AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
May 10, 2010
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 March 31, 2010

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.) |
| 6000 Westown Parkway | |
| 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 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 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 | Smaller reporting company o |
| (Do not check if a smaller reporting company) | |

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

APPLICABLE TO CORPORATE ISSUERS:
Shares of common stock outstanding at April 30, 2010: 58,485,359

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

| | March 31, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| Assets | | |
| Investments: | | |
| Fixed maturity securities: | | |
| Available for sale, at fair value (amortized cost: 2010 - $12,437,208; 2009 - $10,912,680) | $ 12,365,666 | $ 10,704,131 |
| Held for investment, at amortized cost (fair value: 2010 - $1,004,767; 2009 - $1,601,864) | 1,030,490 | 1,635,083 |
| Equity securities, available for sale, at fair value (cost: 2010 - $76,243; 2009 - $82,930) | 87,981 | 93,086 |
| Mortgage loans on real estate | 2,461,975 | 2,449,778 |
| Derivative instruments | 497,469 | 479,272 |
| Other investments | 15,565 | 12,760 |
| Total investments | 16,459,146 | 15,374,110 |
| | | |
| Cash and cash equivalents | 704,166 | 528,002 |
| Coinsurance deposits | 2,420,411 | 2,237,740 |
| Accrued investment income | 131,248 | 113,658 |
| Deferred policy acquisition costs | 1,611,704 | 1,625,785 |
| Deferred sales inducements | 1,028,192 | 1,011,449 |
| Deferred income taxes | 86,826 | 85,661 |
| Income taxes recoverable | — | 103,684 |
| Other assets | 66,057 | 231,915 |
| Total assets | $ 22,507,750 | $ 21,312,004 |
| | | |
| Liabilities and Stockholders' Equity | | |
| Liabilities: | | |
| Policy benefit reserves: | | |
| Traditional life and accident and health insurance products | $ 145,694 | $ 140,351 |
| Annuity products | 20,007,212 | 19,195,870 |
| Other policy funds and contract claims | 132,572 | 119,403 |
| Notes payable | 317,957 | 316,468 |
| Subordinated debentures | 268,383 | 268,347 |

| | | |
|---|---|---|
| Income taxes payable | 24,098 | — |
| Other liabilities | 803,934 | 516,942 |
| Total liabilities | 21,699,850 | 20,557,381 |
| | | |
| Stockholders' equity: | | |
| Common stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding: 2010 - 56,428,074 shares (excluding 5,776,031 treasury shares); 2009 - 56,203,159 shares (excluding 5,936,696 treasury shares) | 56,428 | 56,203 |
| Additional pain-in capital | 424,525 | 422,225 |
| Unallocated common stock held by ESOP; 2010 - 527,272 shares; 2009 - 527,272 shares | (5,498) | (5,679) |
| Accumulated other comprehensive income (loss) | 5,230 | (30,456) |
| Retained earnings | 327,215 | 312,330 |
| Total stockholders' equity | 807,900 | 754,623 |
| Total liabilities and stockholders' equity | $ 22,507,750 | $ 21,312,004 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| Revenues: | | |
| Traditional life and accident and health insurance premiums | $ 3,287 | $ 3,486 |
| Annuity product charges | 15,518 | 15,051 |
| Net investment income | 242,910 | 220,654 |
| Change in fair value of derivatives | 82,015 | (43,823) |
| Net realized gains on investments, excluding other than temporary impairment ("OTTI") losses | 9,903 | 760 |
| OTTI losses on investments: | | |
| Total OTTI losses | (12,584) | (55,391) |
| Portion of OTTI losses recognized in other comprehensive income | 9,361 | 41,953 |
| Net OTTI losses recognized in operations | (3,223) | (13,438) |
| Total revenues | 350,410 | 182,690 |
| | | |
| Benefits and expenses: | | |
| Insurance policy benefits and change in future policy benefits | 2,332 | 2,199 |
| Interest sensitive and index product benefits | 196,869 | 59,763 |
| Amortization of deferred sales inducements | 13,089 | 13,711 |
| Change in fair value of embedded derivatives | 63,875 | 14,183 |
| Interest expense on notes payable | 4,651 | 4,276 |
| Interest expense on subordinated debentures | 3,685 | 4,208 |
| Interest expense on amounts due under repurchase agreements | — | 242 |
| Amortization of deferred policy acquisition costs | 27,268 | 34,644 |
| Other operating costs and expenses | 15,985 | 14,464 |
| Total benefits and expenses | 327,754 | 147,690 |
| Income before income taxes | 22,656 | 35,000 |
| Income tax expense | 7,771 | 8,525 |
| Net income | $ 14,885 | $ 26,475 |
| | | |
| Earnings per common share | $ 0.26 | $ 0.50 |
| Earnings per common share - assuming dilution | $ 0.25 | $ 0.48 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Common Stock | Additional Paid-in Capital | Unallocated Common Stock Held by ESOP | Accumulated Other Comprehensive Income (Loss) | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance at December 31, 2009 | $ 56,203 | $ 422,225 | $ (5,679 ) | $ (30,456 ) | $ 312,330 | $ 754,623 |
| Other comprehensive income: | | | | | | |
| Net income for period | — | — | — | — | 14,885 | 14,885 |
| Change in net unrealized investment gains/losses | — | — | — | 41,770 | — | 41,770 |
| Noncredit component of OTTI losses, available for sale securities, net | — | — | — | (6,084 ) | — | (6,084 ) |
| Other comprehensive income | | | | | | 50,571 |
| Acquisition of 6,300 shares of common stock | (6 ) | (44 ) | — | — | — | (50 ) |
| Allocation of 16,813 shares of common stock by ESOP, including excess income tax benefits | — | (24 ) | 181 | — | — | 157 |
| Share-based compensation, including excess income tax benefits | — | 2,056 | — | — | — | 2,056 |
| Issuance of 231,215 shares of common stock under compensation plans, including excess income tax benefits | 231 | 312 | — | — | — | 543 |
| Balance at March 31, 2010 | $ 56,428 | $ 424,525 | $ (5,498 ) | $ 5,230 | $ 327,215 | $ 807,900 |
| | | | | | | |
| Balance at December 31, 2008 | $ 50,739 | $ 376,782 | $ (6,336 ) | $ (147,376 ) | $ 223,035 | $ 496,844 |
| Cumulative effect of noncredit OTTI, net | — | — | — | (20,094 ) | 25,240 | 5,146 |
| Other comprehensive income: | | | | | | |
| Net income for the period | — | — | — | — | 26,475 | 26,475 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Change in net unrealized investment gains/losses | — | — | — | 6,422 | — | 6,422 |
| Noncredit component of OTTI losses, available for sale securities, net | — | — | — | (27,270) | — | (27,270) |
| Other comprehensive income | | | | | | 5,627 |
| Acquisition of 12,362 shares of common stock | (12) | (40) | — | — | — | (52) |
| Allocation of 9,994 shares of common stock by ESOP, including excess income tax benefits | — | (35) | 107 | — | — | 72 |
| Share-based compensation, including excess income tax benefits | — | 64 | — | — | — | 64 |
| Issuance of 339,015 shares of common stock under compensation plans, including excess income tax benefits | 339 | (339) | — | — | — | — |
| Balance at March 31, 2009 | $ 51,066 | $ 376,432 | $ (6,229) | $ (188,318) | $ 274,750 | $ 507,701 |

See accompanying notes to unaudited consolidated financial statements.

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| Operating activities | | |
| Net income | $ 14,885 | $ 26,475 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Interest sensitive and index product benefits | 196,869 | 59,763 |
| Amortization of deferred sales inducements | 13,089 | 13,711 |
| Annuity product charges | (15,518) | (15,051) |
| Change in fair value of embedded derivatives | 63,875 | 14,183 |
| Increase in traditional life and accident and health insurance reserves | 2,677 | 1,708 |
| Policy acquisition costs deferred | (64,441) | (73,200) |
| Amortization of deferred policy acquisition costs | 27,268 | 34,644 |
| Provision for depreciation and other amortization | 2,345 | 1,519 |
| Amortization of discounts and premiums on investments | (53,692) | (56,721) |
| Realized gains on investments and net OTTI losses recognized | (6,680) | 12,678 |
| Change in fair value of derivatives | (82,653) | 43,531 |
| Deferred income taxes | (21,440) | (2,854) |
| Share-based compensation | 1,881 | 433 |
| Change in accrued investment income | (17,590) | (13,065) |
| Change in income taxes recoverable/payable | 127,782 | (4,253) |
| Change in other assets | 4,303 | (778) |
| Change in other policy funds and contract claims | 13,169 | (1,159) |
| Change in collateral held for derivatives | (25,005) | — |
| Change in other liabilities | (1,971) | 17,975 |
| Other | 143 | 27 |
| Net cash provided by operating activities | 179,296 | 59,566 |
| | | |
| Investing activities | | |
| Sales, maturities, or repayments of investments: | | |
| Fixed maturity securities - available for sale | 1,074,998 | 650,765 |
| Fixed maturity securities - held for investment | 616,334 | 588,601 |
| Equity securities - available for sale | 23,014 | 200 |
| Mortgage loans on real estate | 26,058 | 25,353 |
| Derivative instruments | 135,601 | 2,539 |
| Acquisition of investments: | | |

| | | |
|---|---|---|
| Fixed maturity securities - available for sale | (2,068,305 ) | (1,683,183 ) |
| Equity securities - available for sale | (10,125 ) | — |
| Mortgage loans on real estate | (45,230 ) | (46,936 ) |
| Derivative instruments | (60,809 ) | (50,418 ) |
| Other investments | (26 ) | (13 ) |
| Purchases of property, furniture and equipment | (604 ) | (233 ) |
| Net cash used in investing activities | (309,094 ) | (513,325 ) |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| Financing activities | | |
| Receipts credited to annuity policyholder account balances | $ 846,855 | $ 653,133 |
| Coinsurance deposits | (139,240) | 44,066 |
| Return of annuity policyholder account balances | (382,706) | (342,312) |
| Proceeds from notes payable | — | 25,000 |
| Repayments of notes payable | — | (1,028) |
| Acquisition of common stock | (50) | (34) |
| Excess tax benefits realized from share-based compensation plans | 199 | 20 |
| Proceeds from issuance of common stock | 533 | — |
| Change in checks in excess of cash balance | (19,653) | (31,916) |
| Other | 24 | — |
| Net cash provided by financing activities | 305,962 | 346,929 |
| Increase (decrease) in cash and cash equivalents | 176,164 | (106,830) |
| Cash and cash equivalents at beginning of period | 528,002 | 214,862 |
| Cash and cash equivalents at end of period | $ 704,166 | $ 108,032 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during period for: | | |
| Interest expense | $ 3,911 | $ 5,868 |
| Income taxes | 390 | 15,800 |
| Income tax refunds received | 100,000 | — |
| Non-cash operating activity: | | |
| Deferral of sales inducements | 61,206 | 58,788 |
| Non-cash investing activity: | | |
| Real estate acquired in satisfaction of mortgage loans | 2,905 | — |

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010
(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 month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. 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, 2009.

Reclassifications have been made to prior period financial statements to conform to the current period presentation.

Adopted Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity is now required to disclose separately the amounts of significant transfers in to and out of Level 1 and Level 2 fair value measurement categories and describe the reasons for the transfers. Clarification on existing disclosure requirements is also provided in this update relating to the level of disaggregation of information as to determining appropriate classes of assets and liabilities as well as disclosure requirements regarding valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This standard was effective for us on January 1, 2010, and has not had a material impact on our consolidated financial statements.

In June 2009, the FASB amended accounting standards for transfers and servicing of financial assets and extinguishments of liabilities. The new standard removes the concept of a qualifying special-purpose entity ("QSPE") from existing standards and removes the exception of QSPE's from consolidation requirements. Additionally, more stringent conditions for reporting a transfer of a portion of a financial asset as a sale were created, derecognition criteria was clarified, the initial measurement of retained interests was revised, the guaranteed mortgage securitization recharacterization provisions were removed and disclosure requirements were added. This standard was effective for us on January 1, 2010 and had no effect on our consolidated financial statements upon adoption.

In June 2009, the FASB issued an amendment to the accounting standards for consolidation of variable interest entities. The new standard replaces the quantitative-based risks and rewards calculation of existing standards 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 ("VIE") 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. This standard was effective for us on January 1, 2010, and had no effect on our consolidated financial statements upon adoption. Through our funds withheld coinsurance agreement with an unauthorized life reinsurer we have been named as beneficiary of the trust that holds

the funds withheld. We have determined that this trust is a VIE. We also have determined that the reinsurer is the primary beneficiary of this VIE due to the fact that all earnings of the trust inure to the reinsurer, and the reinsurer directs the operations of the trust subject to an investment policy. Therefore, we have not consolidated the trust prior to or after the adoption of this amendment to the accounting standards for consolidation of VIE's.

New Accounting Pronouncements

In January 2010, the FASB issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity will be required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. This guidance will be effective on January 1, 2011, and we do not expect the adoption to have a material impact on our consolidated financial statements.



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2. 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. 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 for use of inputs in determining fair value. The hierarchy defines the highest priority inputs (Level 1) as quoted prices in active markets for identical assets. 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. Transfers between Level 1 and Level 2 were not material for the three months ended March 31, 2010.

We utilize independent pricing services in estimating the fair values of investment securities. 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. 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.

The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. The pricing service obtains a broker quote when sufficient information, such as security structure or other market information, is not available to produce a valuation. 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.

In addition, we obtain prices from a broker for our callable United States Government sponsored agencies. 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.

Fair value of call options are determined by obtaining prices from our counterparties who use market standard valuation methodologies. Market 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.



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We estimate the fair value of the embedded derivative component 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.

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 of 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 March 31, 2010.

The fixed income securities markets in 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 which are not fair value exit prices.

Derivative instruments: The fair values of derivative instruments are based upon the amount of cash that we will receive to settle each derivative instrument on the reporting date. These amounts are obtained from each of the counterparties and are adjusted for the nonperformance risk of each counterparty net of any collateral held. 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: Other investments is comprised of policy loans, rental real estate and real estate held for sale. 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 real estate owned was determined either by obtaining a third party appraisal of the property or by estimating the potential annual net operating income from each 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.

Policy benefit reserves and coinsurance deposits: 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). 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 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.

Notes payable: 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.

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.

Interest rate swaps: The fair values of our pay fixed/receive variable interest rate swaps are obtained from third parties and are based on market rates currently being offered for similar instruments.

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

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (Dollars in thousands) | | | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Available for sale | $ 12,365,666 | $ 12,365,666 | $ 10,704,131 | $ 10,704,131 |
| Held for investment | 1,030,490 | 1,004,767 | 1,635,083 | 1,601,864 |
| Equity securities, available for sale | 87,981 | 87,981 | 93,086 | 93,086 |
| Mortgage loans on real estate | 2,461,975 | 2,458,944 | 2,449,778 | 2,409,197 |
| Derivative instruments | 497,469 | 497,469 | 479,272 | 479,272 |
| Other investments | 15,565 | 17,438 | 12,760 | 12,760 |
| Cash and cash equivalents | 704,166 | 704,166 | 528,002 | 528,002 |
| Coinsurance deposits | 2,420,411 | 2,052,538 | 2,237,740 | 1,934,996 |
| Liabilities | | | | |
| Policy benefit reserves | 20,152,906 | 16,752,355 | 19,336,221 | 16,152,088 |
| Notes payable | 317,957 | 381,038 | 316,468 | 340,673 |
| Subordinated debentures | 268,383 | 204,082 | 268,347 | 186,215 |
| Interest rate swaps | 2,541 | 2,541 | 1,891 | 1,891 |

Our assets and liabilities which are measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009 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) | | | |
| March 31, 2010 | | | | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government full faith and credit | $ 3,424 | $ 3,424 | $ — | $ — |
| United States Government sponsored agencies | 5,043,470 | — | 5,043,470 | — |
| United States municipalities, states and territories | 528,379 | — | 528,379 | — |
| Corporate securities | 4,254,772 | 63,493 | 4,177,236 | 14,043 |
| Residential mortgage backed securities | 2,535,621 | — | 2,532,812 | 2,809 |
| Equity securities, available for sale: finance, insurance and real estate | 87,981 | 67,327 | 18,597 | 2,057 |
| Derivative instruments | 497,469 | — | 497,469 | — |
| Cash and cash equivalents | 704,166 | 704,166 | — | — |
| | $ 13,655,282 | $ 838,410 | $ 12,797,963 | $ 18,909 |
| Liabilities | | | | |
| Interest rate swaps | $ 2,541 | $ — | $ 2,541 | $ — |
| Fixed index annuities - embedded derivatives | 1,526,117 | — | — | 1,526,117 |
| | $ 1,528,658 | $ — | $ 2,541 | $ 1,526,117 |
| December 31, 2009 | | | | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government full faith and credit | $ 3,310 | $ 2,545 | $ 765 | $ — |
| United States Government sponsored agencies | 3,998,537 | — | 3,998,537 | — |
| United States municipalities, states and territories | 355,634 | — | 355,634 | — |
| Corporate securities | 3,857,549 | 70,363 | 3,773,078 | 14,108 |
| Residential mortgage backed securities | 2,489,101 | — | 2,486,290 | 2,811 |
| Equity securities, available for sale: finance, insurance and real estate | 93,086 | 83,672 | 8,415 | 999 |
| Derivative instruments | 479,272 | — | 479,272 | — |
| Cash and cash equivalents | 528,002 | 528,002 | — | — |
| | $ 11,804,491 | $ 684,582 | $ 11,101,991 | $ 17,918 |

| | | | | |
|---|---|---|---|---|
| Liabilities | | | | |
| Interest rate swaps | $ 1,891 | $ — | $ 1,891 | $ — |
| Fixed index annuities - embedded derivatives | 1,375,866 | — | — | 1,375,866 |
| | $ 1,377,757 | $ — | $ 1,891 | $ 1,375,866 |

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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 months ended March 31, 2010 and 2009:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Available for sale securities | | |
| Beginning balance | $ 17,918 | $ 20,082 |
| Purchases, issuances, and settlements | (136) | (37) |
| Total gains (losses) (realized/unrealized): | | |
| Included in other comprehensive income (loss) | 1,127 | 81 |
| Included in operations | — | (538) |
| Ending balance | $ 18,909 | $ 19,588 |

Realized losses of $0.5 million for the three months ended March 31, 2009 are included in net impairment losses recognized in operations in the unaudited consolidated statements of operations.

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Fixed index annuities - embedded derivatives | | |
| Beginning balance | $ 1,375,866 | $ 998,015 |
| Premiums less benefits | 163,148 | (16,664) |
| Change in unrealized gains, net | (12,897) | (37,965) |
| Ending balance | $ 1,526,117 | $ 943,386 |

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

3. Investments

At March 31, 2010 and December 31, 2009, 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) | | | |
| March 31, 2010 | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government full faith and credit | $ 3,200 | $ 230 | $ (6 ) | $ 3,424 |
| United States Government sponsored agencies | 5,140,664 | 4,509 | (101,703 ) | 5,043,470 |
| United States municipalities, states and territories | 519,466 | 11,359 | (2,446 ) | 528,379 |
| Corporate securities | 4,041,990 | 276,600 | (63,818 ) | 4,254,772 |
| Residential mortgage backed securities | 2,731,888 | 67,154 | (263,421 ) | 2,535,621 |
| | $ 12,437,208 | $ 359,852 | $ (431,394 ) | $ 12,365,666 |
| Held for investment: | | | | |
| United States Government sponsored agencies | $ 954,808 | $ 1,254 | $ — | $ 956,062 |
| Corporate securities | 75,682 | — | (26,977 ) | 48,705 |
| | $ 1,030,490 | $ 1,254 | $ (26,977 ) | $ 1,004,767 |
| Equity securities, available for sale: | | | | |
| Finance, insurance, and real estate | $ 76,243 | $ 13,096 | $ (1,358 ) | $ 87,981 |
| December 31, 2009 | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government full faith and credit | $ 3,101 | $ 215 | $ (6 ) | $ 3,310 |
| United States Government sponsored agencies | 4,113,457 | 3,468 | (118,388 ) | 3,998,537 |
| United States municipalities, states and territories | 350,787 | 7,110 | (2,263 ) | 355,634 |
| Corporate securities | 3,709,446 | 233,023 | (84,920 ) | 3,857,549 |
| Residential mortgage backed securities | 2,735,889 | 59,584 | (306,372 ) | 2,489,101 |
| | $ 10,912,680 | $ 303,400 | $ (511,949 ) | $ 10,704,131 |
| Held for investment: | | | | |
| United States Government sponsored agencies | $ 1,559,434 | $ 1,647 | $ (5,900 ) | $ 1,555,181 |
| Corporate securities | 75,649 | — | (28,966 ) | 46,683 |
| | $ 1,635,083 | $ 1,647 | $ (34,866 ) | $ 1,601,864 |
| Equity securities, available for sale: | | | | |

| | | | | |
|---|---|---|---|---|
| Finance, insurance, and real estate | $ 82,930 | $ 13,425 | $ (3,269 ) | $ 93,086 |

During the three months ended March 31, 2010 and 2009, we received $1.3 billion and $1.0 billion, respectively, in redemption proceeds related to calls of our callable United States Government sponsored agency securities and public and private corporate bonds, of which $616.3 million and $588.6 million, respectively, were classified as held for investment. We reinvested the 2010 proceeds from these redemptions primarily in United States Government sponsored agencies and corporate securities classified as available for sale. At March 31, 2010, 50% of our fixed income securities have call features and 8% were subject to call redemption. Another 26% will become subject to call redemption during the remainder of December 31, 2010.

The amortized cost and fair value of fixed maturity securities at March 31, 2010, 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 residential mortgage 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 in one year or less | $ — | $ — | $ — | $ — |
| Due after one year through five years | 453,158 | 487,804 | — | — |
| Due after five years through ten years | 1,370,177 | 1,504,166 | — | — |
| Due after ten years through twenty years | 1,904,894 | 1,906,244 | 505,000 | 505,669 |
| Due after twenty years | 5,977,091 | 5,931,831 | 525,490 | 499,098 |
| | 9,705,320 | 9,830,045 | 1,030,490 | 1,004,767 |
| Residential mortgage backed securities | 2,731,888 | 2,535,621 | — | — |
| | $ 12,437,208 | $ 12,365,666 | $ 1,030,490 | $ 1,004,767 |

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:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| Net unrealized losses on available for sale fixed maturity securities and equity securities | $ (59,804 ) | $ (198,393 ) |
| Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements | 33,183 | 116,870 |
| Deferred income tax valuation allowance reversal | 22,534 | 22,534 |
| Deferred income tax benefit | 9,317 | 28,533 |
| Net unrealized losses reported as accumulated other comprehensive income (loss) | $ 5,230 | $ (30,456 ) |

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade”. Based on the NAIC designations, we had 97% of our fixed maturity portfolio rated investment grade at March 31, 2010 and December 31, 2009.

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

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| NAIC Designation | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (Dollars in thousands) | | | |

| | | | | |
|---|---|---|---|---|
| 1 | $ 10,307,998 | $ 10,258,514 | $ 9,495,015 | $ 9,370,647 |
| 2 | 2,711,821 | 2,743,291 | 2,571,815 | 2,555,826 |
| 3 | 389,552 | 313,802 | 409,860 | 315,948 |
| 4 | 27,026 | 24,236 | 24,375 | 20,799 |
| 5 | 5,993 | 7,650 | 21,013 | 20,749 |
| 6 | 25,308 | 22,940 | 25,685 | 22,026 |
| | $ 13,467,698 | $ 13,370,433 | $ 12,547,763 | $ 12,305,995 |

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

| | | March 31, 2010 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|---|
| Collateral Type | NAIC Designation | Principal Amount | Amortized Cost | Fair Value | Principal Amount | Amortized Cost | Fair Value |
| | | (Dollars in thousands) | | | | | |
| OTTI has not been recognized | | | | | | | |
| Government agency | 1 | $ 68,217 | $ 67,455 | $ 72,284 | $ 69,496 | $ 68,715 | $ 72,306 |
| Prime | 1 | 1,713,832 | 1,602,181 | 1,619,615 | 1,713,391 | 1,595,502 | 1,585,337 |
| | 2 | 127,337 | 126,596 | 106,156 | 127,951 | 127,210 | 106,395 |
| | 3 | 1,474 | 1,471 | 981 | 1,474 | 1,471 | 977 |
| Alt-A | 1 | 14,253 | 12,912 | 11,324 | 93,963 | 87,071 | 70,749 |
| | 2 | 46,456 | 47,282 | 38,206 | 46,456 | 47,301 | 38,030 |
| | | $ 1,971,569 | $ 1,857,897 | $ 1,848,566 | $ 2,052,731 | $ 1,927,270 | $ 1,873,794 |
| OTTI has been recognized | | | | | | | |
| Prime | 1 | $ 190,038 | $ 171,567 | $ 140,038 | $ 173,149 | $ 156,108 | $ 126,301 |
| | 2 | 221,188 | 210,518 | 159,879 | 223,473 | 212,221 | 156,522 |
| | 3 | 45,001 | 43,207 | 35,903 | 60,965 | 58,965 | 44,853 |
| Alt-A | 1 | 273,389 | 235,361 | 193,767 | 194,682 | 164,402 | 127,341 |
| | 2 | 111,571 | 96,537 | 73,881 | 111,673 | 96,700 | 75,557 |
| | 3 | 130,979 | 112,247 | 80,778 | 134,085 | 115,522 | 81,922 |
| | 6 | 5,237 | 4,554 | 2,809 | 5,394 | 4,701 | 2,811 |
| | | $ 977,403 | $ 873,991 | $ 687,055 | $ 903,421 | $ 808,619 | $ 615,307 |
| Total by collateral type | | | | | | | |
| Government agency | | $ 68,217 | $ 67,455 | $ 72,284 | $ 69,496 | $ 68,715 | $ 72,306 |
| Prime | | 2,298,870 | 2,155,540 | 2,062,572 | 2,300,403 | 2,151,477 | 2,020,385 |
| Alt-A | | 581,885 | 508,893 | 400,765 | 586,253 | 515,697 | 396,410 |
| | | $ 2,948,972 | $ 2,731,888 | $ 2,535,621 | $ 2,956,152 | $ 2,735,889 | $ 2,489,101 |
| Total by NAIC designation | | | | | | | |
| | 1 | $ 2,259,729 | $ 2,089,476 | $ 2,037,028 | $ 2,244,681 | $ 2,071,798 | $ 1,982,034 |
| | 2 | 506,552 | 480,933 | 378,122 | 509,553 | 483,432 | 376,504 |
| | 3 | 177,454 | 156,925 | 117,662 | 196,524 | 175,958 | 127,752 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 6 | 5,237 | 4,554 | 2,809 | 5,394 | 4,701 | 2,811 |
| | $ 2,948,972 | $ 2,731,888 | $ 2,535,621 | $ 2,956,152 | $ 2,735,889 | $ 2,489,101 |

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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 336 and 355 securities, respectively) have been in a continuous unrealized loss position, at March 31, 2010 and December 31, 2009:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| | (Dollars in thousands) | | | | | |
| March 31, 2010 | | | | | | |
| Fixed maturity securities: | | | | | | |
| Available for sale: | | | | | | |
| United States Government full faith and credit | $ 306 | $ (6 ) | $ — | $ — | $ 306 | $ (6 ) |
| United States Government sponsored agencies | 3,556,851 | (81,308 ) | 247,646 | (20,395 ) | 3,804,497 | (101,703 ) |
| United States municipalities, states and territories | 114,342 | (2,446 ) | — | — | 114,342 | (2,446 ) |
| Corporate securities: | | | | | | |
| Finance, insurance and real estate | 131,143 | (4,410 ) | 221,489 | (32,750 ) | 352,632 | (37,160 ) |
| Manufacturing, construction and mining | 145,298 | (2,931 ) | 60,413 | (4,493 ) | 205,711 | (7,424 ) |
| Utilities and related sectors | 189,227 | (4,506 ) | 66,026 | (7,485 ) | 255,253 | (11,991 ) |
| Wholesale/retail trade | 15,771 | (67 ) | 42,202 | (3,906 ) | 57,973 | (3,973 ) |
| Services, media and other | 17,188 | (249 ) | 57,433 | (3,021 ) | 74,621 | (3,270 ) |
| Residential mortgage backed securities | 170,556 | (7,842 ) | 1,182,962 | (255,579 ) | 1,353,518 | (263,421 ) |
| | $ 4,340,682 | $ (103,765 ) | $ 1,878,171 | $ (327,629 ) | $ 6,218,853 | $ (431,394 ) |
| Held for investment: | | | | | | |
| Corporate securities: | | | | | | |
| Finance, insurance and real estate | — | — | 48,705 | (26,977 ) | 48,705 | (26,977 ) |
| | | | | | | |
| Equity securities, available for sale: | | | | | | |
| Finance, insurance and real estate | $ 2,595 | $ (63 ) | $ 22,704 | $ (1,295 ) | $ 25,299 | $ (1,358 ) |

| | | | | | | |
|---|---|---|---|---|---|---|
| December 31, 2009 | | | | | | |
| Fixed maturity securities: | | | | | | |
| Available for sale: | | | | | | |
| United States Government full faith and credit | $ 332 | $ (6 ) | $ — | $ — | $ 332 | $ (6 ) |
| United States Government sponsored agencies | 2,908,205 | (118,388 ) | — | — | 2,908,205 | (118,388 ) |
| United States municipalities, states and territories | 111,969 | (2,263 ) | — | — | 111,969 | (2,263 ) |
| Corporate securities: | | | | | | |
| Finance, insurance and real estate | 154,093 | (10,560 ) | 239,211 | (39,995 ) | 393,304 | (50,555 ) |
| Manufacturing, construction and mining | 93,922 | (2,032 ) | 74,258 | (8,430 ) | 168,180 | (10,462 ) |
| Utilities and related sectors | 149,515 | (5,046 ) | 63,933 | (8,110 ) | 213,448 | (13,156 ) |
| Wholesale/retail trade | 35,629 | (623 ) | 39,547 | (4,800 ) | 75,176 | (5,423 ) |
| Services, media and other | 46,625 | (512 ) | 61,359 | (4,812 ) | 107,984 | (5,324 ) |
| Residential mortgage backed securities | 226,567 | (22,781 ) | 1,186,542 | (283,591 ) | 1,413,109 | (306,372 ) |
| | $ 3,726,857 | $ (162,211 ) | $ 1,664,850 | $ (349,738 ) | $ 5,391,707 | $ (511,949 ) |
| Held for investment: | | | | | | |
| United States Government sponsored agencies | $ 359,100 | $ (5,900 ) | $ — | $ — | $ 359,100 | $ (5,900 ) |
| Corporate securities: | | | | | | |
| Finance, insurance and real estate | — | — | 46,683 | (28,966 ) | 46,683 | (28,966 ) |
| | $ 359,100 | $ (5,900 ) | $ 46,683 | $ (28,966 ) | $ 405,783 | $ (34,866 ) |
| Equity securities, available for sale: | | | | | | |
| Finance, insurance and real estate | $ 9,802 | $ (147 ) | $ 28,877 | $ (3,122 ) | $ 38,679 | $ (3,269 ) |

The following is a description of the factors causing the temporary unrealized losses by investment category as of March 31, 2010:

United States Government sponsored agencies; and United States municipalities, states and territories: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. During the last fifteen 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 March 31, 2010 as the result of these rising interest rates.

Corporate securities: The unrealized losses in these securities are due partially to a rise in interest rates in 2009 as well as the continuation of wider than historic credit spreads in certain sectors of the corporate bond market. While credit spreads narrowed, several sectors remain at spreads wider than pre-crisis levels, such as financial and select economic sensitive issuers. As the result of wider spreads, these issues carry yields less than those available in the market as of March 31, 2010.

Residential mortgage backed securities: At March 31, 2010, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $508.9 million and a fair value of $400.8 million. Despite recent improvements in the capital markets, the fair values of RMBS continue at prices below amortized cost. RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.

Equity securities: The unrealized loss on equity securities, which are primarily investment grade perpetual preferred stocks with exposure to REITS, investment banks and finance companies, are due to the ongoing concerns relating to capital, asset quality and earnings stability due to the financial crisis. All of the equity securities in an unrealized loss position for 12 months or more are investment grade perpetual preferred stocks that are absent credit deterioration. A continued difficult housing market has raised concerns in regard to earnings and dividend stability in many companies which directly affect the values of these securities.

Where the decline in market value of debt securities is attributable to changes in market interest rates or to factors such as market volatility, liquidity and spread widening, and we anticipate recovery of all contractual or expected cash flows, we do not consider these investments to be other than temporarily impaired because we do not intend to sell these investments and it is not more likely than not we will be required to sell these securities 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 a 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 based upon consideration of all the evidence available to us, including the magnitude of an unrealized loss and its duration. In any event, this period does not exceed 18 months from the date of impairment for perpetual preferred securities for which there is evidence of deterioration in credit of the issuer and common equity securities. For perpetual preferred securities absent evidence of a deterioration in credit of the issuer we apply an impairment model, including an anticipated recovery period, similar to a debt security. For equity securities we measure impairment charges based upon the difference between the book value of a security and its fair value.

Approximately 81% of the unrealized losses on fixed maturity securities shown in the above table for March 31, 2010 are on securities that are rated investment grade, defined as being the highest two NAIC designations. Approximately 19% of the unrealized losses on fixed maturity securities shown in the above table for March 31, 2010 are on securities rated below investment grade. All of the securities with unrealized losses are current with respect to the

payment of principal and interest.

Changes in net unrealized losses on investments for the three months ended March 31, 2010 and 2009 are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Fixed maturity securities held for investment carried at amortized cost | $ 7,496 | $ 4,773 |
| | | |
| Investments carried at fair value: | | |
| Fixed maturity securities, available for sale | $ 137,007 | $ (175,066 ) |
| Equity securities, available for sale | 1,582 | (5,500 ) |
| | 138,589 | (180,566 ) |
| Adjustment for effect on other balance sheet accounts: | | |
| Deferred policy acquisition costs and deferred sales inducements | (83,687 ) | 117,578 |
| Deferred income tax asset | (19,216 ) | 22,046 |
| | (102,903 ) | 139,624 |
| Decrease (increase) in net unrealized losses on investments carried at fair value | $ 35,686 | $ (40,942 ) |

Proceeds from sales of available for sale securities for the three months ended March 31, 2010 and 2009 were $138.2 million and $36.4 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the three months ended March 31, 2010 and 2009 were $801.6 million and $487.8 million, respectively. Calls of held for investment fixed maturity securities for the three months ended March 31, 2010 and 2009 were $616.3 million and $588.6 million, respectively.

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Realized gains (losses) on investments, excluding net OTTI losses for the three months ended March 31, 2010 and 2009 are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Available for sale fixed maturity securities: | | |
| Gross realized gains | $ 7,894 | $ 810 |
| Gross realized losses | (129) | (53) |
| | 7,765 | 757 |
| Equity securities: | | |
| Gross realized gains | 6,207 | 3 |
| | 6,207 | 3 |
| Mortgage loans on real estate: | | |
| Impairment losses | (4,069) | — |
| | $ 9,903 | $ 760 |

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

We have a policy and process in place to identify securities that could potentially have an impairment that is 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 residential 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 the security. If our assessment of an equity security has resulted in a

determination that its price will not recover to cost in a reasonable period of time or we intend to sell the security before price recovery, other than temporary impairment has occurred and the difference between cost and fair value will be recognized as a loss 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 calculate the present value of the cash flows expected to be collected discounted at each security's acquisition yield. The difference between the present value of expected future cash flows and the amortized cost basis of the security is the amount of credit loss recognized in operations. The remaining amount of the other than temporary impairment is recognized in other comprehensive income.

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

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

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

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 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 |
| Three months ended March 31, 2010 | | | | | | | |
| Prime | 2006 | 7.3 % | 7.3 % | 11 % | 11 % | 45 % | 45 % |
| | 2007 | 5.8 % | 5.8 % | 19 % | 19 % | 50 % | 50 % |
| Alt-A | 2005 | 6.8 % | 7.4 % | 12 % | 26 % | 45 % | 50 % |
| Three months ended March 31, 2009 | | | | | | | |
| Prime | 2007 | 6.4 % | 7.1 % | 8 % | 13 % | 40 % | 45 % |
| Alt-A | 2005 | 6.1 % | 6.6 % | 11 % | 13 % | 35 % | 45 % |
| | 2006 | 6.0 % | 6.0 % | 16 % | 16 % | 40 % | 40 % |
| | 2007 | 6.4 % | 7.5 % | 19 % | 23 % | 45 % | 45 % |

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.

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The following table summarizes other than temporary impairments for the three months ended March 31, 2010 and 2009, by asset type:

| | Number of Securities | Total OTTI Losses | Portion of OTTI Losses in Other Comprehensive Income | Net OTTI Losses in Operations |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| Three months ended March 31, 2010 | | | | |
| Residential mortgage backed securities | 4 | $ (12,584 ) | $ 9,361 | $ (3,223 ) |
| Three months ended March 31, 2009 | | | | |
| United States Government full faith and credit | 1 | $ (245 ) | $ — | $ (245 ) |
| Corporate securities: | | | | |
| Finance | 1 | (583 ) | 583 | — |
| Insurance | 1 | (430 ) | (468 ) | (898 ) |
| Home building | 2 | (420 ) | (118 ) | (538 ) |
| Residential mortgage backed securities | 11 | (44,203 ) | 41,956 | (2,247 ) |
| Common and preferred stocks: | | | | |
| Finance | 6 | (8,110 ) | — | (8,110 ) |
| Real estate | 2 | (1,400 ) | — | (1,400 ) |
| | 24 | $ (55,391 ) | $ 41,953 | $ (13,438 ) |

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 March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| Cumulative credit loss at beginning of period | $ (82,930 ) | $ (34,229 ) |
| Credit losses on securities for which OTTI has not previously been recognized | (2,419 ) | (2,492 ) |
| Additional credit losses on securities for which OTTI has previously been recognized | (804 ) | (1,436 ) |
| Accumulated losses on securities that were disposed of during the period | 1,622 | — |
| | $ (84,531 ) | $ (38,157 ) |

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security for securities that are part of our investment portfolio at March 31, 2010 and December 31, 2009:

| | Amortized Cost | OTTI Recognized in Other Comprehensive Income | Change in Fair Value Since OTTI was Recognized | Fair Value |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| March 31, 2010 | | | | |
| Corporate fixed maturity securities | $ 25,327 | $ (9,469) | $ 11,353 | $ 27,211 |
| Residential mortgage backed securities | 873,992 | (214,605) | 27,669 | 687,056 |
| Equity securities: | | | | |
| Finance, insurance and real estate | 29,832 | — | 11,784 | 41,616 |
| | $ 929,151 | $ (224,074) | $ 50,806 | $ 755,883 |
| December 31, 2009 | | | | |
| Corporate fixed maturity securities | $ 25,603 | $ (9,488) | $ 7,763 | $ 23,878 |
| Residential mortgage backed securities | 809,632 | (205,245) | 11,809 | 616,196 |
| Equity securities: | | | | |
| Finance, insurance and real estate | 34,645 | — | 13,045 | 47,690 |
| | $ 869,880 | $ (214,733) | $ 32,617 | $ 687,764 |

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio totaled $2.5 billion at March 31, 2010 and December 31, 2009, respectively, with commitments outstanding of $35.8 million at March 31, 2010. 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:

| | March 31, 2010 | | | December 31, 2009 | | |
|---|---|---|---|---|---|---|
| | Carrying Amount | Percent | | Carrying Amount | Percent | |
| | (Dollars in thousands) | | | | | |
| Geographic distribution | | | | | | |
| East | $ 548,648 | 22.4 | % | $ 555,294 | 22.7 | % |
| Middle Atlantic | 166,768 | 6.8 | % | 168,246 | 6.9 | % |
| Mountain | 392,903 | 15.9 | % | 388,940 | 15.9 | % |
| New England | 44,065 | 1.8 | % | 44,541 | 1.8 | % |
| Pacific | 227,096 | 9.2 | % | 216,382 | 8.8 | % |
| South Atlantic | 471,841 | 19.1 | % | 463,773 | 18.9 | % |
| West North Central | 410,765 | 16.7 | % | 410,883 | 16.8 | % |
| West South Central | 199,889 | 8.1 | % | 201,719 | 8.2 | % |
| | $ 2,461,975 | 100.0 | % | $ 2,449,778 | 100.0 | % |
| Property type distribution | | | | | | |
| Office | $ 669,305 | 27.1 | % | $ 664,397 | 27.1 | % |
| Medical Office | 144,366 | 5.9 | % | 145,390 | 5.9 | % |
| Retail | 566,451 | 23.0 | % | 564,023 | 23.0 | % |
| Industrial/Warehouse | 607,595 | 24.5 | % | 606,317 | 24.8 | % |
| Hotel | 150,256 | 6.3 | % | 155,594 | 6.4 | % |
| Apartment | 127,297 | 5.2 | % | 122,854 | 5.0 | % |
| Mixed use/other | 196,705 | 8.0 | % | 191,203 | 7.8 | % |
| | $ 2,461,975 | 100.0 | % | $ 2,449,778 | 100.0 | % |

We evaluate our mortgage loan portfolio for the purpose of determining the need to establish a loan loss reserve. We accomplish this by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. In addition, we analyze the mortgage loan portfolio for the need of a general loan allowance for probable losses on all other loans. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions. Based upon this process and analysis, we have determined that no general loan loss allowance was necessary. 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. We recorded impairment losses of $4.1 million on two mortgage loans with outstanding principal due totaling $9.5 million during the three months ended March 31, 2010, and no impairment losses for the three months ended March 31, 2009. In addition, during the three months ended March 31, 2010, one mortgage loan was satisfied by taking ownership of the real estate serving as collateral on the loan, which had an outstanding principal amount due of $2.9 million, which is net of a specific loan loss allowance of $0.2 million that was recognized in a prior period.

A summary of impaired commercial mortgage loans as of March 31, 2010 and December 31, 2009 is as follows:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| Impaired mortgage loans with allowances | $ 22,052 | $ 15,869 |
| Impaired mortgage loans with no allowance for losses | 83,396 | 53,740 |
| Allowance for probable loan losses | (9,161 ) | (5,266 ) |
| Net carrying value of impaired mortgage loans | $ 96,287 | $ 64,343 |

Mortgage loans summarized in the preceding table represent all loans that we are either not currently collecting or those we feel it is probable we will not collect all amounts due according to the contractual terms of the loan agreements (all loans that we have worked with the borrower to alleviate short-term cash flow issues and delinquent loans at the reporting date). We have not recognized an allowance on any impaired mortgage loans for which we have modified payment terms and the present value of expected future cash flows (discounted at each loan's original interest rate) is equal to or greater than the present value of the remaining contractual cash flows of the original loan.

5. Derivative Instruments

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations.

The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the unaudited consolidated balance sheets are as follows:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| Assets | | |
| Derivative Instruments | | |
| Call options | $ 497,469 | $ 479,272 |
| | $ 497,469 | $ 479,272 |
| Liabilities | | |
| Policy benefit reserves - annuity products | | |
| Fixed index annuities - embedded derivatives | $ 1,526,117 | $ 1,375,866 |
| Other liabilities | | |
| Interest rate swaps | 2,541 | 1,891 |
| | $ 1,528,658 | $ 1,377,757 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |

| | | |
|---|---|---|
| Change in fair value of derivatives: | | |
| Call options | $ 83,302 | $ (43,273 ) |
| Interest rate swaps | (1,287 ) | (550 ) |
| | $ 82,015 | $ (43,823 ) |
| Change in fair value of embedded derivatives: | | |
| Fixed index annuities | $ 63,875 | $ 14,183 |

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

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

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

| | | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|---|
| Counterparty | Credit Rating | Notional Amount | Fair Value | Notional Amount | Fair Value |
| | | (Dollars in thousands) | | | |
| Bank of America | A+ | $ 796 | $ — | $ 796 | $ — |
| BNP Paribas | AA | 1,550,776 | 101,897 | 1,647,627 | 101,888 |
| Lehman | NR | 805 | — | 1,437 | — |
| Bank of New York | AA- | 96,650 | 4,998 | 112,193 | 6,153 |
| Credit Suisse | A+ | 2,480,405 | 154,044 | 2,711,027 | 163,321 |
| Barclays | AA- | 464,465 | 16,288 | 258,853 | 10,082 |
| SunTrust | BBB+ | 333,258 | 20,828 | 427,572 | 27,735 |
| Wells Fargo | AA | 1,404,838 | 80,545 | 1,189,234 | 70,746 |
| J.P. Morgan | AA- | 2,186,034 | 115,166 | 1,648,394 | 99,347 |
| UBS | A+ | 126,142 | 3,703 | — | — |
| | | $ 8,644,169 | $ 497,469 | $ 7,997,133 | $ 479,272 |

As of March 31, 2010 and December 31, 2009, we held $321.1 million and $346.1 million, respectively, of cash and cash equivalents received from counterparties for derivative collateral, which is included in other liabilities on our

consolidated balance sheets. This derivative collateral limits the maximum amount of loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $182.4 million and $149.5 million at March 31, 2010 and December 31, 2009, respectively.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. Except for three options expiring in the second quarter of 2010 which are unlikely to be in the money at expiration, all options purchased from affiliates of Lehman had expired as of March 31, 2010. The amount of option proceeds due on expired options which had been purchased from Lehman that we did not receive payment on for the three months ended March 31, 2009 was $2.9 million. No amount has been recognized for any recovery of these amounts that may result from our claim in Lehman's bankruptcy proceedings.

We have entered into interest rate swaps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures and amounts outstanding under our revolving line of credit. See notes 9 and 10 in our Annual Report on Form 10-K for the year ended December 31, 2009 for more information on our revolving line of credit and subordinated debentures. The terms of the interest rate swaps provide that we pay a fixed rate of interest and receive a floating rate of interest. We record the interest rate swaps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swaps are as follows:

| Maturity Date | Notional Amount | Receive Rate | Pay Rate | Counterparty | March 31, 2010 Fair Value | December 31, 2009 Fair Value |
|---|---|---|---|---|---|---|
| | | | | | (Dollars in thousands) | |
| September 15, 2010 | 20,000 | *LIBOR (a) | 5.19 | Bank of America | (96) | (142) |
| April 7, 2011 | 20,000 | *LIBOR (a) | 5.23 | Bank of America | (247) | (290) |
| October 15, 2011 | 15,000 | **LIBOR | 1.54 | SunTrust | (218) | (144) |
| October 31, 2011 | 30,000 | **LIBOR | 1.51 | SunTrust | (400) | (241) |
| October 31, 2011 | 30,000 | **LIBOR | 1.61 | SunTrust | (453) | (301) |
| October 31, 2011 | 75,000 | **LIBOR | 1.77 | SunTrust | (1,127) | (773) |
| | $ 190,000 | | | | $ (2,541) | $ (1,891) |

* - three month London Interbank Offered Rate
** - one month London Interbank Offered Rate
(a) - subject to a floor of 4.25%

6. Income Taxes

In 2008, we recorded a valuation allowance of $34.5 million on deferred income tax assets related to capital loss carryforwards and other than temporary impairments on investment securities, as utilization of the income tax benefits from a portion of these items was not more likely than not due to the fact that we had insufficient future taxable income from capital gain sources. The valuation allowance decreased by $3.6 million in the three months ended March 31, 2009 to $30.9 million as of March 31, 2009 primarily due to an increase in anticipated future taxable income from capital gain sources, offset in part by a smaller increase in the amount of other than temporary impairments that give rise to the deferred income tax asset for which a valuation allowance is necessary.

7. Notes Payable

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

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | December 2029 Notes | December 2024 Notes | December 2029 Notes | December 2024 Notes |
| | (Dollars in thousands) | | | |
| Notes payable: | | | | |
| Principal amount of liability component | $ 115,839 | $ 81,152 | $ 115,839 | $ 81,152 |
| Unamortized discount | (25,527) | (3,507) | (26,542) | (3,982) |
| Net carrying amount of liability component | $ 90,312 | $ 77,645 | $ 89,297 | $ 77,170 |
| | | | | |
| Additional paid-in capital: | | | | |

| Carrying amount of equity component | $ 15,586 | $ 22,637 | $ 15,586 | $ 22,637 |
|---|---|---|---|---|

The discount is being amortized over the expected life of the notes, which is December 15, 2011 for the 2024 notes and December 15, 2014 for the 2029 notes. The expected life of the notes are based on the dates at which we may redeem the notes or the holders may require us to repurchase the notes. The effective interest rates are 8.5% and 11.8% on the 2024 notes and the 2029 notes, respectively. The interest cost recognized in operations for the 2024 notes, inclusive of the 5.25% coupon and amortization of the discount and debt issue costs, was $1.6 million and $3.5 million for the three months ended March 31, 2010 and 2009 , respectively. The interest cost recognized in operations for the 2029 notes was $2.6 million for the three months ended March 31, 2010.

We are required to include the dilutive effect of the contingent convertible senior notes in our diluted earnings per share calculation. Because the notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the average fair value of our common stock for a reporting period exceeds the conversion price per share of $14.24 for the 2024 notes and $9.69 for the 2029 notes.

8. Contingencies

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

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in two purported class action lawsuits alleging improper sales practices and similar claims as described below. It is often not possible to determine the ultimate outcome of pending legal proceedings or to provide reasonable ranges of potential losses with any degree of certainty. The lawsuits referred to below are in very preliminary stages and we do not have sufficient information to make an assessment of the plaintiffs' claims for liability or damages. The plaintiffs are seeking undefined amounts of damages or other relief, including punitive damages, which are difficult to quantify and cannot be estimated based on the information currently available. We do not believe that these lawsuits, including those discussed below, will have a material adverse effect on our financial position, results of operations or cash flows. However, there can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

We are a defendant in two cases seeking class action status, including (i) Stephens v. American Equity Investment Life Insurance Company, et. al., in the San Luis Obispo Superior Court, San Francisco, California (complaint filed November 29, 2004) (the "SLO Case") and (ii) McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation, in the United States District Court for the Central District of California, Western Division (complaint filed September 7, 2005) (the "Los Angeles Case").

The plaintiffs in the SLO Case seek to represent a class of individuals who are California residents and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. The named plaintiffs in this case are: Chalys M. Stephens and John P. Stephens. Plaintiffs seek injunctive relief and restitution on behalf of all class members under California Business & Professions Code section 17200 et seq.; compensatory damages for breach of contract and breach of fiduciary duty; other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq.; and punitive damages under common law causes of action for fraud and breach of the covenant of good faith and fair dealing. On November 3, 2008, the court issued an order certifying the class. We are vigorously defending the underlying allegations and may seek to decertify the entire class after further discovery into the merits of the case. Trial in this matter has been set for September 2010.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek recessionary and injunctive relief including restitution and disgorgement of profits on behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. We are

vigorously defending against both class action status as well as the underlying claims.

9. Sale of Our Common Stock

On August 20, 2009, we entered into distribution agreements with Fox-Pitt Kelton Cochran Caronia Waller (USA) LLC (“FPK”) and Sandler O’Neill & Partners, L.P. ("Sandler O'Neill"). On December 3, 2009, Macquarie Capital (USA) Inc. ("Macquarie Capital") assumed all of FPK's rights and obligations under our distribution agreement with FPK. Under the distribution agreements, we can offer and sell shares of our common stock up to an aggregate offering price of $50 million. From January 1, 2010 through March 31, 2010, we did not sell any of our common stock pursuant to these distribution agreements. From August 20, 2009 through September 30, 2009, we sold 132,300 shares of our common stock, resulting in gross proceeds to us of $1.1 million. The offering of shares of our common stock pursuant to the distribution agreements will terminate upon the earlier of (1) the sale of all shares of common stock subject to the distribution agreements and (2) the termination of the distribution agreements by us or by Macquarie Capital or Sandler O'Neill.

10. Earnings Per Share

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands, except per share data) | |
| Numerator: | | |
| Net income - numerator for earnings per common share | $ 14,885 | $ 26,475 |
| Interest on convertible subordinated debentures (net of income tax benefit) | 259 | 259 |
| Numerator for earnings per common share - assuming dilution | $ 15,144 | $ 26,734 |
| | | |
| Denominator: | | |
| Weighted average common shares outstanding (1) | 58,224,964 | 52,964,799 |
| Effect of dilutive securities: | | |
| Convertible subordinated debentures | 2,734,528 | 2,734,528 |
| Stock options and deferred compensation agreements | 178,158 | 377 |
| Denominator for earnings per common share - assuming dilution | 61,137,650 | 55,699,704 |
| | | |
| Earnings per common share | $ 0.26 | $ 0.50 |
| Earnings per common share - assuming dilution | $ 0.25 | $ 0.48 |

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

Options to purchase shares of the Company's common stock that were outstanding during the respective periods indicated but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares are as follows:

| Period | Number of Shares | Range of Exercise Prices |
|---|---|---|
| Three months ended March 31, 2010 | 1,918,789 | $8.75 - $14.34 |
| Three months ended March 31, 2009 | 1,963,888 | $8.67 - $14.34 |

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

Management's discussion and analysis reviews our unaudited consolidated financial position at March 31, 2010, and the unaudited consolidated results of operations for the three month periods ended March 31, 2010 and 2009, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

- general economic conditions and other factors, including prevailing interest rate levels and stock and credit market performance which may affect (among other things) our ability to sell our products, our ability to access capital resources and the costs associated therewith, the fair value of our investments, which could result in other than temporary impairments, and certain liabilities, and the lapse rate and profitability of policies;
- customer response to new products and marketing initiatives;
- changes in Federal income tax laws and regulations which may affect the relative income tax advantages of our products;
- increasing competition in the sale of annuities;
- regulatory changes or actions, including those relating to regulation of financial services affecting (among other things) bank sales and underwriting of insurance products and regulation of the sale, underwriting and pricing of products; and
- the risk factors or uncertainties listed from time to time in our filings with the SEC.

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009.

Overview

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a lesser extent, we also sell life insurance policies. Under U.S. generally accepted accounting principles ("GAAP"), premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liabilities for policyholder account balances and not as expenses. Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender and other charges deducted from policyholder account balances, net realized gains on investments, excluding other than temporary impairment losses, and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest sensitive and index product benefits (primarily interest credited to account balances), changes in fair value of embedded derivatives, amortization of deferred policy acquisition costs and deferred sales inducements, other operating costs and expenses and income taxes.

Annuity deposits by product type collected during the three months ended March 31, 2010 and 2009, were as follows:

| Product Type | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| | (Dollars in thousands) | |
| Fixed index annuities: | | |
| Index strategies | $ 403,124 | $ 244,530 |
| Fixed strategy | 337,782 | 354,746 |
| | 740,906 | 599,276 |
| Fixed rate annuities: | | |
| Single-year rate guaranteed | 52,768 | 10,450 |
| Multi-year rate guaranteed | 53,181 | 43,407 |
| | 105,949 | 53,857 |
| Total before coinsurance ceded | 846,855 | 653,133 |
| Coinsurance ceded (a) | | |