

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO

Form 10-Q

November 09, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission File Number : 001-31911

American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

Iowa

42-1447959

(State or other jurisdiction of incorporation or organization)

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

6000 Westown Parkway

West Des Moines, Iowa 50266

(Address of principal executive offices, including zip code)

(515) 221-0002

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 No

APPLICABLE TO CORPORATE ISSUERS:

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

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

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

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

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

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

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CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands)

(Unaudited)

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

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

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except share data)

(Unaudited)

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

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

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

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(Unaudited)

1. Significant Accounting Policies

Consolidation and Basis of Presentation

The accompanying consolidated financial statements of American Equity Investment Life Holding Company (“we”, “us” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three and nine month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ended December 31, 2015. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Adopted Accounting Pronouncements

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

New Accounting Pronouncements

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

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

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2. Fair Values of Financial Instruments

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

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

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

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

- Level 1— Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.
- Level 2— Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.
- Level 3— Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The

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

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

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

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

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

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

Fixed maturity securities and equity securities

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

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

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

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

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

Mortgage loans on real estate

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

Derivative instruments

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

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

Other investments

None of the financial instruments included in other investments are measured at fair value on a recurring basis. Financial instruments included in other investments are policy loans, equity method investments and company owned life insurance (COLI). We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived. The fair value of our equity method investments qualify as Level 3 fair values and were determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread and a liquidity discount. The risk spread and liquidity discount are rates determined by our investment professionals and are unobservable market inputs. The fair value of our COLI approximates the cash surrender value of the policies and whose fair values fall within Level 2 of the fair value hierarchy.

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Cash and cash equivalents

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

Interest rate swap and caps

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

2015 notes hedges

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

Counterparty collateral

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

Policy benefit reserves, coinsurance deposits and SPIA benefit reserves

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

Notes payable

The fair values of our senior unsecured notes and convertible senior notes are based upon pricing matrices developed by a third party pricing service when quoted market prices are not available and are categorized as Level 2 within the fair value hierarchy. Notes payable are not remeasured at fair value on a recurring basis.

Subordinated debentures

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

2015 notes embedded conversion derivative

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

Fixed index annuities - embedded derivatives

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

anniversary. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

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The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and nine months ended September 30, 2015 and 2014:

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

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

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

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

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

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

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3. Investments

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

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

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

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The amortized cost and fair value of fixed maturity securities at September 30, 2015, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives and are shown below as separate lines.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	\$ 134,699	\$ 138,612	\$—	\$—
Due after one year through five years	1,818,945	1,969,759	—	—
Due after five years through ten years	9,951,489	10,005,018	—	—
Due after ten years through twenty years	8,419,743	8,976,207	—	—
Due after twenty years	7,353,317	7,700,456	76,574	62,000
	27,678,193	28,790,052	76,574	62,000
Residential mortgage backed securities	1,431,656	1,556,308	—	—
Commercial mortgage backed securities	3,881,487	3,941,863	—	—
Other asset backed securities	1,066,994	1,101,619	—	—
	\$ 34,058,330	\$ 35,389,842	\$ 76,574	\$ 62,000

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

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

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade.” Based on the NAIC designations, we had 98% of our fixed maturity portfolio rated investment grade at both September 30, 2015 and December 31, 2014.

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

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

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

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

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

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

Held for investment:

Corporate security:

Insurance	\$—	\$—	\$75,838	\$(594)	\$75,838	\$(594)
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Based on the results of our process for evaluating available for sale securities in unrealized loss positions for other-than-temporary-impairments, which is discussed in detail later in this footnote, we have determined that the unrealized losses on the securities in the preceding table are temporary. The unrealized losses at September 30, 2015 are principally related to timing of the purchases of these securities, which carry less yield than those available at September 30, 2015. In addition, a general widening of credit spreads has occurred in risk asset classes and some financial and industrial sector credit spreads remain wide due to continued economic uncertainty and concerns of prolonged economic weakness.

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At September 30, 2015, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 34 securities with a total amortized cost basis of \$215.4 million and a fair value of \$238.8 million.

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

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

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

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

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Net realized gains (losses) on investments, excluding net OTTI losses for the three and nine months ended September 30, 2015 and 2014, are as follows:

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

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

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

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

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

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

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

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

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

We utilize the models from a leading structured product software specialist serving institutional investors. These models incorporate each security's seniority and cash flow structure. In circumstances where the analysis implies a

potential for principal loss at some point in the future, we use the "best estimate" cash flow projection discounted at the security's effective yield at acquisition to determine the amount of our potential credit loss associated with this security. The discounted expected future cash flows equates to our expected recovery value. Any shortfall of the expected recovery when compared to the amortized cost of the security will be recorded as the credit loss component of other than temporary impairment.

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

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The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the nine months ended September 30, 2015 and 2014, which are all senior level tranches within the structure of the securities:

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

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

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

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

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

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized in (from) Other Comprehensive Income	Net OTTI Losses Recognized in Operations
(Dollars in thousands)				
Three months ended September 30, 2015				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	3	\$—	\$(354)	\$(354)
Other asset backed securities	1	(10,000)	5,125)	(4,875)
	4	\$(10,000)	\$4,771)	\$(5,229)
Three months ended September 30, 2014				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	3	\$—	\$(564)	\$(564)
Nine months ended September 30, 2015				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	7	\$(132)	\$(1,182)	\$(1,314)
Other asset backed securities	1	(10,000)	5,125)	(4,875)
	8	\$(10,132)	\$3,943)	\$(6,189)
Nine months ended September 30, 2014				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	6	\$—	\$(2,063)	\$(2,063)
The cumulative portion of other than temporary impairments determined to be credit losses which have been recognized in operations for debt securities are summarized as follows:				
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
(Dollars in thousands)				
Cumulative credit loss at beginning of period	\$(128,010)	\$(127,459)	\$(127,050)	\$(125,960)
Credit losses on securities for which OTTI has not previously been recognized	(4,876)	—	(5,008)	—
Additional credit losses on securities for which OTTI has previously been recognized	(353)	(564)	(1,181)	(2,063)
Accumulated losses on securities that were disposed of during the period	761	—	761	—
Cumulative credit loss at end of period	\$(132,478)	\$(128,023)	\$(132,478)	\$(128,023)

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The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income (loss), by major type of security, for securities that are part of our investment portfolio at September 30, 2015 and December 31, 2014:

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

4. Mortgage Loans on Real Estate

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Commercial

Mortgage Loans

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

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

	Recorded Investment (Dollars in thousands)	Unpaid Principal Balance	Related Allowance
September 30, 2015			
Mortgage loans with an allowance	\$ 16,626	\$ 27,244	\$(10,618)
Mortgage loans with no related allowance	13,396	13,396	—
	\$ 30,022	\$ 40,640	\$(10,618)
December 31, 2014			
Mortgage loans with an allowance	\$ 16,783	\$ 29,116	\$(12,333)
Mortgage loans with no related allowance	2,656	2,656	—
	\$ 19,439	\$ 31,772	\$(12,333)
		Average Recorded Investment (Dollars in thousands)	Interest Income Recognized
Three months ended September 30, 2015			
Mortgage loans with an allowance		\$ 17,336	\$ 44
Mortgage loans with no related allowance		13,414	176
		\$ 30,750	\$ 220
Three months ended September 30, 2014			
Mortgage loans with an allowance		\$ 22,157	\$ 539
Mortgage loans with no related allowance		2,656	—
		\$ 24,813	\$ 539
Nine months ended September 30, 2015			
Mortgage loans with an allowance		\$ 17,649	\$ 866
Mortgage loans with no related allowance		13,432	595
		\$ 31,081	\$ 1,461
Nine months ended September 30, 2014			
Mortgage loans with an allowance		\$ 23,580	\$ 1,696
Mortgage loans with no related allowance		2,656	—
		\$ 26,236	\$ 1,696

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

- borrower is in default,
- borrower has declared bankruptcy,
- there is growing concern about the borrower's ability to continue as a going concern,
- borrower has insufficient cash flows to service debt,
- borrower's inability to obtain funds from other sources, and
- there is a breach of financial covenants by the borrower.

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

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

Mortgage loan workouts, refinances or restructures that are classified as TDRs are individually evaluated and measured for impairment. A summary of mortgage loans on commercial real estate with outstanding principal at September 30, 2015 and December 31, 2014 that we determined to be TDRs are as follows:

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

5. Derivative Instruments

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Change in fair value of derivatives:				
Call options	\$ (347,038)	\$ 45,931	\$ (396,399)	\$ 391,173
2015 notes hedges	(1,141)	(6,823)	(4,516)	(27,124)
Interest rate swap	(2,349)	254	(3,283)	(2,996)
Interest rate caps	(832)	(144)	(1,286)	(2,459)
	\$ (351,360)	\$ 39,218	\$ (405,484)	\$ 358,594
Change in fair value of embedded derivatives:				
Fixed index annuities—embedded derivatives	\$ (413,583)	\$ (188,383)	\$ (578,596)	\$ 9,704
2015 notes embedded conversion derivative	(1,141)	(6,823)	(4,516)	(31,356)
	\$ (414,724)	\$ (195,206)	\$ (583,112)	\$ (21,652)

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

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

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

Counterparty	Credit Rating (S&P)	Credit Rating (Moody's)	September 30, 2015		December 31, 2014	
			Notional Amount	Fair Value	Notional Amount	Fair Value
			(Dollars in thousands)			
Bank of America	A	A1	\$ 5,415,765	\$ 33,313	\$ 2,114,812	\$ 62,932
Barclays	A-	A2	2,816,999	30,954	4,083,259	135,609
BNP Paribas	A+	A1	1,749,912	15,409	1,321,136	42,644
Citibank, N.A.	A	A1	3,314,018	6,834	3,190,204	96,759

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Credit Suisse	A	A1	1,517,315	8,875	2,354,811	75,381
Deutsche Bank	BBB+	A3	1,733,406	1,537	2,682,960	64,028
HSBC	AA-	Aa3	—	—	38,599	1,767
J.P. Morgan	A+	Aa3	703,532	2,309	401,804	13,488
Morgan Stanley	A-	A3	3,622,471	19,178	2,605,687	77,106
Royal Bank of Canada	AA-	Aa3	2,265,389	22,342	1,364,362	41,717
SunTrust	A-	Baa1	836,304	4,096	248,622	5,405
Wells Fargo	AA-	Aa2	4,043,630	35,802	3,550,188	114,277
			\$28,018,741	\$180,649	\$23,956,444	\$731,113

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As of September 30, 2015 and December 31, 2014, we held \$98.0 million and \$743.0 million, respectively, of cash and cash equivalents and other securities from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of economic loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to \$82.8 million and \$47.4 million at September 30, 2015 and December 31, 2014, respectively. The future annual index credits on our fixed index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. We do not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. We must value both the call options and the related forward embedded options in the policies at fair value. During the nine months ended September 30, 2014, we revised future period assumptions for lapse rates and the expected costs of annual call options used in determining fixed index annuity embedded derivatives. These revisions decreased the change in fair value of embedded derivatives for the nine months ended September 30, 2014 by \$62.6 million, which after related adjustments to deferred sales inducements and deferred policy acquisition costs and income taxes, increased net income and earnings per common share - assuming dilution by \$14.8 million and \$0.19, respectively.

We entered into an interest rate swap and interest rate caps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures. See Note 10 in our Annual Report on Form 10-K for the year ended December 31, 2014 for more information on our subordinated debentures. The terms of the interest rate swap provide that we pay a fixed rate of interest and receive a floating rate of interest. The terms of the interest rate caps limit the three month London Interbank Offered Rate ("LIBOR") to 2.50%. The interest rate swap and caps are not effective hedges under accounting guidance for derivative instruments and hedging activities. Therefore, we record the interest rate swap and caps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swap are as follows:

	Notional		Pay		September 30, 2015	December 31, 2014
Maturity Date	Amount	Receive Rate	Rate	Counterparty	Fair Value	Fair Value
(Dollars in thousands)						
March 15, 2021	\$85,500	LIBOR	2.415 %	SunTrust	\$(4,528)	\$(2,644)

Details regarding the interest rate caps are as follows:

	Notional		Cap		September 30, 2015	December 31, 2014
Maturity Date	Amount	Floating Rate	Rate	Counterparty	Fair Value	Fair Value
(Dollars in thousands)						
July 7, 2021	\$40,000	LIBOR	2.50 %	SunTrust	\$748	\$1,398
July 8, 2021	12,000	LIBOR	2.50 %	SunTrust	225	420
July 29, 2021	27,000	LIBOR	2.50 %	SunTrust	519	960
	\$79,000				\$1,492	\$2,778

The interest rate swap converts floating rates to fixed rates for seven years which began in March 2014. The interest rate caps cap our interest rates for seven years which began in July 2014. As of September 30, 2015, we deposited \$2.8 million of collateral with the counterparty to the swap and caps.

In September 2010, concurrently with the issuance of \$200.0 million principal amount of 3.50% Convertible Senior Notes due September 15, 2015 (the "2015 notes"), we entered into hedge transactions (the "2015 notes hedges") with two counterparties whereby we would receive the cash equivalent of the conversion spread on 16.0 million shares of our common stock based upon a strike price of \$12.50 per share, subject to certain conversion rate adjustments in the 2015 notes. The number of shares and strike price of the 2015 notes hedges are subject to adjustment based on dividends we pay subsequent to their purchase. At December 31, 2014, as a result of partial unwind transactions executed in 2013 and 2014 and cash dividend adjustments, we had 2015 notes hedges outstanding on 1.8 million

shares of our common stock at a strike price of \$12.25 per share. The 2015 notes hedges expired on September 15, 2015, and we received \$25.8 million in cash. The 2015 notes hedges were accounted for as derivative assets and were included in other assets in our consolidated balance sheets. The 2015 notes embedded conversion derivative liability was settled with the extinguishment of the 2015 notes (see Note 6) whereby we paid holders of the notes a total of \$25.8 million in cash to settle the conversion premium. The 2015 notes hedges and 2015 notes embedded conversion derivative were adjusted to fair value each reporting period and unrealized gains and losses are reflected in our consolidated statements of operations.

In separate transactions, we sold warrants (the "2015 warrants") to the 2015 notes hedges counterparties for the purchase of up to 16.0 million shares of our common stock at a price of \$16.00 per share. We received \$15.6 million in cash proceeds from the sale of the 2015 warrants, which was recorded as an increase in additional paid-in capital. The number of shares and strike price of the warrants are subject to adjustment based on dividends we pay subsequent to selling the warrants. The warrants expire on various dates from December 2015 through March 2016 and are intended to be settled in net shares. Changes in the fair value of these warrants will not be recognized in our consolidated financial statements as long as the instruments remain classified as equity. At September 30, 2015 and December 31, 2014, as a result of partial unwind transactions executed in 2013 and 2014 and cash dividend adjustments, we had 2015 warrants outstanding on 1.8 million shares of our common stock at a strike price of \$15.68 per share.

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At September 30, 2015 and 2014, the remaining 2015 warrants were dilutive as the average price of our common stock exceeded the strike price of the 2015 warrants and the effect has been included in diluted earnings per share for the three and nine months ended September 30, 2015 and 2014.

6. Notes Payable

The carrying amount of the 2015 notes and the amount by which the if-converted value exceeds the outstanding principal for the 2015 notes is as follows:

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Principal amount of liability component	\$—	\$22,377
Unamortized discount	—	(698)
Net carrying amount of liability component	\$—	\$21,679

Amount by which the if-converted value exceeds principal	\$—	\$30,497
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The discount was amortized over the expected life of the 2015 notes, which was the maturity date of September 15, 2015. The effective interest rate for the 2015 notes was 8.9%. The interest cost recognized in operations for the convertible notes, inclusive of the coupon and amortization of the discount and debt issue costs, was \$0.4 million and \$1.4 million for the three and nine months ended September 30, 2015, compared to \$1.9 million and \$7.6 million for the same periods in 2014. The 2015 notes were excluded from the dilutive effect in our diluted earnings per share calculation as they were intended to be, and were, settled only in cash.

The 2015 notes matured and were extinguished on September 15, 2015. Total consideration paid to holders of the 2015 notes at maturity was \$48.2 million in cash, which included \$22.4 million principal amount and \$25.8 million conversion premium. See Note 5 for a discussion of the settlement of the 2015 notes embedded derivative liability. During the nine months ended September 30, 2014, we extinguished \$36.2 million principal amount of our 2029 notes and \$46.5 million principal amount of our 2015 notes. Total consideration paid to holders of the 2029 notes consisted of \$66.8 million in cash and \$23.2 million in shares of our common stock (946,793 shares). The carrying value of the 2029 notes at extinguishment was \$34.6 million which resulted in a loss of \$2.5 million on extinguishment of debt, net of income taxes. Total consideration paid to holders of the 2015 notes consisted of \$52.9 million in cash and \$33.1 million in shares of our common stock (1,496,664 shares). The carrying value of the 2015 notes at extinguishment was \$43.8 million which resulted in a loss of \$5.4 million, net of income taxes.

We have a \$140 million unsecured revolving line of credit agreement with five banks that terminates on November 22, 2017. The interest rate is floating at a rate based on our election that will be equal to the alternate base rate (as defined in the credit agreement) plus the applicable margin or the adjusted LIBOR rate (as defined in the credit agreement) plus the applicable margin. We also pay a commitment fee based on the available unused portion of the credit facility. The applicable margin and commitment fee rate are based on our credit rating and can change throughout the period of the credit facility. Based upon our current credit rating, the applicable margin is 0.75% for alternate base rate borrowings and 1.75% for adjusted LIBOR rate borrowings, and the commitment fee is 0.30%. Under this agreement, we are required to maintain a minimum risk-based capital ratio at our subsidiary, American Equity Investment Life Insurance Company ("American Equity Life"), of 275%, a maximum ratio of adjusted debt to total adjusted capital of 0.35, and a minimum level of statutory surplus at American Equity Life equal to the sum of 1) 80% of statutory surplus at September 30, 2013, 2) 50% of the statutory net income for each fiscal quarter ending after September 30, 2013, and 3) 50% of all capital contributed to American Equity Life after September 30, 2013. The agreement contains an accordion feature that allows us, on up to three occasions and subject to credit availability, to increase the credit facility by an additional \$50 million in the aggregate. We also have the ability to extend the maturity date by an additional one year past the initial maturity date of November 22, 2017 with the consent of the extending banks. There are currently no guarantors of the credit facility, but certain of our subsidiaries must guarantee our obligations under the credit agreement if such subsidiaries guarantee other material amounts of our debt. No amounts were outstanding at September 30, 2015 and December 31, 2014. As of September 30, 2015, \$577.5 million is unrestricted and could be distributed to shareholders and still be in compliance with all covenants under this credit

agreement.

As part of our investment strategy, we enter into securities repurchase agreements (short-term collateralized borrowings). The maximum amount borrowed was \$40.6 million and \$138.7 million during the nine months ended September 30, 2015 and 2014, respectively. When we do borrow cash on these repurchase agreements, we pledge collateral in the form of debt securities with fair values approximately equal to the amount due and we use the cash to purchase debt securities ahead of the time we collect the cash from selling annuity policies to avoid a lag between the investment of funds and the obligation to credit interest to policyholders. We earn investment income on the securities purchased with these borrowings at a rate in excess of the cost of these borrowings. Such borrowings averaged \$0.6 million for the nine months ended September 30, 2015 compared to \$0.9 million and \$9.4 million for the three and nine months ended September 30, 2014. We had no borrowings under repurchase agreements during the three months ended September 30, 2015. The weighted average interest rate on amounts due under repurchase agreements was 0.39% for the nine months ended September 30, 2015 compared to 0.35% and 0.15% for the three and nine months ended September 30, 2014.

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7. Commitments and Contingencies

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

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

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 were a defendant in a purported class action, McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation (complaint filed September 7, 2005) (the "Los Angeles Case"), involving allegations of improper sales practices and similar claims.

The Los Angeles Case was a consolidated action involving several lawsuits filed by putative class members seeking class action status for a national class of purchasers of annuities issued by us. On July 30, 2013, the parties entered into a settlement agreement and stipulated to certification of the case as a class action for settlement purposes only. Notice of the terms of the settlement was mailed to the members of the class on October 7, 2013 and settlement claim forms were due from members of the class on or before December 6, 2013. On January 27, 2014, a hearing was held regarding the fairness of the settlement. On January 29, 2014, the District Court signed a final order approving the settlement and finding the settlement is fair and represents a complete resolution of all claims asserted on behalf of the class. On January 30, 2014, a final judgment was entered dismissing the case on the merits and with prejudice. On February 28, 2014, a member of the class filed an appeal of the District Court's approval of the terms of the settlement agreement with the United States Court of Appeals for the Ninth Circuit.

We recorded an estimated litigation liability of \$17.5 million during the third quarter of 2012 related to the Los Angeles Case. We increased our estimated litigation liability for this matter to \$21.2 million during the fourth quarter of 2013 following the passage of the deadline for submission of claims by class members in the lawsuit and based upon information available at that time. However, we decreased the liability by \$2.3 million in the first quarter of 2014 as additional information became available concerning the nature and magnitude of the claims received. In addition, during the first quarter of 2014, we paid \$7.8 million in legal fees to the plaintiffs' counsel. The estimated litigation liability at September 30, 2015 is \$11.1 million. While review of the claim forms has been stayed due to the appeal and it is difficult to predict the amount of the liabilities that will ultimately result from the completion of the claims process, the \$11.1 million litigation liability represents our best estimate of probable loss with respect to this litigation. In light of the inherent uncertainties involved in the matter described above, there can be no assurance that such litigation, or any other pending or future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

In addition to our commitments to fund mortgage loans, we have unfunded commitments at September 30, 2015 to limited partnerships of \$28.5 million and to secured bank loans of \$13.9 million.

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8. Earnings Per Share and Stockholders' Equity

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
(Dollars in thousands, except per share data)				
Numerator:				
Net income - numerator for earnings per common share	\$97,306	\$67,815	\$186,054	\$94,806
Denominator:				
Weighted average common shares outstanding (1)	79,675,955	75,082,852	77,994,602	74,030,290
Effect of dilutive securities:				
Convertible senior notes	—	1,982,089	—	2,485,974
2015 warrants and equity forward sale agreements	714,980	1,230,020	766,795	1,730,077
Stock options and deferred compensation agreements	981,271	1,115,927	1,076,166	1,185,973
Restricted stock and restricted stock units	186,430	56,222	139,747	44,944
Denominator for earnings per common share - assuming dilution	81,558,636	79,467,110	79,977,310	79,477,258
Earnings per common share	\$1.22	\$0.90	\$2.39	\$1.28
Earnings per common share - assuming dilution	\$1.19	\$0.85	\$2.33	\$1.19

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

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

Period	Number of Shares	Range of Exercise Prices	
		Minimum	Maximum
Three months ended September 30, 2015	—	\$—	\$—
Three months ended September 30, 2014	1,275,050	\$24.79	\$24.79
Nine months ended September 30, 2015	—	\$—	\$—
Nine months ended September 30, 2014	1,275,050	\$24.79	\$24.79

Stockholders' Equity

In August 2015, we completed an underwritten public offering of 8,600,000 shares of our common stock at a public offering price of \$25.25 per share, of which 4,300,000 shares are subject to a forward sale agreement described below. The offering of 4,300,000 shares of our common stock (shares not subject to the forward sale agreement) resulted in initial net proceeds of approximately \$104.5 million (after deducting fees and expenses related to the offering). The underwriters exercised in full their option to purchase 1,290,000 additional shares of common stock, which is subject to a separate forward sale agreement. Settlement of the forward sale agreements will occur on one or more dates occurring no later than 12 months after August 12, 2015, the closing date of the offering. We used the net proceeds from the offering for a capital contribution to the capital and surplus of our primary life insurance subsidiary. If we elect to exercise our rights to physically settle the forward sales agreements, we intend to use the net proceeds from the settlement for general corporate purposes, including contributions to the capital and surplus of our life insurance subsidiaries to support their continued growth and maintain desired financial strength ratings.

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

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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 September 30, 2015, and the unaudited consolidated results of operations for the three and nine month periods ended September 30, 2015 and 2014, 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, 2014.

Cautionary Statement Regarding Forward-Looking Information

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

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

customer response to new products and marketing initiatives;

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

increasing competition in the sale of annuities;

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

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

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014 and Item 1A of our Quarterly Report on Form 10-Q for the three months ended March 31, 2015.

Overview

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

Our business model contemplates continued growth in invested assets and operating income while maintaining a high quality investment portfolio that will not experience significant losses from impairments of invested assets. Growth in invested assets is predicated on a continuation of attaining a high level of sales while at the same time maintaining a high level of retention of the funds received. The economic and personal investing environments continue to be conducive for high sales levels as retirees and others look to put their money in instruments that will protect their principal and provide them with consistent cash flow sources in their retirement years. We are committed to maintaining a high quality investment portfolio with limited exposure to below investment grade securities and other

riskier assets.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Average yield on invested assets	4.79%	4.89%	4.77%	4.89%
Aggregate cost of money	1.96%	2.07%	1.96%	2.12%
Aggregate investment spread	2.83%	2.82%	2.81%	2.77%
Impact of:				
Investment yield - additional prepayment income	0.14%	0.07%	0.08%	0.05%
Cost of money benefit of over hedging	0.02%	0.05%	0.05%	0.03%

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The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits (primarily costs to purchase call options) and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014. As reported in previous filings, in response to the persistent low interest rate environment, we have been reducing policyholder crediting rates for new annuities and existing annuities since the fourth quarter of 2011. Spread results for the 2015 and 2014 periods reflect the benefit from these reductions; however, the reductions in cost of money were offset by continued lower yields available on investments. We reduced new money crediting rates in early March of 2015 by approximately 0.20%. In addition, during the first quarter of 2015, we began to initiate additional renewal crediting rate reductions on existing policies. A portion of the 2015 renewal rate reductions occurred in the first three quarters of 2015 and the remaining will occur on policy anniversary dates over the next nine months. Our active management of renewal crediting rates will continue should the low investment yields currently available to us persist. The current interest rate environment with low yields for investments with the credit quality we prefer presents a strong headwind to restoring our investment spread to the 3.00% target rate. With our portfolio yield still under pressure from lower rates on benchmark U.S. Treasury securities and narrower credit spreads, further adjustments to new and renewal crediting rates will be considered. We have on average 0.56% of room to reduce rates before we would reach guaranteed rates on the entire September 30, 2015 in force book of business. Our profitability depends in large part upon the amount of assets under our management, investment spreads we earn on our policyholder account balances, our ability to manage our investment portfolio to maximize returns and minimize risks such as interest rate changes and defaults or impairment of investments, our ability to manage interest rates credited to policyholders and costs of the options purchased to fund the annual index credits on our fixed index annuities, our ability to manage the costs of acquiring new business (principally commissions to agents and bonuses credited to policyholders) and our ability to manage our operating expenses.

Results of Operations for the Three and Nine Months Ended September 30, 2015 and 2014

Annuity deposits by product type collected during the three and nine months ended September 30, 2015 and 2014, were as follows:

Product Type	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Fixed index annuities	\$1,764,179	\$1,041,449	\$4,748,612	\$2,883,106
Annual reset fixed rate annuities	8,425	10,959	32,612	43,359
Multi-year fixed rate annuities	45,032	13,741	132,249	90,391
Single premium immediate annuities	8,921	5,633	27,085	18,059
Total before coinsurance ceded	1,826,557	1,071,782	4,940,558	3,034,915
Coinsurance ceded	98,881	36,308	272,827	118,699
Net after coinsurance ceded	\$1,727,676	\$1,035,474	\$4,667,731	\$2,916,216

Annuity deposits before coinsurance ceded increased 70% during the third quarter of 2015 and 63% during the nine months ended September 30, 2015 compared to the same periods in 2014. We attribute these increases in sales to our attractive product offerings, our consistent presence in the fixed index annuity market, our continued strong relationships with and excellent service provided to our distribution partners, the withdrawal in the first quarter of 2015 of a competitor's guaranteed income product that had been the source of significant competition, the increased

attractiveness of safe money products in volatile markets and lower interest rates on competing products such as bank certificates of deposit.

In August 2015, we completed an underwritten public offering of 9,890,000 shares of our common stock at a public offering price of \$25.25 per share, of which 5,590,000 shares are subject to forward sale agreements. The forward sale agreements provide us with flexibility in managing our capital based upon sales levels. The net proceeds available to us through physical settlement of the forward sale agreements based on the forward sale price would be approximately \$135.8 million. See Note 8 to our unaudited consolidated financial statements in this Form 10-Q for more information on this offering. We believe our existing statutory capital and surplus, the statutory surplus we expect to generate internally through statutory earnings and the capital raised through the public offering will be sufficient to support the level of sales we are currently experiencing.

Net income, in general, has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 15% to \$38.9 billion for the third quarter of 2015 and 14% to \$37.4 billion for the nine months ended September 30, 2015 compared to \$33.8 billion and \$32.9 billion for the same periods in 2014. Our investment spread measured in dollars was \$239.5 million for the third quarter of 2015 and \$688.9 million for the nine months ended September 30, 2015 compared to \$206.8 million and \$587.9 million for the same periods in 2014. As previously mentioned, our investment spread has been negatively impacted by the extended low interest rate environment (see Net investment income).

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Net income is also impacted by the change in fair value of derivatives and embedded derivatives which fluctuates from period to period based upon changes in fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in interest rates used to discount the embedded derivative liability. Net income for the three and nine months ended September 30, 2015 was positively impacted by increases in the discount rates used to estimate the fair value of our embedded derivative liabilities. Net income for the three months ended September 30, 2014 was positively impacted by increases in the discount rates used to estimate our embedded derivative liabilities, while net income for the nine months ended September 30, 2014 was negatively impacted by decreases in the discount rates used to estimate our embedded derivative liabilities. The negative effect on net income for the nine months ended September 30, 2014 due to the decrease in discount rates was offset by revisions of assumptions used in determining fixed index annuity embedded derivatives that were made in the second quarter of 2014. These revisions, which consisted of changes in the lapse and expected costs of annual call options assumptions, decreased the change in fair value of embedded derivatives for the nine months ended September 30, 2014 by \$62.6 million, which after related adjustments to deferred sales inducements and deferred policy acquisition costs and income taxes, increased net income for the nine months ended September 30, 2014 by \$14.8 million. See Change in fair value of embedded derivatives.

We periodically revise the key assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements retrospectively through an unlocking process when estimates of current or future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. The impact of unlocking during the three and nine months ended September 30, 2015 was a \$5.6 million decrease in amortization of deferred sales inducements and a \$11.0 million decrease in amortization of deferred policy acquisition costs and included the impact of account balance true ups as of September 30, 2015 and adjustment to future period assumptions for investment spread and lapses. The unlocking process increased net income for the three and nine months ended September 30, 2015 by \$10.7 million. The impact of unlocking during the three and nine months ended September 30, 2014 was a \$12.6 million decrease in amortization of deferred sales inducements and a \$35.5 million decrease in amortization of deferred policy acquisition costs and included the impact of account balance true ups as of September 30, 2014 and adjustment to future period assumptions for investment spread, lapses and certain expenses. The unlocking process increased net income for the three and nine months ended September 30, 2014 by \$31.0 million.

Net income for the 2015 periods was negatively impacted by a revision of assumptions used in determining reserves held for living income benefit riders. The impact increased interest sensitive and index product benefits for the three and nine months ended September 30, 2015 by \$18.3 million and decreased net income for the three and nine months ended September 30, 2015 by \$11.8 million and included the impact of account balance true ups as of September 30, 2015 and adjustment to future period assumptions for the ages at which people elect to exercise the benefit and lapses. For the three and nine months ended September 30, 2014, the impact from the revision of these assumptions, which were consistent with unlocking for deferred policy acquisition costs and deferred sales inducements, increased interest sensitive and index product benefits by \$12.4 million and decreased net income for the three and nine months ended September 30, 2014 by \$8.0 million.

During the nine months ended September 30, 2015, we extinguished the remaining \$22.4 million principal amount of our convertible notes. No gain or loss was recognized related to this extinguishment. During the nine months ended September 30, 2014, we extinguished \$82.7 million principal amount of two issues of convertible notes. The loss on extinguishment of debt recognized was \$10.6 million (\$7.9 million after income taxes).

Operating income (a non-GAAP financial measure) decreased 28% to \$45.9 million in the third quarter of 2015 and increased 4% to \$145.7 million for the nine months ended September 30, 2015 compared to \$64.0 million and \$139.9 million for the same periods in 2014.

In addition to net income, we have consistently utilized operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains and losses on investments including net OTTI losses recognized in operations, fair value changes in derivatives and embedded derivatives, losses on extinguishment of debt and changes in litigation reserves. Because these items fluctuate from year to year in a manner unrelated to

core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and evaluation of operating income together with net income provides information that may enhance an investor's understanding of our underlying results and profitability.

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

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The adjustments made to net income to arrive at operating income for the three and nine months ended September 30, 2015 and 2014 are set forth in the table that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Reconciliation of net income to operating income:				
Net income	\$97,306	\$67,815	\$186,054	\$94,806
Adjustments to arrive at operating income:				
Net realized (gains) losses and net OTTI losses on investments, net of offsets	1,639	1,551	(1,829)	) 3,476
Change in fair value of derivatives and embedded derivatives - index annuities, net of offsets	(54,535)	) (4,957)	) (40,152)	) 34,636
Change in fair value of derivatives and embedded derivatives - debt, net of income taxes	1,506	(427)	) 1,606	29
Extinguishment of debt, net of income taxes	—	—	—	7,912
Litigation reserve, net of offsets	—	—	—	(916)
Operating income	\$45,916	\$63,982	\$145,679	\$139,943

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

Operating income for the 2015 periods includes benefit from unlocking which decreased amortization of deferred sales inducements by \$0.5 million and amortization of deferred acquisition costs by \$4.3 million and increased operating income by \$3.1 million for the three and nine months ended September 30, 2015. The three and nine months ended September 30, 2014 includes benefit from unlocking which decreased amortization of deferred sales inducements by \$10.7 million and amortization of deferred acquisition costs by \$33.0 million and increased operating income by \$28.2 million.

Operating income for the 2015 periods also includes expense from a revision of assumptions used in determining reserves held for living income benefit riders which increased interest sensitive and index product benefits for the three and nine months ended September 30, 2015 by \$18.3 million and decreased operating income for the three and nine months ended September 30, 2015 by \$11.8 million. For the three and nine months ended September 30, 2014, the impact increased interest sensitive and index product benefits by \$12.4 million and decreased operating income by \$8.0 million.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 19% to \$38.0 million in the third quarter of 2015 and 15% to \$99.1 million for the nine months ended September 30, 2015 compared to \$32.0 million and \$86.5 million for the same periods in 2014. The components of annuity product charges are set forth in the table that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2015	2014	2015	2014	
	(Dollars in thousands)				
Surrender charges	\$13,104	\$11,717	\$36,071	\$37,082	
Lifetime income benefit riders (LIBR) fees	24,871	20,241	62,995	49,395	
	\$37,975	\$31,958	\$99,066	\$86,477	
Withdrawals from annuity policies subject to surrender charges	\$106,939	\$66,476	\$288,135	\$252,993	
Average surrender charge collected on withdrawals subject to surrender charges	12.3	% 17.6	% 12.5	% 14.7	%

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Fund values on policies subject to LIBR fees	\$3,816,764	\$3,301,219	\$10,295,527	\$8,733,843
Weighted average per policy LIBR fee	0.65	% 0.61	% 0.61	% 0.57

The increases in annuity product charges were primarily attributable to increases in fees assessed for lifetime income benefit riders due to a larger volume of business in force subject to the fee. See Interest sensitive and index product benefits below for corresponding expense recognized on lifetime income benefit riders.

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Net investment income increased 13% to \$436.1 million in the third quarter of 2015 and 11% to \$1.3 billion for the nine months ended September 30, 2015 compared to \$386.9 million and \$1.1 billion for the same periods in 2014. These increases were principally attributable to the growth in our annuity business and a corresponding increase in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 15% to \$36.5 billion for the third quarter of 2015 and 14% to \$35.1 billion for the nine months ended September 30, 2015 compared to \$31.7 billion and \$30.8 billion for the same periods in 2014. The average yield earned on average invested assets was 4.79% for the third quarter of 2015 and 4.77% for the nine months ended September 30, 2015 compared to 4.89% for both of the same periods in 2014.

The decreases in yield earned on average invested assets were attributable to yields on investments purchased in the first nine months of 2015 and in 2014 being lower than the overall portfolio yield. Additionally, net investment income and average yield were positively impacted by prepayment and fee income received resulting in additional net investment income of \$13.1 million and \$20.0 million for the three and nine months ended September 30, 2015 and \$5.4 million and \$10.5 million for the same periods in 2014, respectively.

Change in fair value of derivatives consists of call options purchased to fund annual index credits on fixed index annuities, the 2015 notes hedges related to our 2015 notes and an interest rate swap and interest rate caps that hedge our floating rate subordinated debentures. The components of change in fair value of derivatives are as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	2015	2014	2015	2014
	(Dollars in thousands)			
Call options:				
Gain (loss) on option expiration	\$(17,336)	\$223,504	\$193,957	\$550,935
Change in unrealized gains/losses 2015 notes hedges	(329,702)	(177,573)	(590,356)	(159,762)
Interest rate swap	(1,141)	(6,823)	(4,516)	(27,124)
Interest rate caps	(2,349)	254	(3,283)	(2,996)
	(832)	(144)	(1,286)	(2,459)
	\$(351,360)	\$39,218	\$(405,484)	\$358,594

The differences between the change in fair value of derivatives between periods for call options are primarily due to the performance of the indices upon which our call options are based. A substantial portion of our call options are based upon the S&P 500 Index with the remainder based upon other equity and bond market indices. The range of index appreciation (after applicable caps, participation rates and asset fees) for options expiring during the three and nine months ended September 30, 2015 and 2014 is as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
	2015	2014	2015	2014
S&P 500 Index				
Point-to-point strategy	0.0 - 8.0%	1.0 - 11.5%	0.0 - 8.9%	1.0 - 11.5%
Monthly average strategy	0.0 - 7.4%	0.8 - 9.0%	0.0 - 9.0%	0.8 - 11.1%
Monthly point-to-point strategy	0.0 - 6.5%	0.0 - 17.9%	0.0 - 12.1%	0.0 - 19.9%
Fixed income (bond index) strategies	0.0 - 7.0%	0.0 - 8.0%	0.0 - 10.0%	0.0 - 8.0%

The change in fair value of derivatives is also influenced by the aggregate costs of options purchased. The aggregate cost of options has increased primarily due to an increased amount of fixed index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014.

The fair value of the 2015 notes hedges changes based upon changes in the price of our common stock, interest rates, stock price volatility, dividend yield and the time to expiration of the 2015 notes hedges. Similarly, the fair value of the conversion option obligation to the holders of the 2015 notes changes based upon these same factors and the

conversion option obligation is accounted for as an embedded derivative liability with changes in fair value reported in the Change in fair value of embedded derivatives. The amount of the change in fair value of the 2015 notes hedges has historically been equal to the amount of the change in the related embedded derivative liability and there has been an offsetting expense in the change in fair value of embedded derivatives. Due to the partial unwind agreements we entered into in the second quarter of 2014, the decrease in the change in fair value of 2015 notes embedded conversion derivative liability exceeded the decrease in the change in fair value of the 2015 notes hedges by \$4.2 million for the nine months ended September 30, 2014. See Note 5 to our unaudited consolidated financial statements for a discussion of 2015 notes hedges and the 2015 warrants.

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Net realized gains (losses) on investments, excluding OTTI losses include gains and losses on the sale of securities and impairment losses on mortgage loans on real estate which fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments, as well as gains (losses) recognized on real estate owned due to any sales and impairments on long-lived assets. The components of net realized gains (losses) on investments are set forth in the table that follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2014	2014	2014
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	\$283	\$179	\$4,783	\$1,536
Gross realized losses	(97)	(148)	(897)	(910)
	186	31	3,886	626
Other investments:				
Gain on sale of real estate	2,245	455	3,278	1,493
Loss on sale of real estate	—	—	(575)	(231)
Impairment losses on real estate	(570)	(1,436)	(1,199)	(2,235)
	1,675	(981)	1,504	(973)
Mortgage loans on real estate:				
Decrease (increase) in allowance for credit losses	(702)	(2,240)	597	(5,787)
Recovery of specific allowance	—	—	4,375	—
	(702)	(2,240)	4,972	(5,787)
	\$1,159	\$(3,190)	\$10,362	\$(6,134)

Losses on available for sale fixed maturity securities were realized primarily due to strategies to reposition the fixed maturity security portfolio that result in improved net investment income, risk or duration profiles as they pertain to our asset liability management. See Financial Condition - Investments and Note 4 to our unaudited consolidated financial statements for additional discussion of allowance for credit losses recognized on mortgage loans on real estate.

Net OTTI losses recognized in operations increased to \$5.2 million in the third quarter of 2015 and increased to \$6.2 million for the nine months ended September 30, 2015 compared to \$0.6 million and \$2.1 million for the same periods in 2014. See Financial Condition - Investments and Note 3 to our unaudited consolidated financial statements for additional discussion of write downs of securities for other than temporary impairments.

Interest sensitive and index product benefits decreased 50% to \$213.5 million in the third quarter of 2015 and 28% to \$802.4 million for the nine months ended September 30, 2015 compared to \$429.4 million and \$1.1 billion for the same periods in 2014. The components of interest sensitive and index product benefits are summarized as follows:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	2014	2014	2014	2014
	(Dollars in thousands)			
Index credits on index policies	\$101,170	\$323,682	\$515,675	\$831,524
Interest credited (including changes in minimum guaranteed interest for fixed index annuities)	64,680	71,113	194,476	215,213
Lifetime income benefit riders	47,615	34,620	92,280	67,644
	\$213,465	\$429,415	\$802,431	\$1,114,381

The decreases in index credits were attributable to changes in the appreciation of the underlying indices (see discussion above under Change in fair value of derivatives) and the amount of funds allocated by policyholders to the respective index options. Total proceeds received upon expiration of the call options purchased to fund the annual index credits were \$103.8 million and \$529.2 million for the three and nine months ended September 30, 2015, compared to \$327.8 million and \$834.5 million for the same periods in 2014. The decreases in interest credited were

primarily due to decreases in the average rate credited to the annuity liabilities outstanding receiving a fixed rate of interest. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 15% to \$38.9 billion during the third quarter of 2015 and 14% to \$37.4 billion for the nine months ended September 30, 2015 compared \$33.8 billion and \$32.9 billion for the same periods in 2014. The increase in benefits recognized for living income benefit rider was due to an increase in the number of policies with lifetime income benefit riders and correlates to the increase in fees discussed in Annuity product charges. See Net income above for discussion of the impact of revisions of assumptions used in determining reserves held for living income benefit riders and interest sensitive and index product benefits for the three and nine months ended September 31, 2015 and 2014.

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Amortization of deferred sales inducements, in general, has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 87% of our net annuity deposits during both the three and nine months ended September 30, 2015, respectively, compared to 95% and 96% during the same periods in 2014. The increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, amortization associated with net realized gains (losses) on investments and net OTTI losses recognized in operations and, for the nine months ended September 30, 2014, amortization associated with changes in litigation liabilities. Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options), because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected lives of the contracts which typically exceed ten years.

Amortization of deferred sales inducements is summarized as follows:

	Three Months Ended September 30, 2015		2014		Nine Months Ended September 30, 2015		2014	
	(Dollars in thousands)							
Amortization of deferred sales inducements before gross profit adjustments	\$53,163		\$36,774		\$155,014		\$125,476	
Gross profit adjustments:								
Fair value accounting for derivatives and embedded derivatives	13,334		4,456		(3,279	)	(28,003)
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation liabilities	(690	)	(569	)	543		(797)
Amortization of deferred sales inducements after gross profit adjustments	\$65,807		\$40,661		\$152,278		\$96,676	

See Net income above for discussion of the impact of unlocking on amortization of deferred sales inducements for the three and nine months ended September 31, 2015 and 2014. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014.

Change in fair value of embedded derivatives includes changes in the fair value of our fixed index annuity embedded derivatives and changes in the fair value of the embedded derivative related to the conversion option of our 2015 notes (see [Note 5](#) to our unaudited consolidated financial statements and Note 9 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2014). The components of change in fair value of embedded derivatives are as follows:

	Three Months Ended September 30, 2015		2014		Nine Months Ended September 30, 2015		2014	
	(Dollars in thousands)							
Fixed index annuities - embedded derivatives	\$(413,583	)	\$(188,383	)	\$(578,596	)	\$9,704	
2015 notes embedded conversion derivative	(1,141	)	(6,823	)	(4,516	)	(31,356)
	\$(414,724	)	\$(195,206	)	\$(583,112	)	\$(21,652)

The change in fair value of the fixed index annuity embedded derivatives resulted from (i) changes in the expected index credits on the next policy anniversary dates, which are related to the change in fair value of the call options acquired to fund those index credits discussed above in Change in fair value of derivatives; (ii) changes in discount rates used in estimating our embedded derivative liabilities; and (iii) the growth in the host component of the policy

liability. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014. The primary reasons for the decreases in the change in fair value of the fixed index annuity embedded derivatives during the three and nine months ended September 30, 2015 were increases in the discount rates used in estimating the fair value of our liability and decreases in the expected index credits on the next policy anniversary dates resulting from decreases in the fair value of the call options acquired to fund these index credits during the first nine months of 2015 as compared to the first nine months of 2014.

See Note 5 to our unaudited consolidated financial statements in this Form 10-Q, incorporated by reference, and Net income above for discussion of the impact of assumption changes on the fixed index annuity embedded derivatives for the nine month period ended September 30, 2014. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014.

As discussed above under Change in fair value of derivatives, the fair value of the 2015 notes embedded conversion derivative changes based upon the same factors effecting the changes in the 2015 notes hedges. The changes in the fair value of the 2015 notes embedded conversion derivative were offset by a comparable increase or decrease in the change in fair value of the 2015 notes hedges.

Interest expense on notes payable decreased 17% to \$7.3 million in the third quarter of 2015 and 22% to \$22.0 million for the nine months ended September 30, 2015 compared to \$8.7 million and \$28.1 million for the same periods in 2014. The decreases in interest expense are primarily attributable to the extinguishment of \$137.9 million principal amount of our convertible senior notes in 2014.

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Amortization of deferred policy acquisition costs, in general, has been increasing each period due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, amortization associated with net realized gains (losses) on investments and net OTTI losses recognized in operations and, for the nine months ended September 30, 2014, amortization associated with changes in litigation liabilities. As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. Amortization of deferred policy acquisition costs is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Amortization of deferred policy acquisition costs before gross profit adjustments	\$71,715	\$36,322	\$216,608	\$167,677
Gross profit adjustments:				
Fair value accounting for derivatives and embedded derivatives	(2,992	) 4,134	(30,532	) (52,500
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation liabilities	(838	) (785	) 795	(1,228
Amortization of deferred policy acquisition costs after gross profit adjustments	\$67,885	\$39,671	\$186,871	\$113,949

See Net income above for discussion of the impact of unlocking on amortization of deferred sales inducements for the three and nine months ended September 31, 2015 and 2014. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014.

Other operating costs and expenses increased 19% to \$24.5 million in the third quarter of 2015 and increased 16% to \$70.5 million for the nine months ended September 30, 2015 compared to \$20.6 million and \$60.6 million for the same periods in 2014. The three and nine months ended September 30, 2015 reflect increases in salaries and benefits related to an increased number of employees, cost of overtime and increased incentive compensation. In addition, the three and nine months ended September 30, 2015 reflect an increase in expense for reinsurance risk charges due to growth in our policyholder liabilities and an increase in printing and postage expenses due to the increase in sales as compared to the same periods in 2014. For the nine months ended September 30, 2015, these increases were offset by certain non-recurring items related to the recovery of funds from a reinsurer related to a previously paid guaranty fund assessment, the recovery of a state tax refund and the reduction of a liability associated with certain employee benefits which totaled approximately \$1.6 million. The nine months ended September 30, 2014, reflect a decrease in an estimated litigation liability of \$2.3 million (see [Note 7](#) to our unaudited consolidated financial statements).

Income tax expense increased to \$51.4 million in the third quarter of 2015 and increased to \$98.3 million for the nine months ended September 30, 2015 compared to \$36.5 million and \$50.5 million for the same periods in 2014. The change in income tax expense was primarily due to changes in income before income taxes.

Income tax expense and the resulting effective tax rate are based upon two components of income before income taxes ("pretax income") that are taxed at different tax rates. Life insurance income is generally taxed at an effective rate of approximately 35.5% reflecting the absence of state income taxes for substantially all of the states that the life insurance subsidiaries do business in. The income (loss) for the parent company and other non-life insurance subsidiaries is generally taxed at an effective tax rate of 41.5% reflecting the combined federal / state income tax rates. The effective tax rates resulting from the combination of the income tax provisions for the life / non-life sources of income vary from period to period based primarily on the relative size of pretax income from the two sources. The effective tax rate was 34.6% for both the three and nine months ended September 30, 2015, respectively, and 35.0%

and 34.8% for the same periods in 2014, respectively.

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Financial Condition

Investments

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

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

The composition of our investment portfolio is summarized as follows:

	September 30, 2015		December 31, 2014		
	Carrying Amount	Percent	Carrying Amount	Percent	
	(Dollars in thousands)				
Fixed maturity securities:					
United States Government full faith and credit	\$37,681	0.1	% \$138,460	0.4	%
United States Government sponsored agencies	1,314,748	3.4	% 1,393,890	3.9	%
United States municipalities, states and territories	3,760,888	9.8	% 3,723,309	10.4	%
Foreign government obligations	216,987	0.6	% 193,803	0.5	%
Corporate securities	23,536,322	61.3	% 21,566,724	59.9	%
Residential mortgage backed securities	1,556,308	4.0	% 1,751,345	4.9	%
Commercial mortgage backed securities	3,941,863	10.3	% 2,807,620	7.8	%
Other asset backed securities	1,101,619	2.9	% 946,483	2.6	%
Total fixed maturity securities	35,466,416	92.4	% 32,521,634	90.4	%
Equity securities	7,833	—	% 7,805	—	%
Mortgage loans on real estate	2,452,402	6.4	% 2,434,580	6.8	%
Derivative instruments	180,649	0.5	% 731,113	2.0	%
Other investments	284,994	0.7	% 286,726	0.8	%
	\$38,392,294	100.0	% \$35,981,858	100.0	%

Fixed Maturity Securities

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

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

Rating Agency Rating	September 30, 2015		December 31, 2014		
	Carrying Amount	Percent of Fixed Maturity Securities	Carrying Amount	Percent of Fixed Maturity Securities	
	(Dollars in thousands)				
Aaa/Aa/A	\$22,808,058	64.3	% \$20,672,331	63.6	%
Baa	11,300,580	31.9	% 10,516,834	32.3	%
Total investment grade	34,108,638	96.2	% 31,189,165	95.9	%
Ba	704,655	2.0	% 548,681	1.7	%
B	56,943	0.1	% 87,272	0.3	%

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Caa and lower	421,999	1.2	% 497,477	1.5	%
In or near default	174,181	0.5	% 199,039	0.6	%
Total below investment grade	1,357,778	3.8	% 1,332,469	4.1	%
	\$35,466,416	100.0	% \$32,521,634	100.0	%

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

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

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

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

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

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

NAIC Designation	September 30, 2015				December 31, 2014			
	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount
	(Dollars in thousands)				(Dollars in thousands)			
1	\$21,918,272	\$23,171,086	\$23,171,086	65.3 %	\$19,223,151	\$20,941,634	\$20,941,634	64.4 %
2	11,432,147	11,581,162	11,581,162	32.7 %	10,432,593	10,981,618	10,981,618	33.8 %
3	745,289	679,289	693,863	2.0 %	602,191	583,313	583,907	1.8 %
4	31,042	17,256	17,256	— %	22,888	14,089	14,089	— %
5	—	—	—	— %	—	—	—	— %
6	8,154	3,049	3,049	— %	655	386	386	— %
	\$34,134,904	\$35,451,842	\$35,466,416	100.0 %	\$30,281,478	\$32,521,040	\$32,521,634	100.0 %

The amortized cost and fair value of fixed maturity securities at September 30, 2015, by contractual maturity, are presented in Note 3 to our unaudited consolidated financial statements in this form 10-Q, which is incorporated by reference in this Item 2.

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Unrealized Losses

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

	Number of Securities	Amortized Cost (Dollars in thousands)	Unrealized Losses	Fair Value
September 30, 2015				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	2	\$7,542	\$(111)	) \$7,431
United States Government sponsored agencies	8	597,247	(7,702)	) 589,545
United States municipalities, states and territories	59	229,069	(8,221)	) 220,848
Foreign government obligations	6	69,374	(10,153)	) 59,221
Corporate securities:				
Finance, insurance and real estate	112	1,655,481	(52,252)	) 1,603,229
Manufacturing, construction and mining	251	3,288,207	(232,857)	) 3,055,350
Utilities and related sectors	164	1,833,845	(84,874)	) 1,748,971
Wholesale/retail trade	31	396,894	(19,648)	) 377,246
Services, media and other	68	751,519	(25,387)	) 726,132
Residential mortgage backed securities	20	60,133	(1,833)	) 58,300
Commercial mortgage backed securities	113	1,318,321	(30,160)	) 1,288,161
Other asset backed securities	20	226,030	(10,670)	) 215,360
	854	\$10,433,662	\$(483,868)	) \$9,949,794
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	\$76,574	\$(14,574)	) \$62,000
December 31, 2014				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	1	\$513	\$(15)	) \$498
United States Government sponsored agencies	7	624,272	(13,933)	) 610,339
United States municipalities, states and territories	17	28,658	(711)	) 27,947
Foreign government obligations	3	29,689	(3,953)	) 25,736
Corporate securities:				
Finance, insurance and real estate	40	672,176	(18,863)	) 653,313
Manufacturing, construction and mining	138	1,843,254	(71,077)	) 1,772,177
Utilities and related sectors	77	736,603	(18,338)	) 718,265
Wholesale/retail trade	17	193,605	(5,412)	) 188,193
Services, media and other	39	418,942	(9,706)	) 409,236
Residential mortgage backed securities	12	44,747	(2,205)	) 42,542
Commercial mortgage backed securities	33	432,201	(3,323)	) 428,878
Other asset backed securities	17	208,937	(7,885)	) 201,052
	401	\$5,233,597	\$(155,421)	) \$5,078,176
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	\$76,432	\$(594)	) \$75,838

Unrealized losses increased \$342.4 million from \$156.0 million at December 31, 2014 to \$498.4 million at September 30, 2015. The increase in unrealized losses was primarily due to a general widening in credit spreads in select industries and credits during the nine months ended September 30, 2015. The 10-year treasury yield curve rates at September 30, 2015 and December 31, 2014 were 2.03% and 2.17%, respectively.

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

NAIC Designation	Carrying Value of Securities with Gross Unrealized Losses (Dollars in thousands)	Percent of Total	Gross Unrealized Losses	Percent of Total	
September 30, 2015					
1	\$5,006,728	49.9	% \$(128,511	) 25.8	%
2	4,475,823	44.7	% (281,640	) 56.5	%
3	523,532	5.2	% (69,382	) 13.9	%
4	17,256	0.2	% (13,784	) 2.8	%
5	—	—	% —	—	%
6	3,029	—	% (5,125	) 1.0	%
	\$10,026,368	100.0	% \$(498,442	) 100.0	%
December 31, 2014					
1	\$2,366,939	45.9	% \$(44,380	) 28.5	%
2	2,381,413	46.2	% (77,681	) 49.8	%
3	391,792	7.6	% (24,876	) 15.9	%
4	14,089	0.3	% (8,799	) 5.6	%
5	—	—	% —	—	%
6	375	—	% (279	) 0.2	%
	\$5,154,608	100.0	% \$(156,015	) 100.0	%

Our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 855 and 402 securities, respectively) have been in a continuous unrealized loss position at September 30, 2015 and December 31, 2014, along with a description of the factors causing the unrealized losses is presented in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in the Item 2.

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2015				
Fixed maturity securities:				
Investment grade:				
Less than six months	617	\$7,621,554	\$7,386,385	\$(235,169)
Six months or more and less than twelve months	97	1,757,803	1,656,232	(101,571)
Twelve months or greater	40	484,057	417,759	(66,298)
Total investment grade	754	9,863,414	9,460,376	(403,038)
Below investment grade:				
Less than six months	69	321,367	297,616	(23,751)
Six months or more and less than twelve months	11	91,295	79,011	(12,284)
Twelve months or greater	21	234,160	174,791	(59,369)
Total below investment grade	101	646,822	551,418	(95,404)
	855	\$10,510,236	\$10,011,794	\$(498,442)
December 31, 2014				
Fixed maturity securities:				
Investment grade:				
Less than six months	154	\$2,114,497	\$2,065,474	\$(49,023)
Six months or more and less than twelve months	6	85,951	82,264	(3,687)
Twelve months or greater	155	2,664,255	2,595,916	(68,339)
Total investment grade	315	4,864,703	4,743,654	(121,049)
Below investment grade:				
Less than six months	55	153,861	151,532	(2,329)
Six months or more and less than twelve months	12	48,846	46,956	(1,890)
Twelve months or greater	20	242,619	211,872	(30,747)
Total below investment grade	87	445,326	410,360	(34,966)
	402	\$5,310,029	\$5,154,014	\$(156,015)

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2015				
Investment grade:				
Less than six months	22	\$211,075	\$147,683	\$(63,392)
Six months or more and less than twelve months	1	3,218	2,253	(965)
Twelve months or greater	—	—	—	—
Total investment grade	23	214,293	149,936	(64,357)
Below investment grade:				
Less than six months	9	104,204	72,539	(31,665)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	1	12,281	3,750	(8,531)
Total below investment grade	10	116,485	76,289	(40,196)
	33	\$330,778	\$226,225	\$(104,553)
December 31, 2014				
Investment grade:				
Less than six months	—	\$—	\$—	\$—
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	—	—	—	—
Total investment grade	—	—	—	—
Below investment grade:				
Less than six months	—	—	—	—
Six months or more and less than twelve months	3	43,881	28,651	(15,230)
Twelve months or greater	1	655	375	(280)
Total below investment grade	4	44,536	29,026	(15,510)
	4	\$44,536	\$29,026	\$(15,510)

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

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(Dollars in thousands)				
September 30, 2015				
Due in one year or less	\$20,667	\$20,256	\$—	\$—
Due after one year through five years	154,607	149,899	—	—
Due after five years through ten years	4,449,940	4,281,618	—	—
Due after ten years through twenty years	1,896,624	1,828,692	—	—
Due after twenty years	2,307,340	2,107,508	76,574	62,000
	8,829,178	8,387,973	76,574	62,000
Residential mortgage backed securities	60,133	58,300	—	—
Commercial mortgage backed securities	1,318,321	1,288,161	—	—
Other asset backed securities	226,030	215,360	—	—
	\$10,433,662	\$9,949,794	\$76,574	\$62,000
December 31, 2014				
Due in one year or less	\$—	\$—	\$—	\$—
Due after one year through five years	74,447	73,594	—	—
Due after five years through ten years	2,753,526	2,692,393	—	—
Due after ten years through twenty years	1,091,955	1,061,437	—	—
Due after twenty years	627,784	578,280	76,432	75,838
	4,547,712	4,405,704	76,432	75,838
Residential mortgage backed securities	44,747	42,542	—	—
Commercial mortgage backed securities	432,201	428,878	—	—
Other asset backed securities	208,937	201,052	—	—
	\$5,233,597	\$5,078,176	\$76,432	\$75,838

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International Exposure

We hold fixed maturity securities with international exposure. As of September 30, 2015, 16% of the carrying value of our fixed maturity securities was comprised of corporate debt securities of issuers based outside of the United States and debt securities of foreign governments. All of these securities are denominated in U.S. dollars and all are investment grade (NAIC designation of either 1 or 2), except for 20 securities with a total fair value of \$117.9 million which have a NAIC 3 designation and one security with a fair value of \$3.0 million which has an NAIC 6 designation. Our investment professionals analyze each holding for credit risk by economic and other factors of each country and industry. The following table presents our international exposure in our fixed maturity portfolio by country or region:

September 30, 2015

	Amortized Cost	Carrying Amount/Fair Value	Percent of Total Carrying Amount
	(Dollars in thousands)		
GIIPS (1)	\$231,761	\$249,974	0.7%
Asia/Pacific	364,013	374,208	1.1%
Non-GIIPS Europe	2,471,399	2,544,977	7.2%
Latin America	240,278	208,981	0.6%
Non-U.S. North America	1,176,395	1,147,498	3.2%
Australia & New Zealand	531,928	541,671	1.5%
Other	378,356	413,988	1.2%
	\$5,394,130	\$5,481,297	15.5%

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

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Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment, we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 25% or greater change in market price relative to its amortized cost and a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our RMBS as we monitor all of our RMBS on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At September 30, 2015, the amortized cost and fair value of securities on the watch list are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
(Dollars in thousands)						
Investment grade						
Corporate fixed maturity securities:						
Finance	1	\$20,000	\$(3,618)	\$16,382	49	—
Industrial	2	24,656	(9,256)	15,400	13 - 29	1 - 4
	3	44,656	(12,874)	31,782		
Other asset backed securities	1	3,218	(965)	2,253	54	5
	4	47,874	(13,839)	34,035		
Below investment grade						
Corporate fixed maturity securities:						
Industrial	6	39,291	(21,179)	18,112	13 - 31	4 - 13
Telecommunications	1	6,000	(3,090)	2,910	15	3
	7	45,291	(24,269)	21,022		
Other asset backed securities	1	8,154	(5,125)	3,029	28	9
	8	53,445	(29,394)	24,051		
	12	\$101,319	\$(43,233)	\$58,086		

One of the securities on the watch list have Eurozone exposure that has contributed to their depressed fair values. Our analysis of all of the securities on the watch list that we have determined are temporarily impaired and their credit performance at September 30, 2015 is as follows:

Finance: The decline in value of this security is due to the continued wide spreads as a result of the ongoing concerns relating to capital, asset quality and earnings stability due to the financial events of the past four years and the ongoing events in the Eurozone. While this issuer has had its financial position and profitability weakened by the credit and liquidity crisis, we have determined that this security was not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of the issuer.

Industrial: The decline in the value of these securities relates to ongoing operational issues related to the decline in certain commodity prices specific to their business. The decline in these commodity prices creates financial challenges as the industry realigns to accommodate the lower prices. These issuers will be stressed greater than the average company due to their price sensitivity and the specific position they hold in the chain of supply. While these issuers

have seen the financial and profitability profile weakened, we have determined that the securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of the issuer.

Other asset backed securities: The decline in value of the investment grade other asset backed security is due to poor performance in the underlying pool of student loans. The investment is backed by a guarantee from the for-profit education services provider. We have determined that this security was not other than temporarily impaired, because the guarantee is in good standing and all required payments have been made, including hyper-amortization payments triggered by the performance of the student loan portfolio. The decline in value of the below investment grade other asset backed security is related directly to the decline in oil prices and the financial stability of its operator. The issuer has direct exposure to the oil market as its primary business is deep water drilling. As oil prices have declined the operator of the deep water vessel has experienced financial pressure on its balance sheet. While the issuer has filed for what is equivalent to Chapter 11 bankruptcy, our asset has not been included in the bankruptcy, and is 100% secured by the deep water drilling asset providing a level of safety in principal recovery.

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Telecommunications: The decline in the value of this security is the result of regional economic recessionary pressure and an increase in competition in the markets it operates. There is potential for merger and acquisition activity in this market and an increase in price volatility is expected. While this issuer has seen weakened performance and heightened risk of merger activity, we have determined that this security was not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of the issuer.

We do not intend to sell these securities and it is more likely than not we will not have to sell these securities before recovery of their amortized cost and, as such, there were no other than temporary impairments on these securities at September 30, 2015 other than the other than temporary impairment recognized on the below investment grade other asset backed security noted above.

Other Than Temporary Impairments

We have a policy and process to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014. During the periods presented, we recognized other than temporary impairment and additional credit losses on residential mortgage backed securities and on one other asset backed security for which we had not previously recognized OTTI. Several factors led us to believe that full recovery of amortized cost will not be expected on the securities for which we recognized credit losses and reclassified OTTI from accumulated other comprehensive income to net income. A discussion of these factors, our policy and process to identify securities that could potentially have impairment that is other than temporary and a summary of OTTI is presented in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, adjusted for amortization of premiums and accrual of discounts net of valuation allowances. At September 30, 2015 and December 31, 2014 the largest principal amount outstanding for any single mortgage loan was \$18.0 million and \$15.8 million, respectively, and the average loan size was \$2.8 million and \$2.7 million at September 30, 2015 and December 31, 2014, respectively. We have the contractual ability to pursue full personal recourse on 6.2% of the loans and partial personal recourse on 18.1% of the loans. In addition, the average loan to value ratio for the overall portfolio was 53.8% and 53.7% at September 30, 2015 and December 31, 2014, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value is indicative of our conservative underwriting policies and practices for making commercial mortgage loans and may not be indicative of collateral values at the reporting date. Our current practice is to only obtain market value appraisals of the underlying collateral at the inception of the loan unless we identify indicators of impairment in our ongoing analysis of the portfolio, in which case, we either calculate a value of the collateral using a capitalization method or obtain a third party appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type in Note 4 to our unaudited consolidated financial statements, incorporated by reference in this Item 2.

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At September 30, 2015, we had commitments to fund commercial mortgage loans totaling \$64.3 million, with fixed interest rates ranging from 4.05% to 4.60%. During 2015 and 2014, due to historically low interest rates, the commercial mortgage loan industry has been very competitive. This competition has resulted in a number of borrowers refinancing with other lenders. For the nine months ended September 30, 2015, we received \$282.9 million in cash for loans being paid in full compared to \$244.5 million for the nine months ended September 30, 2014. Some of the loans being paid off have either reached their maturity or are nearing maturity; however, some borrowers are paying the prepayment fee and refinancing at a lower rate.

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

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

	September 30, 2015		December 31, 2014		
	Principal Outstanding	Percent of Total Principal Outstanding	Principal Outstanding	Percent of Total Principal Outstanding	
	(Dollars in thousands)				
Debt Service Coverage Ratio:					
Greater than or equal to 1.5	\$1,712,952	69.3	% \$1,599,817	65.1	%
Greater than or equal to 1.2 and less than 1.5	510,716	20.7	% 537,828	21.9	%
Greater than or equal to 1.0 and less than 1.2	130,266	5.3	% 155,004	6.3	%
Less than 1.0	116,522	4.7	% 165,072	6.7	%
	\$2,470,456	100.0	% \$2,457,721	100.0	%

Approximately 84% (based on principal outstanding) of our mortgage loans that have a debt service coverage ratio of less than 1.0 are performing and current with contractual principal and interest payments at September 30, 2015.

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

	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
Impaired mortgage loans with an allowance	\$27,244	\$29,116
Impaired mortgage loans with no related allowance	13,396	2,656
Allowance for probable loan losses	(10,618	) (12,333
Net carrying value of impaired mortgage loans	\$30,022	\$19,439

At September 30, 2015, we had no commercial mortgage loans that were delinquent (60 days or more past due at the reporting date) in their principal and interest payments.

Derivative Instruments

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

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. A presentation of our derivative instruments along with a discussion of the business strategy involved with our derivatives is included in Note 5 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Liquidity and Capital Resources

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were \$3.3 billion for the nine months ended September 30, 2015 compared to \$1.6 billion for the nine months ended September 30, 2014, with the increase primarily attributable to a \$1.7 billion increase in net annuity deposits after coinsurance which was partially offset by a \$93.9 million (after coinsurance) increase in funds returned to policyholders. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed maturity securities and fixed rate commercial mortgage loans.

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

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

Currently, American Equity Life may pay dividends or make other distributions without the prior approval of the Iowa Insurance Commissioner, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory capital and surplus at the preceding December 31. For 2015, up to \$343.3

million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Commissioner. In addition, dividends and surplus note payments may be made only out of statutory earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities in the life subsidiary's state of domicile. American Equity Life had \$1.3 billion of statutory earned surplus at September 30, 2015.

The maximum distribution permitted by law or contract is not necessarily indicative of an insurer's actual ability to pay such distributions, which may be constrained by business and regulatory considerations, such as the impact of such distributions on surplus, which could affect the insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends or make other distributions. Further, state insurance laws and regulations require that the statutory surplus of our life subsidiaries following any dividend or distribution must be reasonable in relation to their outstanding liabilities and adequate for their financial needs. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from rating agencies. Both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries.

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In August 2015, we completed an underwritten public offering of 9,890,000 shares of our common stock at a public offering price of \$25.25 per share, of which 5,590,000 shares are subject to forward sale agreements. During the third quarter of 2015, we contributed \$120 million to the capital and surplus of American Equity Life which included \$104.5 million of initial net proceeds from the issuance of 4.3 million shares of common stock in our August 2015 public stock offering. If we elect to exercise our rights to physically settle the forward sales agreements, we intend to use the net proceeds from the settlement of approximately \$135.8 million, based on the current forward price, for general corporate purposes, including contributions to the capital and surplus of our life insurance subsidiaries to support their continued growth and maintain desired financial strength ratings.

On August 5, 2015, Standard & Poor's raised its counterparty credit rating on American Equity Investment Life Holding Company to BBB- from BB+ and its financial strength rating on American Equity Life to A- from BBB+. On August 7, 2015, Fitch Ratings upgraded the issuer default rating of American Equity Investment Life Holding Company to BBB- from BB+.

The transfer of funds by American Equity Life is also restricted by a covenant in our line of credit agreement which requires American Equity Life to maintain a minimum risk-based capital ratio of 275% and a minimum level of statutory surplus equal to the sum of 1) 80% of statutory surplus at September 30, 2013, 2) 50% of the statutory net income for each fiscal quarter ending after September 30, 2013, and 3) 50% of all capital contributed to American Equity Life after September 30, 2013. American Equity Life's risk-based capital ratio was 372% at December 31, 2014. Under this agreement, we are also required to maintain a maximum ratio of adjusted debt to total adjusted capital of 0.35.

Cash and cash equivalents of the parent holding company at September 30, 2015, were \$36.7 million. In addition, we have a \$140 million revolving line of credit, with no borrowings outstanding, available through November 2017 for general corporate purposes of the parent company and its subsidiaries. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution under a currently effective shelf registration statement on Form S-3. The terms of any offering would be established at the time of the offering, subject to market conditions.

New Accounting Pronouncements

See Note 1 to our unaudited consolidated financial statements, which is incorporated by reference in this Item 2, for new accounting pronouncement disclosures that supplement the disclosures in Note 1 to our audited consolidated financial statements in our 2014 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to invest our available funds in a manner that will maximize shareholder value and fund future obligations to policyholders and debtors, subject to appropriate risk considerations. We seek to meet this objective through investments that: (i) consist substantially of investment grade fixed maturity securities; (ii) have projected returns which satisfy our spread targets; and (iii) have characteristics which support the underlying liabilities. Many of our products incorporate surrender charges, market interest rate adjustments or other features to encourage persistency. We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs; and (vi) other factors. An OTTI shall be considered to have occurred when we have an intention to sell available for sale securities in an unrealized loss position. If we do not intend to sell a debt security, we consider all available evidence to make an assessment of whether it is more likely than not that we will be required to sell the security before the recovery of its amortized cost basis. If it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, an OTTI will be considered to have occurred.

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate subordinated debentures. Our floating rate trust preferred securities bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was \$164.5 million at September 30, 2015, of which \$85.5 million has been swapped to a fixed rate which began in March 2014

and \$79.0 million has been capped for a term of seven years which began in July 2014 (see [Note 5](#) to our unaudited consolidated financial statements). The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (caps, participation rates or asset fee rates for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions. A major component of our interest rate risk management program is structuring the investment portfolio with cash flow characteristics consistent with the cash flow characteristics of our insurance liabilities. We use models to simulate cash flows expected from our existing business under various interest rate scenarios. These simulations enable us to measure the potential gain or loss in fair value of our interest rate-sensitive financial instruments, to evaluate the adequacy of expected cash flows from our assets to meet the expected cash requirements of our liabilities and to determine if it is necessary to lengthen or shorten the average life and duration of our investment portfolio. The "duration" of a security is the time weighted present value of the security's expected cash flows and is used to measure a security's sensitivity to changes in interest rates. When the durations of assets and liabilities are similar, exposure to interest rate risk is minimized because a change in value of assets should be largely offset by a change in the value of liabilities.

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If interest rates were to increase 10% (29 basis points) from levels at September 30, 2015, we estimate that the fair value of our fixed maturity securities would decrease by approximately \$859.9 million. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be a decrease of \$283.4 million in accumulated other comprehensive income and a decrease in stockholders' equity. The computer models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2014.

At September 30, 2015, 33% of our fixed income securities have call features, of which 2% (\$0.7 billion) were subject to call redemption. Another 0.4% (\$0.1 billion) will become subject to call redemption during the next twelve months. We have reinvestment risk related to these potential redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to the redeemed bonds. Such reinvestment risk typically occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on annuity liabilities, we have the ability to reduce crediting rates (caps, participation rates or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At September 30, 2015, approximately 99% of our annuity liabilities were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies.

We purchase call options on the applicable indices to fund the annual index credits on our fixed index annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for fixed index products. For the nine months ended September 30, 2015 and 2014, the annual index credits to policyholders on their anniversaries were \$515.7 million and \$831.5 million, respectively. Proceeds received at expiration of these options related to such credits were \$529.2 million and \$834.5 million for the nine months ended September 30, 2015 and 2014, respectively.

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15 and 15d-15, our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective as of September 30, 2015 in recording, processing,

summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7 - Commitments and Contingencies to the unaudited consolidated financial statements, which is incorporated by reference in this Item 1, for litigation and regulatory disclosures that supplements the disclosure in Note 13 - Commitments and Contingencies to the audited consolidated financial statements of our 2014 Annual Report on Form 10-K.

Item 1A. Risk Factors

Our 2014 Annual Report on Form 10-K described our Risk Factors. In light of recent activity by the U.S. Department of Labor, we modified the Risk Factor titled Changes in state and federal regulation may affect our profitability in our Form 10-Q for the quarterly period ended March 31, 2015. There have been no other material changes to the Risk Factors during the nine months ended September 30, 2015.

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

There were no issuer purchases of equity securities for the quarter ended September 30, 2015.

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Item 6. Exhibits

Exhibit No.	Description	Method of Filing
12.1	Ratio of Earnings to Fixed Charges	Filed herewith
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.INS	XBRL Instance Document	*
101.SCH	XBRL Taxonomy Extension Schema Document	*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	*
*	Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities and Exchange Act of 1934, as amended and otherwise are not subject to liability under those sections.	

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9,
2015

AMERICAN EQUITY INVESTMENT LIFE
HOLDING COMPANY

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

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

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