primarily in United States Government sponsored agency securities, corporate securities and mortgage backed securities classified as available for sale. At June 30, 2009, 49% of our fixed income securities have call features and 8% were subject to call redemption. Another 23% will become subject to call redemption through December 31, 2009.

The amortized cost and fair value of fixed maturity securities at June 30, 2009, 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 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)			
Due after one year through five years	$ 421,249	$ 415,627	$	$
Due after five years through ten years	1,362,394	1,388,357		
Due after ten years through twenty years	1,605,266	1,577,355	705,000	703,804
Due after twenty years	3,681,336	3,524,738	1,438,403	1,406,592
	7,070,245	6,906,077	2,143,403	2,110,396
Mortgage and asset backed securities	3,002,426	2,580,030		
	$ 10,072,671	$ 9,486,107	$ 2,143,403	$ 2,110,396

Net unrealized losses 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, 2009	December 31, 2008
	(Dollars in thousands)	
Net unrealized losses on available for sale fixed maturity securities and equity securities	$ (597,556)	$ (555,845)
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	358,159	329,113
Deferred tax valuation allowance	30,842	
Deferred income tax asset	83,789	79,356
Net unrealized losses reported as accumulated other comprehensive loss	$ (124,766)	$ (147,376)

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 446 and 394 securities, respectively) have been in a continuous unrealized loss position, at June 30, 2009 and December 31, 2008:

	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, 2009						
Fixed maturity securities:						
Available for sale:						
United States Government sponsored agencies	$ 2,315,678	$ (111,295)	$	$	$ 2,315,678	$ (111,295)
U.S. states, territories and political subdivisions	71,064	(750)			71,064	(750)
Corporate securities:						
Finance, insurance and real estate	110,806	(17,271)	299,138	(70,124)	409,944	(87,395)
Manufacturing, construction and mining	139,971	(9,601)	192,921	(24,551)	332,892	(34,152)
Utilities and related sectors	118,630	(7,277)	158,542	(21,631)	277,172	(28,908)
Wholesale/retail trade	86,136	(6,666)	33,905	(6,912)	120,041	(13,578)
Services, media and other	40,363	(2,094)	122,163	(14,714)	162,526	(16,808)
Mortgage and asset backed securities	1,251,494	(108,874)	952,906	(326,775)	2,204,400	(435,649)
	$ 4,134,142	$ (263,828)	$ 1,759,575	$ (464,707)	$ 5,893,717	$ (728,535)
Held for investment:						
United States Government sponsored agencies	$ 954,344	$ (8,059)	$ 297,156	$ (2,844)	$ 1,251,500	$ (10,903)
Corporate security:						
Finance, insurance and real estate			50,518	(25,066)	50,518	(25,066)
	$ 954,344	$ (8,059)	$ 347,674	$ (27,910)	$ 1,302,018	$ (35,969)
Equity securities, available for sale:						
Finance, insurance and real estate	$ 20,312	$ (12,329)	$ 26,760	$ (8,240)	$ 47,072	$ (20,569)
December 31, 2008						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$	$	$ 18,645	$ (129)	$ 18,645	$ (129)
United States Government sponsored agencies	60,475	(57)	298,925	(1,076)	359,400	(1,133)
Corporate securities:						
Finance, insurance and real estate	205,148	(44,478)	146,226	(46,761)	351,374	(91,239)
Manufacturing, construction and mining	294,428	(37,589)	65,578	(27,978)	360,006	(65,567)
Utilities and related sectors	192,110	(22,816)	116,173	(32,307)	308,283	(55,123)
Wholesale/retail trade	120,056	(16,557)	11,825	(9,680)	131,881	(26,237)
Services, media and other	119,297	(22,425)	79,664	(16,787)	198,961	(39,212)
	1,117,973	(221,480)	297,442	(67,157)	1,415,415	(288,637)

Mortgage and asset backed securities												
	$	2,109,487	$	(365,402)	$	1,034,478	$	(201,875)	$	3,143,965	$	(567,277)
Held for investment:												
United States Government sponsored agencies	$		$		$	360,016	$	(4,984)	$	360,016	$	(4,984)
Corporate security:												
Finance, insurance and real estate						58,049		(17,472)		58,049		(17,472)
	$		$		$	418,065	$	(22,456)	$	418,065	$	(22,456)
Equity securities, available for sale:												
Finance, insurance and real estate	$	30,093	$	(14,360)	$	20,358	$	(11,618)	$	50,451	$	(25,978)

The following is a description of the factors causing the temporary unrealized losses by investment category as of June 30, 2009:

United States Government sponsored agencies and U.S. states, territories and political subdivisions: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. During the last six months spreads on agency securities have improved; however, long term interest rates have risen by a greater amount. These securities carry yields less than those available at June 30, 2009 as the result of these rising interest rates.

Corporate securities: The unrealized losses in these securities are due to both the recent rise in interest rates as well as the continuation in wider than historic credit spreads on corporate securities. While credit spreads have improved on a recovering economy, the rise in interest rates during the last six months has caused many of the securities purchased late last year and early in 2009 to carry yields less than those available at June 30, 2009.

Mortgage and asset backed securities: At June 30, 2009, we had no exposure to subprime mortgage-backed securities. All of our mortgage-backed securities are pools of residential mortgage loans. Substantially all of the securities that we own are in the highest rated tranche of the pool in which they are structured and are not subordinated to any other tranche. Our Alt-A mortgage-backed securities are comprised of 36 securities with a total amortized cost basis of $561.7 million and a fair value of $400.4 million. Fair values of residential mortgage-backed securities have continued at prices significantly less than amortized cost as spreads in this sector have not improved like other sectors of the fixed income market. With the uncertainty of future foreclosures and high delinquencies on residential mortgages, these security prices will likely remain below our cost basis until the housing market conditions improve.

Equity securities: The unrealized loss on equity securities, which includes exposure to REITS, investment banks and finance companies, is related both to the decline in the equity market over the last 12 months and specific securities that have experienced additional constraints as a result of the slow down in the economy.

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 amortized cost, we do not consider these investments to be other than temporarily impaired because we do not intend to sell these securities before recovery of their amortized cost and it is more likely than not that we will not be required to sell prior to recovery . Where there is a decline in the fair value of equity securities, other than temporary impairment is not recognized when we anticipate a recovery of cost within a reasonable period of time.

Approximately 55% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2009 are on securities that are rated investment grade, defined as being the highest two National Association of Insurance Commissioners (NAIC) designations. Approximately 45% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2009 are on securities rated below investment grade. All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized losses on investments for the six months ended June 30, 2009 and 2008 are as follows:

	June 30,	
	2009	**2008**

	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$ (16,972)	$ 62,327
Investments carried at fair value:		
Fixed maturity securities, available for sale	$ (56,324)	$ (165,647)
Equity securities, available for sale	14,613	1,970
	(41,711)	(163,677)
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	29,046	87,529
Deferred tax valuation allowance	30,842	
Deferred income tax asset	4,433	26,652