AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-K
March 16, 2009

Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2008**

**or**

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

**For the transition period from _______________ to _______________**

**Commission File Number: 001-31911**

# American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Iowa** | **42-1447959** |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

**5000 Westown Parkway, Suite 440**
**West Des Moines, Iowa**
(Address of principal executive offices) **50266**
(Zip Code)

**5000 Westown Parkway, Suite 440**
**West Des Moines, Iowa**
(Address of principal executive offices) **50266**
(Zip Code)

Registrant's telephone number, including area code: **(515) 221-0002**

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

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|

| | |
|---|---|
| Common stock, par value $1 | New York Stock Exchange |

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No ý

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this From 10-K. o

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

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer ý | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was $396,193,326 based on the closing price of $8.15 per share, the closing price of the common stock on the New York Stock Exchange on June 30, 2008.

Shares of common stock outstanding as of February 27, 2009: 53,157,759

Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the annual meeting of shareholders to be held June 4, 2009, which will be filed within 120 days after December 31, 2008 are incorporated by reference into Part III of this report.

Table of Contents

**AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY**
**FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2008**
**TABLE OF CONTENTS**

# PART I

## Item 1. Business

### Introduction

We are a leader in the development and sale of index and fixed rate annuity products. We were incorporated in the state of Iowa on December 15, 1995. We are a full service underwriter of fixed annuity and life insurance products through our wholly-owned life insurance subsidiaries, American Equity Investment Life Insurance Company ("American Equity Life") and American Equity Investment Life Insurance Company of New York. We formed a new wholly-owned life insurance company, Eagle Life Insurance Company ("Eagle Life"), on September 17, 2008. Eagle Life has not issued any insurance business. Our business consists primarily of the sale of index and fixed rate annuities and, accordingly, we have only one business segment. Our business strategy is to focus on our annuity business and earn predictable returns by managing investment spreads and investment risk. We are currently licensed to sell our products in 50 states and the District of Columbia. Throughout this report, unless otherwise specified or the context otherwise requires, all references to "American Equity", the "Company", "we", "our" and similar references are to American Equity Investment Life Holding Company and its consolidated subsidiaries.

Investor related information, including periodic reports filed on Forms 10-K, 10-Q and 8-K and all amendments to such reports may be found on our internet website at *www.american-equity.com* as soon as reasonably practicable after such reports are filed with the Securities and Exchange Commission ("SEC"). In addition, we have available on our website our: (i) code of business conduct and ethics; (ii) audit committee charter; (iii) compensation committee charter; (iv) nominating/corporate governance committee charter and (v) corporate governance guidelines. The information incorporated herein by reference is also electronically accessible from the SEC's website at *www.sec.gov*.

### Annuity Market Overview

Our target market includes the group of individuals ages 45-75 who are seeking to accumulate tax-deferred savings. We believe that significant growth opportunities exist for annuity products because of favorable demographic and economic trends. According to the U.S. Census Bureau, there were 35 million Americans age 65 and older in 2000, representing 12% of the U.S. population. By 2030, this sector of the population is expected to increase to 20% of the total population. Our index and fixed rate annuity products are particularly attractive to this group as a result of the guarantee of principal with respect to those products, competitive rates of credited interest, tax-deferred growth and alternative payout options.

According to Advantage Group Associates, Inc., total industry sales of index annuities increased 6% to $26.8 billion in 2008 from $25.2 billion in 2007. Our wide range of index and fixed rate annuity products has enabled us to enjoy favorable growth during volatile equity and bond markets.

### Strategy

Our business strategy is to grow our annuity business and earn predictable returns by managing investment spreads and investment risk. Key elements of this strategy include the following:

***Enhance our Current Independent Agency Network.*** We believe that our successful relationships with approximately 65 national marketing organizations represent a significant competitive advantage. Our objective is to improve the productivity and efficiency of our core distribution channel by focusing our marketing and recruiting efforts on those independent agents capable of selling $1 million or more of annuity premium annually. This level of production qualifies them for our Gold Eagle program which was introduced at the beginning of 2007. Gold Eagle qualifiers receive a combination of cash and equity-based incentives as motivation for producing business for us. The equity-based incentive compensation component of our Gold Eagle program is unique in our industry and distinguishes us from our competitors. Our continuing focus on relationships and efficiency will ultimately reduce our independent agents to a core group of professional annuity producers. We will also be alert to opportunities to establish relationships with national marketing organizations and agents not presently associated with us and will continue to provide all of our marketers with the highest quality service possible.

***Continue to Introduce Innovative and Competitive Products.*** We intend to be at the forefront of the index and fixed rate annuity industry in developing and introducing innovative and new competitive products. We were one of the first companies to offer an index annuity offering a choice among interest crediting strategies which includes both equity and bond indices as well as a traditional fixed rate strategy. Most recently we were one of the first companies to include a lifetime income benefit rider with our index annuities. We believe that our continued focus on anticipating and being responsive to the product needs of our independent agents and policyholders will lead to increased customer loyalty, revenues and profitability.

***Use our Expertise to Achieve Targeted Spreads on Annuity Products.*** We have had a successful track record in achieving the targeted spreads on our annuity products. We intend to leverage our experience and expertise in managing the investment spread during a range of interest rate environments to achieve our targeted spreads.

***Maintain our Profitability Focus and Improve Operating Efficiency.*** We are committed to improving our profitability by advancing the scope and sophistication of our investment management and spread capabilities and continuously seeking out operating efficiencies within our Company. We have made substantial investments in technology improvements to our business, including the development of a password-secure website which allows our independent agents to receive proprietary sales, marketing and product materials. In addition, we have acquired and implemented software designed to enable us to operate in a completely paperless environment with respect to policy administration. Further, we have implemented competitive incentive programs for our national marketing organizations, agents and employees to stimulate performance.

***Take Advantage of the Growing Popularity of Index Products.*** We believe that the growing popularity of index products that allow equity and bond market participation without the risk of loss of the premium deposit presents an attractive opportunity to grow our business. We intend to capitalize on our reputation as a leading marketer of index annuities in this expanding segment of the annuity market.

**Products**

Annuities offer our policyholders a tax-deferred means of accumulating retirement savings, as well as a reliable source of income during the payout period. When our policyholders contribute cash to annuities we account for these receipts as policy benefit reserves in the liability section of our balance sheet. The annuity deposits collected, by product type, during the three most recent fiscal years are as follows:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | 2007 | | 2006 | |
| | Deposits Collected | Deposits as a % of Total | Deposits Collected | Deposits as a % of Total | Deposits Collected | Deposits as a % of Total |
| | (Dollars in thousands) | | | | | |
| Index annuities | $2,241,098 | 98% | $2,093,576 | 98% | $1,787,258 | 96% |
| Fixed rate annuities | 47,908 | 2% | 51,106 | 2% | 82,708 | 4% |
| | $2,289,006 | 100% | $2,144,682 | 100% | $1,869,966 | 100% |

*Index Annuities*

Index annuities allow policyholders to earn index credits based on the performance of a particular index without the risk of loss of their principal. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more index based strategies and a traditional fixed rate strategy. Approximately 93%, 86% and 76% of our index annuity sales for the years ended December 31, 2008, 2007 and 2006, respectively, were "premium bonus" products. The initial annuity deposit on these policies is increased at issuance by a specified premium bonus ranging from 5% to 10%. Generally, there is a compensating adjustment in the commission paid to the agent or the surrender charges on the policy to offset the premium bonus.

The annuity contract value is equal to the sum of premiums paid, premium bonuses and interest credited ("index credits"), which is based upon an overall limit (or "cap") or a percentage (the "participation rate") of the annual appreciation (based in certain situations on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. Caps and participation rates limit the amount of annual interest the policyholder may earn in any one contract year and may be adjusted by us annually subject to stated minimums. Caps generally range from 4% to 12% and participation rates generally range from 25% to 100%. In addition, some products have an "asset fee" ranging from 1.5% to 5%, which is deducted from annual interest to be credited. For products with asset fees, if the annual appreciation in the index does not exceed the asset fee, the policyholder's index credit is zero. The minimum guaranteed contract values are equal to 87.5% of the premium collected plus interest credited at an annual rate ranging from 2% to 3.5%.

*Fixed Rate Annuities*

Fixed rate deferred annuities include annual reset and multi-year rate guaranteed products. Our annual reset fixed rate annuities have an annual interest rate (the "crediting rate") that is guaranteed for the first policy year. After the first policy year, we have the discretionary ability to change the crediting rate once annually to any rate at or above a guaranteed minimum rate. Our multi-year rate guaranteed annuities are similar to our annual reset products except that the initial crediting rate is guaranteed for up to a five-year period before it may be changed at our discretion. The guaranteed rate on our fixed rate deferred annuities ranges from 2.2% to 4% and the initial guaranteed rate on our multi-year rate guaranteed policies ranges from 4% to 5.25%.

The initial crediting rate is largely a function of the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to crediting rates, we take into account the yield on our investment portfolio, annuity surrender assumptions, competitive industry pricing and crediting rate history for particular groups of annuity policies with similar characteristics. As of December 31, 2008, crediting rates on our outstanding fixed rate deferred annuities generally ranged from 3% to 5.25%. The average crediting rate on our outstanding fixed rate deferred annuities at December 31, 2008 was 3.41%.

We also sell single premium immediate annuities ("SPIAs"). Our SPIAs are designed to provide a series of periodic payments for a fixed period of time or for life, according to the policyholder's choice at the time of issue. The amounts, frequency, and length of time of the payments are fixed at the outset of the annuity contract. SPIAs are often purchased by persons at or near retirement age who desire a steady stream of payments over a future period of years. The implicit interest rate on SPIAs is based on market conditions when the policy is issued. The implicit interest rate on our outstanding SPIAs averaged 3.47% at December 31, 2008.

*Withdrawal Options  Index and Fixed Rate Annuities*

Policyholders are typically permitted penalty-free withdrawals up to 10% of the contract value in each year after the first year, subject to limitations. Withdrawals in excess of allowable penalty-free amounts are assessed a surrender charge during a penalty period which range from 5 to 17 years for index annuities and 3 to 15 years for fixed rate annuities from the date the policy is issued. This surrender charge initially ranges from 4.7% to 20% for index annuities and 8% to 25% for fixed rate annuities of the contract value and generally decreases by approximately one to two percentage points per year during the surrender charge period. Surrender charges are set at levels aimed at protecting us from loss on early terminations and reducing the likelihood of policyholders terminating their policies during periods of increasing interest rates. This practice lengthens the effective duration of the policy liabilities and enhances our ability to maintain profitability on such policies. The policyholder may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years, or a combination of these payment options.

Beginning in July 2007, substantially all of our index annuity policies were issued with a lifetime income benefit rider. This rider provides an additional liquidity option to policyholders who elect to receive a guaranteed lifetime income from their contract without requiring them to annuitize their contract value. The amount of the lifetime income benefit available is determined by the growth in the policy's income account value as defined in the policy and the policyholder's age at the time the policyholder elects to begin receiving lifetime income benefit payments. Lifetime income benefit payments may be stopped and restarted at the election of the policyholder.

*Life Insurance*

These products include traditional ordinary and term, universal life and other interest-sensitive life insurance products. We have approximately $2.6 billion of life insurance in force as of December 31, 2008. We intend to continue offering a complete line of life insurance products for individual and group markets. Premiums related to this business accounted for 4% of revenues for the year ended December 31, 2008 and 2% of revenues for the years ended December 31, 2007 and 2006.

**Investments**

Investment activities are an integral part of our business, and net investment income is a significant component of our total revenues. Profitability of many of our products is significantly affected by spreads between interest yields on investments, the cost of options to fund the annual index credits on our index annuities and rates credited on our fixed rate annuities. We manage the index-based risk component of our index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect the change in the cost of such options which varies based on market conditions. All options are purchased to fund the index credits on our index annuities on their respective anniversary dates, and new options are purchased at each of the anniversary dates to fund

Table of Contents

the next annual index credits. All credited rates on non-multi-year rate guaranteed fixed rate deferred annuities may be changed annually, subject to minimum guarantees. Changes in caps, participation rates and asset fees on index annuities and crediting rates on fixed rate annuities may not be sufficient to maintain targeted investment spreads in all economic and market environments. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or to maintain caps, participation rates, asset fees and crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions. For the year ended December 31, 2008, the weighted average yield, computed on the average amortized cost basis of our investment portfolio, was 6.20% and the weighted average cost of our liabilities, excluding amortization of deferred sales inducements, was 3.43%.

For additional information regarding the composition of our investment portfolio and our interest rate risk management, see Financial Condition Investments, Quantitative and Qualitative Disclosures About Market Risk and note 3 to our audited consolidated financial statements.

**Marketing**

We market our products through a variable cost brokerage distribution network of approximately 65 national marketing organizations and, through them, 45,000 independent agents as of December 31, 2008. We emphasize high quality service to our agents and policyholders along with the prompt payment of commissions to our agents. We believe this has been significant in building excellent relationships with our existing agency force.

Our independent agents and agencies range in profile from national sales organizations to personal producing general agents. We actively recruit new agents and terminate those agents who have not produced business for us in recent periods and are unlikely to sell our products in the future. In our recruitment efforts, we emphasize that agents have direct access to our executive officers, giving us an edge in recruiting over larger and foreign-owned competitors. We also emphasize our products and our Gold Eagle program which provides unique cash and equity-based incentives to those agents selling $1 million or more of annuity premium annually. We also have favorable relationships with our national marketing organizations, which have enabled us to efficiently sell through an expanded number of independent agents.

The insurance distribution system is comprised of insurance brokers and marketing organizations. We are pursuing a strategy to increase the efficiency of our distribution network by strengthening our relationships with key national and regional marketing organizations and are alert for opportunities to establish relationships with organizations not presently associated with us. These organizations typically recruit agents for us by advertising our products and our commission structure through direct mail advertising or seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing our products. We compensate marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited by such organizations. We also conduct incentive programs for marketing organizations and agents from time to time, including equity-based programs for our leading national marketers and those agents qualifying for our Gold Eagle program. For additional information regarding our equity-based programs for our leading national marketers and independent agents, see note 10 to our audited consolidated financial statements. We generally do not enter into exclusive arrangements with these marketing organizations.

One of our national marketing organizations accounted for more than 12% of the annuity deposits collected during 2008 and we expect this organization to continue as a marketer for American Equity Life with a focus on selling our products. The states with the largest share of direct premiums collected during 2008 were: Florida (12.8%), California (9.4%), Texas (9.2%), Illinois (6.6%) and Pennsylvania (5.6%).

Table of Contents

**Competition and Ratings**

We operate in a highly competitive industry. Many of our competitors are substantially larger and enjoy substantially greater financial resources, higher ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships. Our annuity products compete with index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank investments and other investment and retirement funding alternatives offered by asset managers, banks, and broker-dealers. Our insurance products compete with products of other insurance companies, financial intermediaries and other institutions based on a number of features, including crediting rates, policy terms and conditions, service provided to distribution channels and policyholders, ratings, reputation and broker compensation.

The sales agents for our products use the ratings assigned to an insurer by independent rating agencies as one factor in determining which insurer's annuity to market. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. Following is a summary of American Equity Life's financial strength ratings:

| | Financial Strength Rating | Outlook Statement |
|---|---|---|
| **A.M. Best Company** | | |
| November 2008 current | A- | Negative |
| August 2006 October 2008 | A- | Stable |
| July 2002 July 2006 | B++ | Stable |
| **Standard & Poor's** | | |
| July 2008 current | BBB+ | Negative |
| July 2002 June 2008 | BBB+ | Stable |

The degree to which ratings adjustments have affected sales and persistency is unknown. We believe the rating upgrade from A.M. Best Company in 2006 enhanced our competitive position and improved our prospects for future sales. However, the degree to which this rating upgrade will affect future sales and persistency is unknown.

Financial strength ratings generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to policyholders, agents and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell or hold securities.

In addition to the financial strength ratings, rating agencies use an "outlook statement" to indicate a medium or long-term trend which, if continued, may lead to a rating change. A positive outlook indicates a rating may be raised and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when ratings are not likely to be changed. Outlooks should not be confused with expected stability of the issuer's financial or economic performance. A rating may have a "stable" outlook to indicate that the rating is not expected to change, but a "stable" outlook does not preclude a rating agency from changing a rating at any time without notice.

During 2008, A.M. Best and Standard & Poor's each revised its outlook for the U.S. life insurance sector to negative from stable. In January 2009, Standard & Poor's reiterated its negative outlook on the U.S. life insurance sector. We believe the rating agencies may heighten the level of scrutiny they apply to insurance companies, may increase the frequency and scope of their credit reviews, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels.

Table of Contents

A.M. Best Company ratings currently range from "A++" (Superior) to "F" (In Liquidation), and include 16 separate ratings categories. Within these categories, "A++" (Superior) and "A+" (Superior) are the highest, followed by "A" (Excellent) and "A-" (Excellent) then followed by "B++" (Good) and "B+" (Good). Publications of A.M. Best Company indicate that the "A-" rating is assigned to those companies that, in A.M. Best Company's opinion, have demonstrated an excellent ability to meet their ongoing obligations to policyholders.

Standard & Poor's insurer financial strength ratings currently range from "AAA (extremely strong)" to "R (under regulatory supervision)", and include 21 separate ratings categories, while "NR" indicates that Standard & Poor's has no opinion about the insurer's financial strength. Within these categories, "AAA" and "AA" are the highest, followed by "A" and "BBB". Publications of Standard & Poor's indicate that an insurer rated "BBB" is regarded as having good financial security characteristics, but is more likely to be affected by adverse business conditions than are higher rated insurers.

A.M. Best Company and Standard & Poor's review their ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue for any given period of time or that it will not be changed or withdrawn entirely if, in their judgment, circumstances so warrant. If our ratings were to be adjusted again for any reason, we could experience a material decline in the sales of our products and the persistency of our existing business.

**Reinsurance**

*Coinsurance*

American Equity Life has entered into two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), covering 70% of certain of our index and fixed rate annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003, and 20% of those contracts issued from January 1, 2004 to July 31, 2004, when the agreement was suspended by mutual consent of the parties. As a result of the suspension, new business is no longer ceded to EquiTrust. The business reinsured under these agreements is not eligible for recapture before the expiration of 10 years. Coinsurance deposits (aggregate policy benefit reserves transferred to EquiTrust under these agreements) were $1.5 billion and $1.7 billion at December 31, 2008 and 2007, respectively. We remain liable to policyholders with respect to the policy liabilities ceded to EquiTrust should EquiTrust fail to meet the obligations it has coinsured. EquiTrust has received a financial strength rating of "B+" (Good) with a negative outlook from A.M. Best Company and a financial strength rating of "A-" with a negative outlook from Standard & Poor's. None of the coinsurance deposits with EquiTrust are deemed by management to be uncollectible.

*Financing Arrangements*

American Equity Life has two reinsurance transactions with Hannover Life Reassurance Company of America, ("Hannover"), which are treated as reinsurance under statutory accounting practices and as financing arrangements under U.S. generally accepted accounting principles ("GAAP"). The statutory surplus benefits under these agreements are eliminated under GAAP and the associated charges are recorded as risk charges and included in other operating costs and expenses in the consolidated statements of operations. Hannover has received a financial strength rating of "A" (Excellent) with a positive outlook from A.M. Best Company. The transactions became effective October 1, 2005 (the "2005 Hannover Transaction") and December 31, 2008 (the "2008 Hannover Transaction").

The 2008 Hannover Transaction is a coinsurance and yearly renewable term reinsurance agreement for statutory purposes and provided $29.5 million in net statutory surplus benefit during 2008. American Equity Life had entered into two other reinsurance agreements similar to the 2008 Hannover Transaction in 2002 and 2003 and recaptured one of these agreements in 2007 and the other in 2008

Table of Contents

when the surplus benefit for each agreement had been reduced to zero. Risk charges attributable to these transactions were $0.6 million, $0.7 million and $1.2 million during 2008, 2007 and 2006, respectively.

The 2005 Hannover Transaction is a yearly renewable term reinsurance agreement for statutory purposes on inforce business covering 40% of waived surrender charges related to penalty free withdrawals and deaths. We may recapture the risks reinsured under this agreement as of the end of any quarter beginning October 1, 2008. We pay quarterly reinsurance premiums under this agreement with an experience refund calculated on a quarterly basis resulting in a risk charge equal to approximately 6.0% of the weighted average reserve credit recorded on a statutory basis by American Equity Life. The reserve credit recorded on a statutory basis by American Equity Life at December 31, 2008 and 2007 was $59.8 million and $68.6 million, respectively. Risk charges attributable to the 2005 Hannover Transaction were $3.8 million, $4.1 million and $3.8 million during 2008, 2007 and 2006, respectively.

*Indemnity Reinsurance*

Consistent with the general practice of the life insurance industry, American Equity Life enters into agreements of indemnity reinsurance with other insurance companies in order to reinsure portions of the coverage provided by its annuity, life and accident and health insurance products. Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to diversify its risks. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured.

The maximum loss retained by us on all life insurance policies we have issued was $0.1 million or less as of December 31, 2008. American Equity Life's reinsured business under indemnity reinsurance agreements is primarily ceded to two reinsurers. Reinsurance related to life and accident and health insurance that was ceded by us to these reinsurers was immaterial.

During 2007, American Equity Life entered into reinsurance agreements with Ace Tempest Life Reinsurance Ltd and Hannover to cede to each 50% of the risk associated with our lifetime income benefit rider on certain index annuities issued in 2007. The amounts ceded under these agreements were immaterial as of and for the years ended December 31, 2008 and 2007.

We believe the assuming companies will be able to honor all contractual commitments, based on our periodic review of their financial statements, insurance industry reports and reports filed with state insurance departments.

**Regulation**

Life insurance companies are subject to regulation and supervision by the states in which they transact business. State insurance laws establish supervisory agencies with broad regulatory authority, including the power to:

- grant and revoke licenses to transact business;
- regulate and supervise trade practices and market conduct;
- establish guaranty associations;
- license agents;
- approve policy forms;
- approve premium rates for some lines of business;
- establish reserve requirements;

- prescribe the form and content of required financial statements and reports;
- determine the reasonableness and adequacy of statutory capital and surplus;
- perform financial, market conduct and other examinations;
- define acceptable accounting principles for statutory reporting;
- regulate the type and amount of permitted investments; and
- limit the amount of dividends and surplus note payments that can be paid without obtaining regulatory approval.

Our life subsidiaries are subject to periodic examinations by state regulatory authorities. In 2005, the Iowa Insurance Division completed an examination of American Equity Life as of December 31, 2003. Although no adjustments to our 2003 statutory financial statements were recommended or required as a result of this examination, during 2005 we revised certain statutory reserve calculations in response to the examination report. We have been notified by the Iowa Insurance Division that they will be performing an examination of American Equity Life as of December 31, 2008 but that examination has not yet begun. In 2008, the New York Insurance Department completed an examination of American Equity Investment Life Insurance Company of New York as of December 31, 2004. There were no material adjustments required as a result of this examination. The New York Insurance Department is currently conducting an examination of American Equity Life Insurance Company of New York as of December 31, 2007.

The payment of dividends or the distributions, including surplus note payments, by our life subsidiaries is subject to regulation by each subsidiary's state of domicile's insurance department. Currently, American Equity Life may pay dividends or make other distributions without the prior approval of its state of domicile's insurance department, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's statutory net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory surplus at the preceding December 31. For 2009, up to $98.3 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Division. In addition, dividends and surplus note payments may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. American Equity Life had $151.2 million of statutory earned surplus at December 31, 2008.

Most states have also enacted regulations on the activities of insurance holding company systems, including acquisitions, extraordinary dividends, the terms of surplus notes, the terms of affiliate transactions and other related matters. We are registered pursuant to such legislation in Iowa. A number of state legislatures have also considered or have enacted legislative proposals that alter and, in many cases, increase the authority of state agencies to regulate insurance companies and holding company systems.

Most states, including Iowa and New York where our life subsidiaries are domiciled, have enacted legislation or adopted administrative regulations affecting the acquisition of control of insurance companies as well as transactions between insurance companies and persons controlling them. The nature and extent of such legislation and regulations currently in effect vary from state to state. However, most states require administrative approval of the direct or indirect acquisition of 10% or more of the outstanding voting securities of an insurance company incorporated in the state. The acquisition of 10% of such securities is generally deemed to be the acquisition of "control" for the purpose of the holding company statutes and requires not only the filing of detailed information concerning the acquiring parties and the plan of acquisition, but also administrative approval prior to the acquisition. In many states, the insurance authority may find that "control" in fact does not exist in circumstances in which a person owns or controls more than 10% of the voting securities.

Table of Contents

Although the federal government does not directly regulate the business of insurance, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation can significantly affect the insurance business. In addition, legislation has been passed which could result in the federal government assuming some role in regulating insurance companies and which allows combinations between insurance companies, banks and other entities.

In 1998, the SEC requested comments as to whether index annuities, such as those sold by us, should be treated as securities under the federal securities laws rather than as insurance products exempted from such laws. Treatment of these products as securities would require additional registration and licensing of these products and the agents selling them, as well as cause us to seek additional marketing relationships for these products. Again in 2008, the SEC requested comments in Release No. 33-8933 regarding whether and how to apply federal securities laws to index annuities and certain other insurance contracts. In this release, the SEC proposed new Rule 151A under the Securities Act of 1933, as amended ("Rule 151A") to clarify the status under the federal securities laws of index annuities, under which payments to the purchaser are dependent on the performance of a securities index. Subsequently, on December 17, 2008, the SEC voted to approve Rule 151A and apply federal securities oversight to index annuities issued on or after January 12, 2011. Along with several other parties we have filed a petition for judicial review of this rule and are seeking to have it overturned. Our motion for expedited review of this case was granted by the court, which is scheduled to hear oral argument in the case on May 8, 2009. Should this legal challenge be unsuccessful, costs of compliance with Rule 151A will be substantial and may include, among other things: (i) the costs of registering one or more index annuities; (ii) the annual costs of printing and mailing prospectuses to policyholders; (iii) the costs of expanding the operations of our broker dealer subsidiary; (iv) the costs of establishing relationships with other broker dealers; and (v) the costs of compensating broker dealers in connection with product sales. In addition, we believe that certain of our sales agents would choose not to become licensed to sell SEC registered products, which could lead to a substantial decline in new annuity deposits unless we are successful in developing new insurance products they are permitted to and want to sell.

State insurance regulators and the National Association of Insurance Commissioners ("NAIC") are continually reexamining existing laws and regulations and developing new legislation for the passage by state legislatures and new regulations for adoption by insurance authorities. Proposed laws and regulations or those still under development pertain to insurer solvency and market conduct and in recent years have focused on:

- insurance company investments;
- risk-based capital ("RBC") guidelines, which consist of regulatory targeted surplus levels based on the relationship of statutory capital and surplus, with prescribed adjustments, to the sum of stated percentages of each element of a specified list of company risk exposures;
- the implementation of non-statutory guidelines and the circumstances under which dividends may be paid;
- principles-based reserving;
- product approvals;
- agent licensing;
- underwriting practices; and
- insurance and annuity sales practices.

Table of Contents

The NAIC's RBC requirements are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. The RBC formula defines a minimum capital standard which supplements low, fixed minimum capital and surplus requirements previously implemented on a state-by-state basis. Such requirements are not designed as a ranking mechanism for adequately capitalized companies.

The NAIC's RBC requirements provide for four levels of regulatory attention depending on the ratio of a company's total adjusted capital to its RBC. Adjusted capital is defined as the total of statutory capital, surplus, asset valuation reserve and certain other adjustments. Calculations using the NAIC formula at December 31, 2008, indicated that American Equity Life's ratio of total adjusted capital to the highest level at which regulatory action might be initiated was 347%.

Our life subsidiaries also may be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. These assessments may be deferred or forgiven under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium taxes. Assessments related to business reinsured for periods prior to the effective date of the reinsurance are the responsibility of the ceding companies.

**Federal Income Tax**

The annuity and life insurance products that we market generally provide the policyholder with a federal income tax advantage, as compared to certain other savings investments such as certificates of deposit and taxable bonds, in that federal income taxation on any increases in the contract values (i.e., the "inside build-up") of these products is deferred until it is received by the policyholder. With other savings investments, the increase in value is generally taxed each year as it is realized. Additionally, life insurance death benefits are generally exempt from income tax.

From time to time, various tax law changes have been proposed that could have an adverse effect on our business, including the elimination of all or a portion of the income tax advantage described above for annuities and life insurance. If legislation were enacted to eliminate the tax deferral for annuities, such a change would have an adverse effect on our ability to sell non-qualified annuities. Non-qualified annuities are annuities that are not sold to an individual retirement account or other qualified retirement plan.

In June 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act") was enacted. The 2001 Act implemented a staged decrease in individual tax rates that began in 2001 and was accelerated when the Jobs and Growth Tax Relief Reconciliation Act of 2003 was enacted. While the decreases in rates are temporary (the pre-2001 rates will return in 2011), the present value of the tax deferred advantage of annuities and life insurance products is less, which might hinder our ability to sell such products and/or increase the rate at which our current policyholders surrender their policies.

Our life subsidiaries are taxed under the life insurance company provisions of the Internal Revenue Code of 1986, as amended (the "Code"). Provisions in the Code require a portion of the expenses incurred in selling insurance products to be capitalized and deducted over a period of years, as opposed to being immediately deducted in the year incurred. This provision increases the current income tax expense charged to gain from operations for statutory accounting purposes which reduces statutory net income and surplus and, accordingly, may decrease the amount of cash dividends that may be paid by our life subsidiaries.

Table of Contents

**Employees**

As of December 31, 2008, we had 330 full-time employees, of which 322 are located in West Des Moines, Iowa, and 8 are located in the Pell City, Alabama office. We have experienced no work stoppages or strikes and consider our relations with our employees to be excellent. None of our employees are represented by a union.

## Item 1A. Risk Factors

**The current financial crisis has resulted in unprecedented levels of market volatility and an overall deterioration in the debt and equity markets which have adversely affected us and will further adversely affect us if these conditions continue or deteriorate further in 2009.**

Markets in the United States and elsewhere have been experiencing extreme volatility and disruption for more than 12 months, due in part to the financial stresses affecting the liquidity of the banking system and the financial markets. In recent months, this volatility and disruption has reached unprecedented levels. The United States has entered into a severe recession that is likely to persist well into and perhaps through and even beyond 2009. These circumstances have also exerted downward pressure on stock prices and reduced access to the equity and debt markets for certain issuers. The unprecedented market volatility and general decline in the debt and equity markets has directly and materially affected our investment portfolio. The prolonged and severe disruptions in the public debt and equity markets (including, among other things, widening of credit spreads, bankruptcies, and government intervention in a number of large financial institutions) have resulted in us recognizing significant other than temporary impairment losses, counterparty defaults on derivative instruments (call options) purchased from one of our counterparties to fund annual index credits on our index annuities and our unrealized loss position has increased substantially.

Due to the other than temporary impairments recognized on our investments during 2008, there may be pressure on our capital position during 2009 if market conditions continue to deteriorate resulting in additional other than temporary impairments and impairments on commercial mortgage loans. This may result in us needing to raise additional capital to sustain our current business in force and new sales of our annuity products, which may be difficult under current market conditions. If capital is available, it may be at terms that are not favorable to us. If we are unable to raise adequate capital, we may be required to limit growth in sales of our annuity products.

**Governmental initiatives intended to alleviate the current financial crisis that have been adopted may not be effective and, in any event, may be accompanied by other initiatives, including new capital requirements or other regulations, that could materially affect our results of operations, financial condition and liquidity in ways that we cannot predict.**

We are subject to extensive laws and regulations that are administered and enforced by a number of different regulatory authorities including state insurance regulators, the NAIC, the Securities and Exchange Commission and the New York Stock Exchange. In light of the current financial crisis, some of these authorities are or may in the future consider enhanced or new regulatory requirements intended to prevent future crises or otherwise assure the stability of institutions under their supervision. These authorities may also seek to exercise their supervisory or enforcement authority in new or more robust ways. All of these possibilities, if they occurred, could affect the way we conduct our business and manage our capital, and may require us to satisfy increased capital requirements, any of which in turn could materially affect our results of operations, financial condition and liquidity.

Table of Contents

**The markets in the United States and elsewhere have been experiencing unprecedented levels of market volatility and disruption. We are exposed to significant financial and capital risk, including changing interest rates, credit spreads and equity prices which may have an adverse affect on sales of our products, profitability, investment portfolio and reported book value per share.**

Future changes in interest rates, credit spreads and equity and bond indices may result in fluctuations in the income derived from our investments. These and other factors due to the current recession could have a material adverse effect on our financial condition, results of operations or cash flows.

Our interest rate risk is related to market price and changes in cash flow. Substantial and sustained increases and decreases in market interest rates can materially and adversely affect the profitability of our products, our ability to earn predictable returns, the fair value of our investments and the reported value of stockholders' equity. A rise in interest rates, in the absence of other countervailing changes, will increase the unrealized loss position of our investment portfolio. With respect to our available for sale fixed maturity securities, such declines in value (net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements) reduce our reported stockholders' equity and book value per share. We have a portfolio of held for investment securities, which consists principally of long duration bonds issued by United States government agencies, the value of which is also sensitive to interest rate changes.

Credit and cash flow assumption risk is the risk that issuers of securities, mortgagees on mortgage loans or other parties, including reinsurers and derivatives counterparties, default on their contractual obligations or experience adverse changes to their contractual cash flow streams. We attempt to minimize the adverse impact of this risk by monitoring portfolio diversification by asset class, creditor, industry, and by complying with investment limitations governed by state insurance laws and regulations as applicable. We also consider all relevant objective information available in estimating the cash flows related to asset-backed securities. We monitor and manage exposures to determine whether securities are impaired or loans are deemed uncollectible.

Disintermediation risk is the risk that our policyholders may surrender all or part of their contracts in a rising interest rate environment, which may require us to sell assets in an unrealized loss position. Sustained declines in long-term interest rates may result in increased redemptions of our fixed income securities that have call features. We have reinvestment risk related to these redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to or better than those of the redeemed bonds. We have a certain ability to mitigate this risk by lowering crediting rates on our products subject to certain restrictions as discussed below. At December 31, 2008, 65% of our fixed income securities have call features and are subject to redemption currently or in the near future.

Our exposure to credit spreads is related to market price and changes in cash flows related to changes in credit spreads. The recent widening of credit spreads has contributed to the increase in the net unrealized loss position of our investment portfolio. If credit spreads continue to widen significantly, this could lead to additional other than temporary impairments. If credit spreads tighten significantly, this will reduce net investment income associated with new purchases of fixed maturity securities.

We are subject to the risk that the issuers of our fixed maturity securities and other debt securities and borrowers on our commercial mortgages, will default on principal and interest payments, particularly if a major downturn in economic activity occurs. An increase in defaults on our fixed maturity securities and commercial mortgage loan portfolios could harm our financial strength and reduce our profitability.

We use derivative instruments to fund the annual credits on our index annuities. We purchase derivative instruments, consisting primarily of one-year call options, from a number of counterparties.

Our policy is to acquire such options only from counterparties rated "A-"or better by a nationally recognized rating agency and the maximum credit exposure to any single counterparty is subject to concentration limits. If our counterparties fail to honor their obligations under the derivative instruments, our revenues may not be sufficient to fund the annual index credits on our index annuities. Any such failure could harm our financial strength and reduce our profitability.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. Our maximum remaining exposure due to the Lehman bankruptcy was $16.8 million at December 31, 2008. The amount of loss that we will realize upon expiration of these options will depend on the performance of the underlying indices upon which the options are based, the amount of related index credits we will make to policyholders and the amount, if any, that we will recover from Lehman through our claims in bankruptcy proceedings. The amount of option proceeds due on expired options purchased from Lehman that we did not receive payment on was $2.1 million.

We may also have difficulty selling our commercial mortgage loans because they are less liquid than our publicly traded securities. As of December 31, 2008, our commercial mortgage loans represented approximately 18.3% of the value of our invested assets. If we require significant amounts of cash on short notice, we may have difficulty selling these loans at attractive prices or in a timely manner, or both.

A key component of our net income is the investment spread. A narrowing of investment spreads may adversely affect operating results. Although we have the right to adjust interest crediting rates (cap, participation or asset fee rates for index annuities) on most products, changes to crediting rates may not be sufficient to maintain targeted investment spreads in all economic and market environments. In general, our ability to lower crediting rates is subject to a minimum crediting rates filed with and approved by state regulators. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid the narrowing of spreads under certain market conditions. Our policy structure generally provides for resetting of policy crediting rates at least annually and imposes withdrawal penalties for withdrawals during the first 3 to 17 years a policy is in force.

Managing the investment spread on our index annuities is more complex than it is for fixed rate annuity products. We manage the index-based risk component of our index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect changes in the cost of such options which varies based on market conditions. The price of such options generally increases with increases in the volatility in the indices and interest rates, which may either narrow the spread or cause us to lower caps or participation rates. Thus, the volatility of the indices adds an additional degree of uncertainty to the profitability of the index products. We attempt to mitigate this risk by resetting caps, participation rates and asset fees annually on the policy anniversaries.

**Our valuation of fixed maturity and equity securities may include methodologies, estimates and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our results of operations or financial condition.**

Fixed maturity securities and equity securities are reported at fair value in our consolidated balance sheets. During periods of market disruption including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain of our securities if trading becomes less frequent and/or market data becomes less observable. Prices provided by independent broker quotes or independent pricing services that are used in the determination of fair value can vary significantly for a particular security. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment. As such, valuations may include inputs and assumptions that are less observable or require greater judgment as well as valuation methods that require greater judgment. Further, rapidly changing and unprecedented credit and equity market conditions could materially impact the valuation of securities as reported in our consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on our results of operations or financial condition.

**We face competition from companies that have greater financial resources, broader arrays of products, higher ratings and stronger financial performance, which may impair our ability to retain existing customers, attract new customers and maintain our profitability and financial strength.**

We operate in a highly competitive industry. Many of our competitors are substantially larger and enjoy substantially greater financial resources, higher ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships. Our annuity products compete with index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank investments and other retirement funding alternatives offered by asset managers, banks and broker-dealers. Our insurance products compete with those of other insurance companies, financial intermediaries and other institutions based on a number of factors, including premium rates, policy terms and conditions, service provided to distribution channels and policyholders, ratings by rating agencies, reputation and commission structures. While we compete with numerous other companies, we view the following as our most significant competitors:

- Aviva USA;
- Allianz Life Insurance Company of North America;
- Midland National Life Insurance Company;
- ING USA Annuity & Life Insurance Company; and
- North American Company for Life and Health Insurance.

Our ability to compete depends in part on rates of interest credited to policyholder account balances or the parameters governing the determination of index credits which is driven by our investment performance. We will not be able to accumulate and retain assets under management for our products if our investment results underperform the market or the competition, since such under performance likely would result in asset withdrawals and reduced sales.

We compete for distribution sources for our products. We believe that our success in competing for distributors depends on factors such as our financial strength, the services we provide to, and the relationships we develop with these distributors and offering competitive commission structures. Our distributors are generally free to sell products from whichever providers they wish, which makes it important for us to continually offer distributors products and services they find attractive. If our products or services fall short of distributors' needs, we may not be able to establish and maintain satisfactory relationships with distributors of our annuity and life insurance products. Our ability to compete in the past has also depended in part on our ability to develop innovative new products and bring them to market more quickly than our competitors. In order for us to compete in the future, we will need to continue to bring innovative products to market in a timely fashion. Otherwise, our revenues and profitability could suffer.

National banks, with pre-existing customer bases for financial services products, may increasingly compete with insurers, as a result of legislation removing restrictions on bank affiliations with insurers. This legislation, the Gramm-Leach-Bliley Act of 1999, permits mergers that combine commercial banks, insurers and securities firms under one holding company. Until passage of the Gramm-Leach-Bliley Act, prior legislation had limited the ability of banks to engage in securities-related businesses and had restricted banks from being affiliated with insurance companies. The ability of banks to increase their securities-related business or to affiliate with insurance companies may materially and adversely affect sales of all of our products by substantially increasing the number and financial strength of our potential competitors.

**Our reinsurance program involves risks because we remain liable with respect to the liabilities ceded to reinsurers if the reinsurers fail to meet the obligations assumed by them.**

Our life insurance subsidiaries cede insurance to other insurance companies through reinsurance. In particular, American Equity Life has entered into two coinsurance agreements with EquiTrust covering $1.5 billion of policy benefit reserves at December 31, 2008. New business is no longer ceded to EquiTrust. EquiTrust has been assigned a financial strength rating of "B+" with a negative outlook by A.M. Best Company and a financial strength rating of "A-" with a negative outlook by Standard & Poor's. We remain liable with respect to the policy liabilities ceded to EquiTrust should it fail to meet the obligations assumed by it.

In addition, we have entered into other types of reinsurance contracts including indemnity reinsurance and financing arrangements. Should any of these reinsurers fail to meet the obligations assumed under such contracts, we remain liable with respect to the liabilities ceded. For further information regarding our reinsurance program, see Business Reinsurance.

**We may experience volatility in net income due to accounting standards for derivatives.**

Pursuant to Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"), as amended, all of our derivative instruments, including certain derivative instruments embedded in other contracts, are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings. This impacts certain revenues and expenses we report for our index annuity business as follows:

We must mark to market the call options purchased to fund the annual index credits on our index annuities based upon quoted market prices from related counterparties and the associated credit worthiness of each counterparty. We record the change in fair value of these options as a component of our revenues. The change in fair value of derivatives includes the gains or losses recognized at expiration of the option term or upon early termination and changes in fair value for open positions.

Under SFAS 133, the contractual obligations for future annual index credits are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in equity market performance and changes in the interest rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values.

The application of SFAS 133 in future periods to our index annuity business may cause substantial volatility in our reported net income.

**If we do not manage our growth effectively, our financial performance could be adversely affected; our historical growth rates may not be indicative of our future growth.**

We have experienced rapid growth since our formation in December 1995. For the year ended December 31, 2008, our deposits from sales of new annuities were $2.3 billion. Our work force has grown from 65 employees and 4,000 independent agents as of December 31, 1997 to 330 employees and 45,000 independent agents as of December 31, 2008. We intend to continue to grow by recruiting new independent agents, increasing the productivity of our existing agents, expanding our insurance distribution network, developing new products, expanding into new product lines, and continuing to develop new incentives for our sales agents. Future growth will impose significant added responsibilities on our management, including the need to identify, recruit, maintain and integrate additional

Table of Contents

employees, including management. There can be no assurance that we will be successful in expanding our business or that our systems, procedures and controls will be adequate to support our operations as they expand. In addition, due to our rapid growth and resulting increased size, it may be necessary to expand the scope of our investing activities to asset classes in which we historically have not invested or have not had significant exposure. If we are unable to adequately manage our investments in these classes, our financial condition or operating results in the future could be less favorable than in the past. Further, we have utilized reinsurance in the past to support our growth. The future availability and cost of reinsurance is uncertain. Our failure to manage growth effectively, or our inability to recruit, maintain and integrate additional qualified employees and independent agents, could have a material adverse effect on our business, financial condition or results of operations. In addition, due to our rapid growth, our historical growth rates are not likely to accurately reflect our future growth rates or our growth potential. We cannot assure you that our future revenues will increase or that we will continue to be profitable.

**We must retain and attract key employees or else we may not grow or be successful.**

We are dependent upon our executive management for the operation and development of our business. Our executive management team includes:

David J. Noble, Chairman;

Wendy L. Carlson, President and Chief Executive Officer;

John M. Matovina, Vice Chairman, Chief Financial Officer and Treasurer;

Debra J. Richardson, Executive Vice President and Secretary;

Ronald J. Grensteiner, President of American Equity Life;

James R. Gerlach, Executive Vice President; and

Terry A. Reimer, Executive Vice President.

Although we have change in control agreements with members of our executive management team, we do not have employment contracts with any of the members of our executive management team. Although none of our executive management team has indicated that they intend to terminate their employment with us, there can be no assurance that these employees will remain with us for any particular period of time. Also, we do not maintain "key person" life insurance for any of our personnel.

**If we are unable to attract and retain national marketing organizations and independent agents, sales of our products may be reduced.**

We distribute our annuity products through a variable cost distribution network which included over 65 national marketing organizations and 45,000 independent agents as of December 31, 2008. We must attract and retain such marketers and agents to sell our products. Insurance companies compete vigorously for productive agents. We compete with other life insurance companies for marketers and agents primarily on the basis of our financial position, support services, compensation and product features. Such marketers and agents may promote products offered by other life insurance companies that may offer a larger variety of products than we do. Our competitiveness for such marketers and agents also depends upon the long-term relationships we develop with them. If we are unable to attract and retain sufficient marketers and agents to sell our products, our ability to compete and our revenues would suffer.

Table of Contents

**We may require additional capital to support our business and sustained future growth which may not be available when needed or may be available only on unfavorable terms.**

Our long-term strategic capital requirements will depend on many factors including the accumulated statutory earnings of our life insurance subsidiaries and the relationship between the statutory capital and surplus of our life insurance subsidiaries and various elements of required capital. To support long-term capital requirements, we may need to increase or maintain the statutory capital and surplus of our life insurance subsidiaries through additional financings, which could include debt, equity, financing arrangements and/or other surplus relief transactions. Adverse market conditions have affected and continue to affect the availability and cost of capital. Such financings, if available at all, may be available only on terms that are not favorable to us. If we cannot maintain adequate capital, we may be required to limit growth in sales of new annuity products, and such action could adversely affect our business, financial condition or results of operations.

**Changes in state and federal regulation may affect our profitability.**

We are subject to regulation under applicable insurance statutes, including insurance holding company statutes, in the various states in which our life insurance subsidiaries transact business. Our life insurance subsidiaries are domiciled in New York and Iowa. We are currently licensed to sell our products in 50 states and the District of Columbia. Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies or their holding companies.

Regulators oversee matters relating to trade practices, policy forms, claims practices, guaranty funds, types and amounts of investments, reserve adequacy, insurer solvency, minimum amounts of capital and surplus, transactions with related parties, changes in control and payment of dividends.

State insurance regulators and the NAIC continually reexamine existing laws and regulations, and may impose changes in the future.

Our life insurance subsidiaries are subject to the NAIC's RBC requirements which are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. Our life insurance subsidiaries also may be required, under solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities for insolvent insurance companies.

Although the federal government does not directly regulate the insurance business, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation, can significantly affect the insurance business. As increased scrutiny has been placed upon the insurance regulatory framework, a number of state legislatures have considered or enacted legislative proposals that alter, and in many cases increase, state authority to regulate insurance companies and holding company systems. In addition, legislation has been introduced in Congress which could result in the federal government assuming some role in the regulation of the insurance industry. The regulatory framework at the state and federal level applicable to our insurance products is evolving. The changing regulatory framework could affect the design of such products and our ability to sell certain products. Any changes in these laws and regulations could materially and adversely affect our business, financial condition or results of operations.

On December 17, 2008, the SEC voted to approve Rule 151A which would apply federal securities oversight to index annuities issued on or after January 12, 2011. Along with several other parties we have filed a petition for judicial review of this rule and are seeking to have it overturned. Our motion for expedited review of this case was granted by the court and we believe the court will issue a ruling before the end of 2009. Should this legal challenge be unsuccessful, costs of compliance with Rule 151A will be substantial and will include, among other things: (i) the costs of registering one or more index annuities; (ii) the annual costs of printing and mailing prospectuses to policyholders; (iii) the costs of expanding the operations of our broker dealer subsidiary; (iv) the costs of establishing relationships with other broker dealers; and (v) the costs of compensating broker dealers in connection with product sales. In addition, we believe a portion of our sales agents would choose not to become licensed to sell SEC registered products, which could lead to a substantial decline in new annuity deposits unless we are successful in developing new insurance products they want to sell.

**Changes in federal income taxation laws, including any reduction in individual income tax rates, may affect sales of our products and profitability.**

The annuity and life insurance products that we market generally provide the policyholder with certain federal income tax advantages. For example, federal income taxation on any increases in the contract values (i.e. the "inside build-up") of these products is deferred until it is received by the policyholder. With other savings investments, such as certificates of deposit and taxable bonds, the increase in value is generally taxed each year as it is realized. Additionally, life insurance death benefits are generally exempt from income tax.

From time to time, various tax law changes have been proposed that could have an adverse effect on our business, including the elimination of all or a portion of the income tax advantages described above for annuities and life insurance. If legislation were enacted to eliminate the tax deferral for annuities, such a change would have an adverse effect on our ability to sell non-qualified annuities. Non-qualified annuities are annuities that are not sold to a qualified retirement plan.

The 2001 Act implemented a staged reduction in individual federal income tax rates that began in 2001. The enactment of the 2003 Act accelerated such rate reductions. While the reduction in income tax rates is temporary (pre-2001 rates will return in 2011), the present value of the tax deferred advantage of annuities and life insurance products is less, which might hinder our ability to sell such products and/or increase the rate at which our current policyholders surrender their policies.

**We face risks relating to litigation, including the costs of such litigation, management distraction and the potential for damage awards, which may adversely impact our business.**

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, the Financial Industry Regulatory Authority, Inc. ("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. Companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in several purported class action lawsuits alleging improper sales practices. In these lawsuits, the plaintiffs are seeking returns of premiums and other compensatory and punitive damages. Although we do not believe that these lawsuits will have a material adverse effect on our business, financial condition or results of operations, there can be no assurance that such litigation, or any future litigation, will not have such an effect, whether financially, through distraction of our management or otherwise. For additional information, see Legal Proceedings and note 12 to our audited consolidated financial statements.

**A downgrade in our credit or financial strength ratings may increase our future cost of capital and may reduce new sales, adversely affect relationships with distributors and increase policy surrenders and withdrawals.**

Currently, our senior unsecured indebtedness carries a "bbb-" rating from A.M. Best Company and a "BB+" rating from Standard & Poor's. Our ability to maintain such ratings is dependent upon the results of operations of our subsidiaries and our financial strength. If we fail to preserve the strength of our balance sheet and to maintain a capital structure that rating agencies deem suitable, it could result in a downgrade of the ratings applicable to our senior unsecured indebtedness. A downgrade would likely reduce the fair value of the common stock and may increase our future cost of capital.

Financial strength ratings are important factors in establishing the competitive position of life insurance and annuity companies. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. A ratings downgrade, or the potential for a ratings downgrade, could have a number of adverse effects on our business. For example, distributors and sales agents for life insurance and annuity products use the ratings as one factor in determining which insurer's annuities to market. A ratings downgrade could cause those distributors and agents to seek alternative carriers. In addition, a ratings downgrade could materially increase the number of policy or contract surrenders we experience.

Financial strength ratings generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to agents, policyholders and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell or hold securities.

American Equity Life has received financial strength ratings of "A-" (Excellent) with a negative outlook from A.M. Best Company and "BBB+" with a negative outlook from Standard & Poor's. A.M. Best Company and Standard & Poor's review their ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue for any given period of time or that it will not be changed or withdrawn entirely if, in their judgment, circumstances so warrant. If our ratings were to be downgraded for any reason, we could experience a material decline in the sales of our products and the persistency of our existing business. For additional information, see Business Competition and Ratings.

**Our system of internal control ensures the accuracy or completeness of our disclosures and a loss of public confidence in the quality of our internal controls or disclosures could have a negative impact on us.**

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to provide an annual report on our internal control over financial reporting, including an assessment as to whether or not our internal control over financial reporting is effective. We are also required to have our auditors opine on the effectiveness of our internal control over financial reporting. We have discovered, and may in the future discover deficiencies in our internal control that need remediation. If we determine that our remediation has been ineffective, or we identify additional material weaknesses in our internal control over financial reporting, we could be subjected to additional regulatory scrutiny, future delays in filing our financial statements and a loss of public confidence in the reliability of our financial statements, which could have a negative impact on our liquidity, access to capital markets, and financial condition.

In addition, we do not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Based on the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events. Therefore, a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, while we document our assumptions and review financial disclosures with the audit committee of our board of directors, the regulations and literature governing our disclosures are complex and reasonable persons may disagree as to their application to a particular situation or set of circumstances.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We lease approximately 64,000 square feet of commercial office space in one building in West Des Moines, Iowa, for our principal offices under an operating lease that expires on December 31, 2015. We also lease approximately 6,000 square feet for our office in Pell City, Alabama, pursuant to an operating lease that expires on December 31, 2009.

**Item 3. Legal Proceedings**

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. During the fourth quarter of 2007, we received a formal request for information from the SEC concerning our acquisition of American Equity Investment Service Company on September 2, 2005. The SEC advised us that the request should not be construed as an adverse reflection on American Equity or any other person, nor should it be interpreted as an indication that American Equity or any other person has violated any law. We are cooperating with the SEC's request for information.

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

We are a defendant in two cases seeking class action status, including (i) *Stephens v. American Equity Investment Life Insurance Company, et. al.*, in the San Luis Obispo Superior Court, San Francisco, California (complaint filed November 29, 2004) (the "SLO Case") and (ii) *In Re: American Equity Annuity Practices and Sales Litigation*, in the United States District Court for the Central District of California, Western Division (complaint filed September 7, 2005) (the "Los Angeles Case"). The plaintiff in the SLO Case seeks to represent a class of individuals who are California residents and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. On November 3, 2008, the court issued an order certifying the class. We are seeking to decertify a portion of the class and may seek to decertify the entire class after further discovery into the merits of the case. We are vigorously defending the underlying allegations, which include misrepresentation, breach of contract, breach of a state law regarding unfair competition and other claims.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. We are vigorously defending against both class action status as well as the underlying claims, which include misrepresentation and violations of the Racketeer Influenced and Corrupt Organizations Act, among others.

### Item 4. Submission of Matters to a Vote of Security Holders

None.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol AEL. The following table sets forth the high and low prices of our common stock as quoted on the NYSE.

| **2008** | **High** | **Low** |
|---|---|---|
| First Quarter | $10.21 | $ 6.82 |
| Second Quarter | $11.63 | $ 7.61 |
| Third Quarter | $10.75 | $ 7.27 |
| Fourth Quarter | $ 7.75 | $ 3.65 |
| **2007** | | |
| First Quarter | $14.07 | $12.17 |
| Second Quarter | $13.97 | $11.37 |
| Third Quarter | $12.55 | $ 9.51 |
| Fourth Quarter | $11.25 | $ 8.09 |

As of December 31, 2008, there were approximately 7,100 holders of our common stock. In 2008 and 2007, we paid an annual cash dividend of $0.07 and $0.06, respectively, per share on our common stock. We intend to continue to pay an annual cash dividend on such shares so long as we have sufficient capital and/or future earnings to do so. However, we anticipate retaining most of our future earnings, if any, for use in our operations and the expansion of our business. Any further determination as to dividend policy will be made by our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition and future prospects and such other factors as our board of directors may deem relevant.

Since we are a holding company, our ability to pay cash dividends depends in large measure on our subsidiaries' ability to make distributions of cash or property to us. Iowa insurance laws restrict the amount of distributions American Equity Life can pay to us without the approval of the Iowa Insurance

Table of Contents

Division. See Management's Discussion and Analysis of Financial Condition and Results of Operations and note 11 to our audited consolidated financial statements.

There were no sales of unregistered equity securities during 2008.

**Issuer Purchases of Equity Securities**

There were no issuer purchases of equity securities for the quarter ended December 31, 2008.

We have a Rabbi Trust, the NMO Deferred Compensation Trust, which purchases our common shares to fund the amount of shares earned by our agents and vested under the NMO Deferred Compensation Plan. At December 31, 2008, agents had earned 87,613 shares which had vested but had not yet been purchased and contributed to the Rabbi Trust.

In addition, we have a share repurchase program under which we are authorized to purchase up to 10,000,000 shares of our common stock. As of December 31, 2008 we have repurchased 3,845,296 shares of our common stock under this program. We suspended the repurchase of our common stock under this program in August of 2008.

The maximum number of shares that may yet be purchased under these plans is 6,242,317 at December 31, 2008.

Table of Contents

## Item 6. Selected Consolidated Financial Data

The summary consolidated financial and other data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements and related notes appearing elsewhere in this report. The results for past periods are not necessarily indicative of results that may be expected for future periods.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| | (Dollars in thousands, except per share data) | | | | |
| **Consolidated Statements of Operations Data:** | | | | | |
| Revenues | | | | | |
| Traditional life and accident and health insurance premiums | $ 12,512 | $ 12,623 | $ 13,622 | $ 13,578 | $ 15,115 |
| Annuity product charges | 52,671 | 45,828 | 39,472 | 25,686 | 22,462 |
| Net investment income | 822,077 | 719,916 | 677,638 | 554,118 | 428,385 |
| Realized gains (losses) on investments | (187,093) | (3,882) | 1,345 | (7,635) | 943 |
| Change in fair value of derivatives | (372,009) | (59,985) | 183,783 | (18,029) | 28,696 |
| Gain on retirement of debt | 13,651 | | | | |
| Total revenues | 341,809 | 714,500 | 915,860 | 567,718 | 495,601 |
| Benefits and expenses | | | | | |
| Insurance policy benefits and change in future policy benefits | 8,972 | 8,419 | 8,808 | 8,504 | 10,151 |
| Interest credited to account balances | 205,131 | 560,209 | 404,269 | 299,254 | 298,399 |
| Amortization of deferred sales inducements | 30,705 | 11,708 | 24,793 | 12,225 | 10,635 |
| Change in fair value of embedded derivatives | (210,753) | (67,902) | 151,057 | 31,087 | (8,567) |
| Interest expense on notes payable | 15,425 | 16,221 | 20,382 | 16,324 | 2,358 |
| Interest expense on subordinated debentures | 19,445 | 22,520 | 21,354 | 14,145 | 9,609 |
| Interest expense on amounts due under repurchase agreements | 8,207 | 15,926 | 32,931 | 11,280 | 3,148 |
| Amortization of deferred policy acquisition costs | 126,738 | 56,330 | 94,923 | 68,109 | 67,867 |
| Other operating costs and expenses | 52,633 | 48,230 | 40,418 | 35,896 | 32,520 |
| Total benefits and expenses | 256,503 | 671,661 | 798,935 | 496,824 | 426,120 |
| Income before income taxes and minority interests | 85,306 | 42,839 | 116,925 | 70,894 | 69,481 |
| Income tax expense | 64,531 | 13,863 | 41,440 | 25,402 | 40,611 |
| Income before minority interests | 20,775 | 28,976 | 75,485 | 45,492 | 28,870 |
| Minority interest | | | | 2,500 | (453) |
| Net income | $ 20,775 | $ 28,976 | $ 75,485 | $ 42,992 | $ 29,323 |
| **Per Share Data:** | | | | | |
| Earnings per common share | $ 0.39 | $ 0.51 | $ 1.34 | $ 1.09 | $ 0.77 |
| Earnings per common share assuming dilution | $ 0.39 | $ 0.50 | $ 1.27 | $ 0.99 | $ 0.71 |
| Dividends declared per common share | $ 0.07 | $ 0.06 | $ 0.05 | $ 0.04 | $ 0.02 |

| | As of and for the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2005 | 2004 |
| | (Dollars in thousands, except per share data) | | | | |
| **Consolidated Balance Sheet Data:** | | | | | |
| Total assets | $ 17,087,813 | $ 16,394,372 | $ 14,990,123 | $ 14,042,794 | $ 11,087,288 |
| Policy benefit reserves | 15,809,539 | 14,711,780 | 13,207,931 | 12,237,988 | 9,807,969 |
| Notes payable | 258,462 | 268,339 | 266,383 | 281,043 | 283,375 |
| Subordinated debentures | 268,209 | 268,330 | 268,489 | 230,658 | 173,576 |
| Total stockholders' equity | 492,205 | 611,635 | 595,066 | 519,358 | 305,543 |

| | | | | | |
|---|---|---|---|---|---|
| **Other Data:** | | | | | |
| Book value per share (a) | $ 9.37 | $ 10.94 | $ 10.60 | $ 9.35 | $ 7.970 |
| Life subsidiaries' statutory capital and surplus | 983,325 | 990,801 | 992,478 | 686,841 | 608,930 |
| Life subsidiaries' statutory net gain from operations before income taxes and realized capital gains (losses) | 129,046 | 41,473 | 95,217 | 112,498 | 93,640 |
| Life subsidiaries' statutory net income (loss) | (7,073) | 17,010 | 89,875 | 40,534 | 47,711 |

(a) Book value per share is calculated as total stockholders' equity divided by the total number of shares of common stock outstanding. Shares outstanding include shares held by rabbi trusts and exclude unallocated shares held by our employee stock ownership plan see note 10 to our audited consolidated financial statements.

Table of Contents

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis reviews our consolidated financial position at December 31, 2008 and 2007, and our consolidated results of operations for the three years in the period ended December 31, 2008, and where appropriate, factors that may affect future financial performance. This discussion should be read in conjunction with our audited consolidated financial statements, notes thereto and selected consolidated financial data appearing elsewhere in this report.

### 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 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 the 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 private placement memorandums or filings with the SEC.

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of this report.

### 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 charges deducted from the account balances of policyholders in connection with withdrawals, realized gains and losses on investments and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest credited to account balances, changes in fair value of embedded derivatives, amortization of deferred policy acquisition costs and deferred sales inducements, other operating costs and expenses and income taxes.

Table of Contents

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:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Average yield on invested assets | 6.20% | 6.11% | 6.14% |
| Cost of money: | | | |
| Aggregate | 3.43% | 3.50% | 3.41% |
| Cost of money for index annuities | 3.43% | 3.51% | 3.28% |
| Average crediting rate for fixed rate annuities: | | | |
| Annually adjustable | 3.26% | 3.28% | 3.25% |
| Multi-year rate guaranteed | 3.88% | 4.14% | 4.81% |
| Investment spread: | | | |
| Aggregate | 2.77% | 2.61% | 2.73% |
| Index annuities | 2.77% | 2.60% | 2.86% |
| Fixed rate annuities: | | | |
| Annually adjustable | 2.94% | 2.83% | 2.89% |
| Multi-year rate guaranteed | 2.32% | 1.97% | 1.33% |

The cost of money for 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. With respect to our index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration or early termination of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies Derivative Instruments Index Products.

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 assets, our ability to manage interest rates credited to policyholders and costs of the options purchased to fund the annual index credits on our index annuities, our ability to manage the costs of acquiring new business (principally commissions to agents and first year bonuses credited to policyholders) and our ability to manage our operating expenses.

**Critical Accounting Policies**

The increasing complexity of the business environment and applicable authoritative accounting guidance require us to closely monitor our accounting policies. We have identified five critical accounting policies that are complex and require significant judgment. The following summary of our critical accounting policies is intended to enhance your ability to assess our financial condition and results of operations and the potential volatility due to changes in estimates.

*Valuation of Investments*

Our fixed maturity securities (bonds and redeemable preferred stocks maturing more than one year after issuance) and equity securities (common and non-redeemable preferred stocks) classified as available for sale are reported at fair value. Unrealized gains and losses, if any, on these securities are included directly in stockholders' equity as a component of Accumulated Other Comprehensive Loss, net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements. Unrealized gains and losses represent the difference between the cost (book) basis and the estimated fair value of these investments. We use significant judgment within the process used to determine fair value of these investments.

Effective January 1, 2008, we adopted Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value as 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. Three levels of fair value hierarchy were established by SFAS 157 to set priority for use of inputs in determining fair value. The highest level inputs (Level 1) are quoted prices in active markets for identical assets. Level 2 inputs are observable market data other than Level 1 inputs such as quoted prices for similar assets, quoted prices for identical or similar assets in markets that are not active and inputs other than quoted prices (interest rates, yield curves, etc.). Level 3 inputs are our own assumptions about what a market participant would use in determining fair value such as estimated future cash flows and replacement costs.

The following table presents the fair value of fixed maturity and equity securities, available for sale, by pricing source and SFAS 157 hierarchy level as of December 31, 2008:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| Priced via third party pricing services | $ 169,499 | $ 1,839,770 | $ | $ 2,009,269 |
| Priced via independent broker quotations | 2,733 | 4,633,011 | | 4,635,744 |
| Priced via matrices | | 51,199 | | 51,199 |
| Priced via other methods | | 12,304 | 20,082 | 32,386 |
| | $ 172,232 | $ 6,536,284 | $ 20,082 | $ 6,728,598 |
| % of Total | 2.6% | 97.1% | 0.3% | 100.0% |

Management's assessment of all available data when determining fair value of our investments is necessary to appropriately apply SFAS 157. The first step in our process of determining fair value of our investments is obtaining quotes for each individual investment from an independent broker. These quotes are non-binding, but they are determined based on observable market data. The process that the independent broker uses for determining fair value begins with obtaining prices from an independent pricing service. The broker then evaluates other observable market data to determine if that price should be modified for facts and circumstances that may have not been considered by the pricing service. Inputs used by both the broker and the pricing service include market information, such as yield data, and other factors relating to instruments or securities with similar characteristics.

If there is sufficient trading volumes and the market in which the investment is traded is determined to be active, the independent broker determines the price to be the value at which trades were initiated at the financial reporting date. If there were an insufficient number of trades to determine a price based on actual trades, then the independent broker will utilize the pricing service's price as well as available market information, to determine a fair value price. For those securities that the pricing service does not provide a price, the independent broker will use a pricing matrix, as well as other known market data, to determine a fair value price.

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

*Evaluation of Other Than Temporary Impairments*

The evaluation of investments for other than temporary impairments involves significant judgment and estimates by management. The carrying amount of each of our investments is reviewed on an ongoing basis for changes in market interest rates and credit deterioration. If this review indicates a decline in fair value below cost or amortized cost that is other than temporary, our carrying amount in the investment is reduced to its fair value and a specific write down is taken. Such reductions in carrying amount are recognized as realized losses and charged to earnings. The fair value of the other than temporarily impaired investment becomes its new cost basis. For fixed maturities, we accrete the new cost basis to the estimated future cash flows over the expected remaining life of the security by adjusting the security's yield.

Our periodic assessment of our ability to recover the amortized cost basis of investments that have materially lower estimated fair values requires a high degree of management judgment and involves uncertainty. The evaluation of securities for impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in fair value of investments should be recognized in current period earnings. Factors considered in evaluating whether a decline in value is other than temporary include:

- the length of time and the extent to which the fair value has been less than 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 and ability to retain the investment for a period of time sufficient to allow for recovery;
- consideration of rating agency actions;
- changes in estimated cash flows of asset-backed and mortgage-backed securities; and
- our assessment in the case of equity securities including perpetual preferred stocks that the security cannot recover to cost in a reasonable period of time.

In addition, where our intent was to retain the investment to allow for recovery, but our intent changes due to changes or events that could not have been reasonably anticipated, an other than temporary impairment charge is recognized. Once an impairment charge has been recorded, we then continue to review the other than temporarily impaired securities for appropriate valuation on an ongoing basis. Unrealized losses may be recognized in future periods through a charge to earnings, should we later conclude that the decline in fair value below amortized cost is other than temporary pursuant to our accounting policy described above. The use of different methodologies and assumptions

Table of Contents

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.

*Derivative Instruments Index Products*

We offer a variety of index annuities with crediting strategies linked to the S&P 500 Index and other equity and bond market indices. We purchase call options on the applicable indices as an investment to provide the income needed to fund the annual index credits on the index products. New one-year options are purchased at the outset of each contract year. We purchase call options weekly and daily based upon new and renewing index account values during the applicable week or day, and the purchases are made by category according to the particular products and indices applicable to the new or renewing account values. Any proceeds received at the expiration of the one-year option term fund the related index credits to the policyholders. If there is no gain in an index, the policyholder receives a zero index credit on the policy, and we incur no costs beyond the option cost, except in cases where the minimum guaranteed value of a contract exceeds its index value.

Fair value changes associated with the call options are reported as an increase or decrease in revenues in our consolidated statements of operations in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133"). Under SFAS 133, all of our derivative instruments associated with our index products, including certain derivative instruments embedded in the index annuity contracts, are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings. This impacts certain revenues and expenses we report for our index business as follows:

We must mark to market the call options purchased to fund the annual index credits on our index annuities based upon quoted market prices from related counterparties and the associated credit worthiness of each counterparty. We record the change in fair value of these options as a component of our 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.

Under SFAS 133, the contractual obligations for future annual index credits are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. Policy liabilities for index annuities are equal to the sum of the "host" (or guaranteed) component and the embedded derivative component for each index annuity policy. The host value is established at inception of the contract and accreted over the policy's life at a constant rate of interest. We estimate the fair value of the embedded derivative component at each valuation date by (i) projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and (ii) discounting the excess of the projected contract value amounts at the applicable risk free interest rates adjusted for non-performance 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. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in the fair values of the call options purchased to fund the annual index credits and changes in the interest rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values. The amounts reported in the consolidated statements of operations as "Interest credited to account balances" represent amounts credited to policy liabilities pursuant to SFAS 97 which include index credits through the most recent policy anniversary. The amounts reported in the consolidated statements of operations as "Changes in fair value of embedded derivatives" equal the change in the difference between policy benefit reserves for index annuities under SFAS 133 and SFAS 97 at each balance sheet date.

In general, the change in the fair value of the embedded derivatives will not correspond to the change in fair value of the purchased call options because the purchased call options are one year options while the options valued in the embedded derivatives represent the rights of the contract holder to receive index credits over the entire period the index annuities are expected to be in force, which typically exceeds 10 years.

If the discount rates used to discount the excess projected contract values at December 31, 2008 were to increase by 100 basis points, our reserves for index annuities would decrease by $59.8 million and there would be a corresponding decrease of $39.2 million to our combined balance for deferred policy acquisition costs and deferred sales inducements. Correspondingly, a decrease by 100 basis points in the discount rate used to discount the excess projected contract values would increase our reserves for index annuities by $66.1 million and increase our combined balance for deferred policy acquisition costs and deferred sales inducements by $30.5 million.

*Deferred Policy Acquisition Costs and Deferred Sales Inducements*

Costs relating to the production of new business are not expensed when incurred but instead are capitalized as deferred policy acquisition costs or deferred sales inducements. Only costs which are expected to be recovered from future policy revenues and gross profits may be deferred. Deferred policy acquisition costs and deferred sales inducements are subject to loss recognition testing on a quarterly basis or when an event occurs that may warrant loss recognition. Deferred policy acquisition costs consist principally of commissions and certain costs of policy issuance. Deferred sales inducements consist of first-year premium and interest bonuses credited to policyholder account balances.

For annuity products, these costs are being amortized generally in proportion to expected gross profits from interest margins and, to a lesser extent, from surrender charges. Current and future period gross profits/margins for index annuities also include the impact of amounts recorded for the change in fair value of derivatives and the change in fair value of embedded derivatives. Current period amortization is adjusted 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. Our estimates of future gross profits/margins are based on actuarial assumptions related to the underlying policies terms, lives of the policies, yield on investments supporting the liabilities and level of expenses necessary to maintain the polices over their entire lives. Revisions are made based on historical results and our best estimates of future experience.

The impact of unlocking during 2008 was a $1.3 million increase in the amortization of deferred sales inducements and a $14.6 million increase in amortization of deferred policy acquisition costs. The impact of unlocking during 2008 was primarily due to actual index credits to policies being lower than what was estimated due to the lack of performance of the indices upon which the index credits are based. There were no changes in our estimated future gross profits in 2007 that resulted in adjustments to the combined balance of deferred policy acquisition costs and deferred sales inducements. The impact of unlocking during 2006 was a $0.6 million decrease in amortization of deferred sales inducements and a $0.3 million increase in amortization of deferred policy acquisition costs. The impact of unlocking during 2006 was primarily due to the impact of actual surrender experience on certain older business, offset in part by increases in the estimates of projected future interest margins and reductions in the estimates of projected future policy maintenance expenses.

If estimated gross profits for all future years on business in force at December 31, 2008 were to increase by a reasonably likely amount of 10%, our combined balance for deferred policy acquisition costs and deferred sales inducements at December 31, 2008 would increase by $41.8 million. Correspondingly, a reasonably likely 10% decrease in estimated gross profits for all future years would result in a $46.6 million decrease in the combined December 31, 2008 balances.

*Deferred Income Taxes*

We account for income taxes using the liability method. This method provides for the tax effects of transactions reported in the consolidated financial statements for both taxes currently due and deferred. Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. A temporary difference is a transaction, or amount of a transaction, that is recognized currently for financial reporting purposes but will not be recognized for tax purposes until a future tax period, or is recognized currently for tax purposes but will not be recognized for financial reporting purposes until a future reporting period. Deferred income taxes are measured by applying enacted tax rates for the years in which the temporary differences are expected to be recovered or settled to the amount of each temporary difference.

The realization of deferred income tax assets is primarily based upon management's estimates of future taxable income. Valuation allowances are established when management estimates, based on available information, that it is more likely than not that deferred income tax assets will not be realized. Significant judgment is required in determining whether valuation allowances should be established, as well as the amount of such allowances. When making such determination, consideration is given to, among other things, the following:

- future taxable income of the necessary character exclusive of reversing temporary differences and carryforwards;
- future reversals of existing taxable temporary differences;
- taxable income in prior carryback years; and
- tax planning strategies.

Actual realization of deferred income tax assets and liabilities may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting related income tax balances.

The realization of deferred income tax assets related to unrealized losses on our available for sale fixed maturity securities is also based upon our intent to hold these securities for a period of time sufficient to allow for a recovery in fair value and not realize the unrealized loss. During 2008, we established a valuation allowance of $34.5 million and a corresponding increase in tax expense in connection with deferred income tax assets related to realized losses from other than temporary impairments and capital loss carryforwards.

**Results of Operations for the Three Years Ended December 31, 2008**

Annuity deposits by product type collected during 2008, 2007 and 2006, were as follows:

| Product Type | Year Ended December 31, 2008 | 2007 | 2006 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Index Annuities: | | | |
| Index Strategies | $1,303,871 | $1,578,347 | $1,160,467 |
| Fixed Strategy | 937,227 | 515,229 | 626,791 |
| | 2,241,098 | 2,093,576 | 1,787,258 |
| Fixed Rate Annuities: | | | |
| Single-Year Rate Guaranteed | 28,930 | 45,948 | 76,164 |
| Multi-Year Rate Guaranteed | 18,978 | 5,158 | 6,544 |
| | 47,908 | 51,106 | 82,708 |
| Total before coinsurance ceded | 2,289,006 | 2,144,682 | 1,869,966 |
| Coinsurance ceded | 1,310 | 1,779 | 2,859 |
| Net after coinsurance ceded | $2,287,696 | $2,142,903 | $1,867,107 |

Net annuity deposits after coinsurance increased 7% during 2008 compared to 2007, and 15% during 2007 compared to 2006. We attribute the increase in 2008 to several factors, including our continued strong relationships with our national marketing organizations and field force of licensed, independent insurance agents, the increased attractiveness of safe money products in volatile markets, declining interest rates on competing products such as bank certificates of deposit, and product enhancements including a new generation of guaranteed income withdrawal benefit riders. We attribute the increase in 2007 to the reinstatement of our A.M. Best Company financial strength rating to A- (Excellent) from B++ (Very Good) on August 3, 2006, certain product initiatives and agent incentives introduced in 2007 and more rational pricing from certain competitors.

**Net income** decreased 28% to $20.8 million in 2008 and 62% to $29.0 million in 2007, from $75.5 million in 2006. Net income for 2008 includes the impact of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* ("SFAS 157") as discussed below.

Net income has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. Average annuity account values outstanding increased 13% for the year ended December 31, 2008 compared to 2007 and 12% for the year ended December 31, 2007 compared to 2006. Our investment spread measured on a percentage basis was 2.77%, 2.61% and 2.73% for the years ended December 31, 2008, 2007 and 2006, respectively. The increase in investment spread for 2008 compared to 2007 resulted from a higher investment yield earned on average assets due to higher yields on investments purchased subsequent to 2007 and a lower aggregate cost of money on our index annuities. The lower cost of money for index annuities during 2008 was due to adjustments we made throughout 2007 to caps, participation rates and asset fees to manage the cost of options purchased to fund the annual index credits. The decrease in investment spread for 2007 compared to 2006 was due to a higher average cost of money for index annuities. The higher cost of money for index annuities during 2007 was due to increases in the cost of options purchased to fund the index credits on our index annuities which was attributable to increased equity market volatility throughout 2007.

Table of Contents

The comparability of the net income amounts is significantly impacted by realized gains (losses) on investments, the impact of the application of SFAS 133 to our index annuity business and contingent convertible senior notes and gain on retirement of debt. We estimate that these items increased (decreased) net income as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| Realized gains (losses) on investments | $ (92,524) | $ (1,688) | $ 427 |
| Application of SFAS 133 to index annuity business | 31,125 | (32,727) | (4,352) |
| Application of SFAS 133 to contingent convertible senior notes | (609) | (624) | 6,076 |
| Gain on retirement of debt | 7,986 | | |

Realized gains and losses on investments fluctuate from year to year based upon changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. We recognized significant other than temporary impairments on fixed income and equity securities during 2008. The amounts disclosed above are net of the related reductions in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes. Income tax benefits related to realized gains (losses) on investments have been reduced by $34.5 million in 2008 for the establishment of a deferred tax valuation allowance related to the other than temporary impairments and capital loss carryforwards.

Amounts attributable to the application of SFAS 133 to our index annuity business fluctuate based upon changes in the fair values of call options purchased to fund the annual index credits for index annuities and changes in the interest rates used to discount the embedded derivative liability. The significant increase in the impact from this item for 2008 is primarily attributable to the adoption of SFAS 157 which requires that the discount rates used in the calculation of the fair value of embedded derivatives for index annuities include non performance risk related to those liabilities. Prior to the adoption of SFAS 157, the discount rates used were risk-free interest rates. SFAS 157 was adopted prospectively on January 1, 2008, and the changes in the discount rates resulted in a decrease in policy benefit reserves on January 1, 2008 of $150.6 million. The net income impact of this decrease in reserves net of the related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs and income taxes was $40.7 million. Excluding the impact of the adoption of SFAS 157, amounts attributable to the application of SFAS 133 to our index annuity business for the year ended December 31, 2008 were significantly less than 2007 due to the negative equity market performance in 2008 compared to a stronger equity market performance in 2007. The significant increase in the impact from this item for 2007 compared to 2006 is attributable to the overall decline in the equity markets during 2007 and declines in the risk-free interest rates used to discount the embedded derivative liability.

Changes in the amounts attributable to the application of SFAS 133 to our contingent convertible senior notes are discussed below under change in fair value of embedded derivatives and interest expense on notes payable.

**Annuity product charges** (surrender charges assessed against policy withdrawals) increased 15% to $52.7 million in 2008, and 16% to $45.8 million in 2007, from $39.5 million in 2006. The increase in 2008 was principally due to an increase in the average surrender charge collected. The increase in 2007 was principally due to an increase in policy withdrawals subject to surrender charges due to growth in the volume and aging of the business in force. Withdrawals from annuity and single premium universal life policies subject to surrender charges were $337.5 million, $325.5 million and $270.3 million for 2008, 2007 and 2006, respectively. The average surrender charge collected on withdrawals subject to a surrender charge was 15.5%, 14.0% and 14.5% for 2008, 2007 and 2006, respectively.

Table of Contents

**Net investment income** increased 14% to $822.1 million in 2008 and 6% to $719.9 million in 2007 from $677.6 million in 2006. These increases were principally attributable to the growth in our annuity business and corresponding increases in our invested assets and the average yield earned on investments. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 6% to $13.2 billion at December 31, 2008 and 13% to $12.5 billion at December 31, 2007 compared to $11.1 billion at December 31, 2006, while the average yield earned on average invested assets was 6.20%, 6.11% and 6.14% for 2008, 2007 and 2006, respectively. The increase in the yield earned on average invested assets for 2008 was attributable to higher yields on investments purchases subsequent to September 30, 2007. The decline in the yield earned on average invested assets for 2007 was attributable to an overall decline in yield on the mix of assets owned in the respective periods. See Quantitative and Qualitative Disclosures About Market Risk.

**Realized gains (losses) on investments** include gains and losses on the sale of securities as well as losses recognized when the fair value of a security is written down through earnings in recognition of an other than temporary impairment. Realized gains and losses on investments fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. The components of realized gains (losses) on investments for the years ended December 31, 2008, 2007 and 2006 are set forth in the table that follows. See Financial Condition Investments for additional discussion of write downs of the fair values of securities for other than temporary impairments.

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| Available for sale fixed maturity securities: | | | |
| Gross realized gains | $ 5,852 | $ 931 | $ 4,628 |
| Gross realized losses | (589) | (88) | (3,054) |
| Other than temporary impairments | (123,131) | (3,948) | (1,337) |
| | (117,868) | (3,105) | 237 |
| Equity securities: | | | |
| Gross realized gains | 292 | 232 | 1,208 |
| Gross realized losses | | (574) | (100) |
| Other than temporary impairments | (69,517) | (435) | |
| | (69,225) | (777) | 1,108 |
| | $ (187,093) | $ (3,882) | $ 1,345 |

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

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| Call options: | | | |
| Gain (loss) on option expiration or early termination | $ (270,361) | $ 183,488 | $ 61,846 |
| Change in unrealized gain/loss | (100,453) | (242,199) | 121,833 |
| Interest rate swaps | (1,195) | (1,274) | 104 |
| | $ (372,009) | $ (59,985) | $ 183,783 |

Table of Contents

The differences between the change in fair value of derivatives between years 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 for options expiring during the years ended December 31, 2008, 2007 and 2006 is as follows:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2008 | | 2007 | | 2006 | |
| S&P 500 Index | | | | | | |
| Point-to-point strategy | 0.0% | 2.6% | 6.9% | 24.4% | 1.4% | 16.0% |
| Monthly average strategy | 0.0% | 6.4% | 1.2% | 14.1% | 1.1% | 9.1% |
| Monthly point-to-point strategy | 0.0% | 0.0% | 0.0% | 18.8% | 0.0% | 12.7% |
| Lehman Brothers U.S. Aggregate and U.S. Treasury indices | 0.3% | 7.0% | 2.6% | 8.8% | 0.0% | 5.9% |

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the index annuity policies (caps, participation rates, and asset fees) which allow us to manage the cost of the options purchased to fund the annual index credits. 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 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. Costs for options purchased during the year ended December 31, 2008 decreased compared to 2007 due to adjustments to caps, participation rates, and asset fees. During the year ended December 31, 2007, the cost of options increased compared to 2006 due to market volatility. See Critical Accounting Policies  Derivative Instruments  Index Products.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. Our maximum remaining exposure due to the Lehman bankruptcy was $16.8 million at December 31, 2008. As of December 31, 2008, we have recorded no fair value in respect to the unexpired options we own that were purchased from Lehman after taking into consideration counterparty risk. The amount of loss that we will realize upon expiration of these options will depend on the performance of the underlying indices upon which the options are based, the amount of related index credits we will make to policyholders and the amount, if any, that we will recover from Lehman through our claim in bankruptcy proceedings. The amount of option proceeds due on expired options purchased from Lehman that we did not receive payment on for 2008 was $2.1 million.

**Gain on retirement of debt** of $13.7 million in 2008 resulted from the purchase of $78.1 million of principal amount of our convertible senior notes at a discount. See Financial Condition  Liabilities for a description of our convertible senior notes.

**Interest credited to account balances** decreased 63% to $205.1 million in 2008 and increased 39% to $560.2 million in 2007 from $404.3 million in 2006. The components of interest credited to account balances are summarized as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| Index credits on index policies | $ 33,337 | $403,416 | $219,586 |
| Interest credited (including changes in minimum guaranteed interest for index annuities) | 171,794 | 156,793 | 184,683 |
| | $205,131 | $560,209 | $404,269 |

Table of Contents

The changes 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 or gains recognized upon early termination of the call options purchased to fund the annual index credits were $26.2 million, $392.1 million and $214.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. The increase in interest credited for 2008 was due to an increase in minimum guaranteed interest for index annuities and an increase in the average amount of annuity liabilities outstanding receiving a fixed rate of interest offset in part by decreases in interest crediting rates on several of our products and an immaterial correction to single premium annuity reserves in the fourth quarter of 2008 which reduced interest credited by $2.2 million. The increase in minimum guaranteed interest for index annuities is directly attributable to the weak equity market performance during 2008 which resulted in the decreases in index credits. The decrease in interest credited for 2007 was due to a decrease in the average amount of annuity liabilities outstanding receiving a fixed rate of interest and decreases in interest crediting rates on several of our products. A significant factor in the reductions in interest credited on fixed rate annuities in 2007 was the reduced interest on multi-year rate guarantee annuities. A significant amount of these annuities were sold in 2001 with an initial rate guaranteed for the first five policy years. We experienced surrenders of these policies upon expiration of this initial guaranteed interest during 2006 and reduced the crediting rates on those policies that remained in force. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 13% to $13.5 billion in 2008 and 12% to $11.9 billion in 2007 from $10.6 billion in 2006.

**Amortization of deferred sales inducements** increased 162% to $30.7 million in 2008 and decreased 53% to $11.7 million in 2007 from $24.8 million in 2006. Amortization of deferred sales inducements was increased by $1.3 million in 2008 and decreased by $0.6 million during 2006 due to the impact of unlocking discussed above. In general, amortization of deferred sales inducements has been increasing each year due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium and interest bonus annuity products. Bonus products represented 92%, 86% and 77% of our total annuity deposits during 2008, 2007 and 2006, respectively. The anticipated increase in amortization from these factors has been affected by amortization associated with the application of SFAS 133 to our index annuity business and amortization associated with net realized losses on investments.

The application of SFAS 133 to our index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our 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 life of the contracts which typically exceed 10 years. The gross profit adjustments resulting from the application of SFAS 133 to our index annuity business increased amortization by $13.9 million, and decreased amortization by $23.4 million and $2.9 million in 2008, 2007 and 2006, respectively. The gross profit adjustments from net realized gains and losses on investments decreased amortization by $35.6 million and $0.3 million in 2008 and 2007, respectively, and increased amortization by $0.2 million in 2006. Excluding the amortization amounts attributable to the application of SFAS 133 and realized gains and losses on investments, amortization would have been $52.4 million, $35.4 million and $27.5 million for 2008, 2007 and 2006, respectively. See Critical Accounting Policies  Deferred Policy Acquisition Costs and Deferred Sales Inducements.

Table of Contents

**Change in fair value of embedded derivatives** was a decrease of $210.8 million during 2008 compared to a decrease of $67.9 million in 2007 and an increase of $151.1 million in 2006. The components of change in fair value of derivatives are summarized as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| | (Dollars in thousands) | | |
| Index annuities | $(210,753) | $(67,902) | $166,285 |
| Contingent convertible senior notes | | | (15,228) |
| | $(210,753) | $(67,902) | $151,057 |

The changes related to the embedded derivatives within our index annuities resulted from (i) changes in the expected index credits on the next policy anniversary dates, which are related to the change in fair value of the call options acquired to fund these index credits discussed above in change in fair value of derivatives; (ii) changes in discount rates used in estimating our liability for policy growth; (iii) changes in estimates of expected costs of annual call options that will be purchased in the future to fund index credits beyond the next policy anniversary; and (iv) the growth in the host component of the policy liability. See Critical Accounting Policies Derivative Instruments Index Products. The primary reasons for the significant decrease in the fair value of embedded derivatives for 2008 were increases in the discount rates used in estimating our liability for policy growth and a decrease in our estimate of the expected future cost of annual call options. The increase in the discount rates to reflect the non performance risk of the Company upon the adoption of SFAS 157 on January 1, 2008 as discussed above decreased the fair value of embedded derivatives for 2008 by $150.6 million and the decrease in the estimate of future option costs decreased the fair value of the embedded derivatives for 2008 by $51.6 million.

The conversion option embedded within our contingent convertible senior notes was required to be bifurcated and recorded at fair value in accordance with SFAS 133 beginning December 15, 2005 due to an insufficient number of authorized shares. See notes 1 and 7 to our audited consolidated financial statements. Effective June 8, 2006, the conversion option was no longer required to be bifurcated and recorded at fair value upon shareholder approval of an increase of authorized shares. The change in the fair value of the conversion option embedded within these notes for the year ended December 31, 2006 coincides with the changes in the per share price of our common stock during the period of time during 2006 that the conversion option was required to be bifurcated.

**Interest expense on notes payable** decreased 5% to $15.4 million in 2008 and 20% to $16.2 million in 2007 from $20.4 million in 2006. The decrease in 2008 was attributable to our purchase of $78.1 million principal amount of our 5.25% contingent convertible notes during 2008, offset in part by interest on borrowings under our revolving line of credit, which had a weighted average interest rate of 4.14% for the year ended December 31, 2008. The line of credit borrowings were used to fund the purchase of our common stock and our contingent convertible notes. The decrease in 2007 was primarily due to a decrease in the amortization of the discount on our contingent convertible notes to $1.1 million from $4.7 million in 2006. This discount was created in the fourth quarter of 2005 when the conversion option embedded in our contingent convertible senior notes was bifurcated from the host instrument, and adjusted when the derivative was unbifurcated from the host instrument on June 8, 2006. See note 8 to our audited consolidated financial statements.

**Interest expense on subordinated debentures** decreased 14% to $19.4 million in 2008 and increased 5% to $22.5 million in 2007 from $21.4 million in 2006. The decrease for 2008 was primarily due to decreases in the weighted average interest rates on the outstanding subordinated debentures. The increase for 2007 was primarily due to the issuance of additional subordinated debentures of $41.2 million during 2006, offset by decreases in the weighted average interest rates on the outstanding subordinated debentures. The weighted average interest rate on the outstanding subordinated debentures were 7.15%, 8.32% and 8.35% for 2008, 2007 and 2006, respectively. The weighted average interest rates have decreased because substantially all of the subordinated debentures issued during 2004 - 2006 have a floating rate of interest based upon the three month London Interbank Offered Rate plus an applicable margin. See Financial Condition  Liabilities.

**Interest expense on amounts due under repurchase agreements** decreased 48% to $8.2 million in 2008 and 52% to $15.9 million in 2007 from $32.9 million in 2006. The decrease in 2008 was principally due to a decrease in the weighted average interest rates on amounts borrowed, offset by an increase in the borrowings outstanding. The decrease in 2007 was principally due to a decrease in the borrowings outstanding, offset by an increase in the weighted average interest rates on amounts borrowed. Weighted average interest rates were 2.28%, 5.27% and 5.24% for 2008, 2007 and 2006, respectively, and average borrowings outstanding were $359.9 million, $301.9 million and $628.0 million during 2008, 2007 and 2006, respectively.

**Amortization of deferred policy acquisition costs** increased 125% to $126.7 million in 2008 and decreased 41% to $56.3 million in 2007 from $94.9 million in 2006. Amortization of deferred policy acquisition costs was increased by $14.6 million in 2008 and $0.3 million during 2006 due to the impact of unlocking discussed above. In general, amortization has been increasing each year due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The anticipated increase in amortization from these factors has been affected by amortization associated with the application of SFAS 133 to our index annuity business and amortization associated with net realized losses on investments.

As discussed above, the application of SFAS 133 to our index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our index annuity contracts. The gross profit adjustments resulting from the application of SFAS 133 to our index annuity business increased amortization by $44.2 million, and decreased amortization by $52.3 million, and $6.7 million in 2008, 2007 and 2006, respectively. The gross profit adjustments from net realized gains (losses) decreased amortization by $61.6 million and $0.9 million for 2008 and 2007, respectively, and increased amortization by $0.5 million in 2006. Excluding the amortization amounts attributable to the application of SFAS 133 and realized gains and losses on investments, amortization would have been $144.2 million, $109.5 million and $101.1 million for 2008, 2007 and 2006, respectively.

**Other operating costs and expenses** increased 9% to $52.6 million in 2008 and 19% to $48.2 million in 2007 from $40.4 million in 2006. The increase in 2008 was principally attributable to an increase of $4.3 million in salaries and benefits and $1.0 million in general overhead, offset by decreases in legal fees of $0.8 million. The increase in 2007 was principally attributable to increases in legal fees related to the defense of ongoing litigation amounting to $6.0 million and $1.2 million in costs related to the development of an electronic document database.

**Income tax expense** increased 365% to $64.5 million in 2008 and decreased 67% to $13.9 million in 2007 from $41.4 million in 2006. The increase for 2008 was primarily due to the establishment of a deferred tax valuation allowance related to realized losses from other than temporary impairments which increased income tax expense for the year ended December 31, 2008 by $34.5 million, and changes in income before income taxes. The effective tax rates were 75.6%, 32.4% and 35.4% for 2008, 2007 and 2006, respectively. The effective tax rate for 2008 was more than the applicable statutory federal income tax rate of 35% primarily due to the establishment of the deferred tax valuation allowance as discussed above. The effective tax rate for 2007 was less than the applicable statutory federal income tax rate of 35% and the preceding year's effective tax rate primarily due to state income tax benefits attributable to losses in the non-life subgroup.

Table of Contents

**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, mortgage loans on real estate and short-term investments.

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 and debt securities rated investment grade by established nationally recognized rating organizations 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:

| | December 31, | | | |
|---|---|---|---|---|
| | 2008 | | 2007 | |
| | Carrying Amount | Percent | Carrying Amount | Percent |
| | (Dollars in thousands) | | | |
| Fixed maturity securities: | | | | |
| United States Government full faith and credit | $ 22,050 | 0.2% | $ 19,882 | 0.2% |
| United States Government sponsored agencies | 6,633,481 | 52.1% | 8,208,909 | 65.1% |
| Corporate securities, including redeemable preferred stocks | 1,764,390 | 13.9% | 1,419,129 | 11.2% |
| Mortgage and asset-backed securities | 1,813,274 | 14.3% | 716,585 | 5.7% |
| Total fixed maturity securities | 10,233,195 | 80.5% | 10,364,505 | 82.2% |
| Equity securities | 99,552 | 0.8% | 87,412 | 0.7% |
| Mortgage loans on real estate | 2,329,824 | 18.3% | 1,953,894 | 15.5% |
| Derivative instruments | 56,588 | 0.4% | 204,657 | 1.6% |
| Policy loans | 446 | | 427 | |
| | $ 12,719,605 | 100.0% | $ 12,610,895 | 100.0% |

During 2008, we received $2.8 billion in net redemption proceeds related to calls of our callable United States Government sponsored agency securities, of which $2.0 billion were classified as held for investment. We reinvested the proceeds from these redemptions primarily in corporate securities and mortgage-backed securities classified as available for sale. At December 31, 2008, 65% of our fixed income securities have call features and 14% of those securities were subject to call redemption. Another 48% of our fixed income securities will become subject to call redemption during 2009.

Table of Contents

A summary of our mortgage and asset-backed portfolios by collateral type split between investment grade and non-investment grade based upon National Association of Insurance Commissioners ("NAIC") designation is as follows:

| | December 31, 2008 | | | December 31, 2007 | | |
|---|---|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Percent of Fixed Maturity Securities | Amortized Cost | Estimated Fair Value | Percent of Fixed Maturity Securities |
| | (Dollars in thousands) | | | (Dollars in thousands) | | |
| **Investment grade** | | | | | | |
| Government agency | $ 72,959 | $ 74,923 | 0.7% | $ 75,611 | $ 75,353 | 0.7% |
| Prime | 1,382,684 | 1,198,272 | 11.7% | 453,337 | 439,158 | 4.2% |
| Alt-A | 357,059 | 280,182 | 2.7% | 187,707 | 184,258 | 1.8% |
| Non-mortgage | 16,841 | 15,764 | 0.2% | 20,020 | 17,816 | 0.2% |
| | 1,829,543 | 1,569,141 | 15.3% | 736,675 | 716,585 | 6.9% |
| **Below investment grade:** | | | | | | |
| Prime | 80,464 | 65,708 | 0.6% | | | |
| Alt-A | 185,849 | 178,425 | 1.7% | | | |
| | 266,313 | 244,133 | 2.3% | | | |
| | $2,095,856 | $1,813,274 | 17.6% | $736,675 | $ 716,585 | 6.9% |

The table below presents our total fixed maturity securities by NAIC designation and the equivalent ratings of a nationally recognized securities rating organization.

| | | December 31, | | | |
|---|---|---|---|---|---|
| | | 2008 | | 2007 | |
| NAIC Designation | Rating Agency | Carrying Amount | Percent | Carrying Amount | Percent |
| | | (Dollars in thousands) | | | |
| 1 | Aaa/Aa/A | $ 8,510,772 | 83.2% | $ 9,361,755 | 90.3% |
| 2 | Baa | 1,292,303 | 12.6% | 915,259 | 8.8% |
| Total investment grade | | 9,803,075 | 95.8% | 10,277,014 | 99.1% |
| 3 | Ba | 225,594 | 2.2% | 53,784 | 0.5% |
| 4 | B | 135,989 | 1.3% | 20,310 | 0.3% |
| 5 | Caa and lower | 31,375 | 0.3% | 13,397 | 0.1% |
| 6 | In or near default | 37,162 | 0.4% | | |
| Total below investment grade | | 430,120 | 4.2% | 87,491 | 0.9% |
| | | $10,233,195 | 100.0% | $10,364,505 | 100.0% |

We have experienced credit deterioration in our fixed maturity portfolio which primarily occurred during the fourth quarter of 2008 on mortgage-backed securities and financial sector securities due to the global financial crisis.

The amortized cost and estimated fair value of fixed maturity securities by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of the Company's

Table of Contents

mortgage-backed and asset-backed securities provide for periodic payments throughout their lives, and are shown below as a separate line item.

| | Available-for-sale | | Held for investment | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| **December 31, 2008** | | | | |
| Due after one year through five years | $ 313,611 | $ 282,869 | $ | $ |
| Due after five years through ten years | 797,903 | 728,597 | | |
| Due after ten years through twenty years | 2,259,873 | 2,211,963 | 805,170 | 801,384 |
| Due after twenty years | 1,692,043 | 1,592,343 | 2,798,979 | 2,786,730 |
| | 5,063,430 | 4,815,772 | 3,604,149 | 3,588,114 |
| Mortgage-backed and asset-backed securities | 2,095,856 | 1,813,274 | | |
| | $7,159,286 | $6,629,046 | $3,604,149 | $3,588,114 |
| **December 31, 2007** | | | | |
| Due after one year through five years | $ 416,270 | $ 411,117 | $ | $ |
| Due after five years through ten years | 790,569 | 763,781 | | |
| Due after ten years through twenty years | 1,810,608 | 1,797,912 | 815,124 | 801,004 |
| Due after twenty years | 1,366,146 | 1,319,377 | 4,540,609 | 4,411,811 |
| | 4,383,593 | 4,292,187 | 5,355,733 | 5,212,815 |
| Mortgage-backed and asset-backed securities | 736,675 | 716,585 | | |
| | $5,120,268 | $5,008,772 | $5,355,733 | $5,212,815 |

We have classified a portion of our fixed maturity investments as available for sale. Available for sale securities are reported at fair value and unrealized gains and losses, if any, on these securities (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) are included directly in a separate component of stockholders' equity, thereby exposing stockholders' equity to volatility for changes in the reported fair value of securities classified as available for sale.

Table of Contents

At December 31, 2008 and 2007, the amortized cost and estimated fair value of fixed maturity securities and equity securities that were in an unrealized loss position were as follows:

| | Number of Securities | Amortized Cost | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| | | (Dollars in thousands) | | |
| **December 31, 2008** | | | | |
| Fixed maturity securities, available for sale: | | | | |
| United States Government full faith and credit | 1 | $ 18,774 | $ (129) | $ 18,645 |
| United States Government sponsored agencies | 9 | 360,533 | (1,133) | 359,400 |
| Corporate securities, public utilities and redeemable preferred stocks: | | | | |
| Finance, insurance and real estate | 67 | 442,613 | (91,239) | 351,374 |
| Manufacturing, construction and mining | 57 | 425,573 | (65,567) | 360,006 |
| Utilities and related sectors | 61 | 363,406 | (55,123) | 308,283 |
| Wholesale/retail trade | 26 | 158,118 | (26,237) | 131,881 |
| Services, media and other | 41 | 238,173 | (39,212) | 198,961 |
| Mortgage and asset-backed securities | 101 | 1,704,052 | (288,637) | 1,415,415 |
| | 363 | $3,711,242 | $(567,277) | $3,143,965 |
| Fixed maturity securities, held for investment: | | | | |
| United States Government sponsored agencies | 4 | $ 365,000 | $ (4,984) | $ 360,016 |
| Redeemable preferred stock | 1 | 75,521 | (17,472) | 58,049 |
| | 5 | $ 440,521 | $ (22,456) | $ 418,065 |
| Equity securities, available for sale | 26 | $ 76,429 | $ (25,978) | $ 50,451 |
| **December 31, 2007** | | | | |
| Fixed maturity securities, available for sale: | | | | |
| United States Government full faith and credit | 1 | $ 18,695 | $ (1,708) | $ 16,987 |
| United States Government sponsored agencies | 49 | 2,231,910 | (30,090) | 2,201,820 |
| Corporate securities, public utilities and redeemable preferred stocks: | | | | |
| Finance, insurance and real estate | 53 | 377,456 | (36,507) | 340,949 |
| Manufacturing, construction and mining | 31 | 207,948 | (12,659) | 195,289 |
| Utilities and related sectors | 32 | 181,664 | (10,087) | 171,577 |
| Wholesale/retail trade | 17 | 82,492 | (4,018) | 78,474 |
| Services, media and other | 23 | 115,664 | (6,359) | 109,305 |
| Mortgage and asset-backed securities | 40 | 495,284 | (24,746) | 470,538 |
| | 246 | $3,711,113 | $(126,174) | $3,584,939 |
| Fixed maturity securities, held for investment: | | | | |
| United States Government sponsored agencies | 78 | $4,910,611 | $(133,206) | $4,777,405 |
| Redeemable preferred stock | 1 | 75,401 | (10,138) | 65,263 |
| | 79 | $4,986,012 | $(143,344) | $4,842,668 |
| Equity securities, available for sale | 27 | $ 90,812 | $ (17,915) | $ 72,897 |

Table of Contents

The following table sets forth the composition by credit quality (NAIC designation and the equivalent ratings of a nationally recognized securities rating organization) of fixed maturity securities with gross unrealized losses:

| NAIC Designation | Rating Agency | Carrying Value of Securities with Gross Unrealized Losses | Percent of Total | Gross Unrealized Losses | Percent of Total |
|---|---|---|---|---|---|
| | | (Dollars in thousands) | | | |
| **December 31, 2008** | | | | | |
| 1 | Aaa/Aa/A | $ 2,235,159 | 62.3% | $ (289,300) | 49.1% |
| 2 | Baa | 1,110,279 | 31.0% | (223,225) | 37.9% |
| Total investment grade | | 3,345,438 | 93.3% | (512,525) | 86.9% |
| 3 | Ba | 224,003 | 6.2% | (68,397) | 11.6% |
| 4 | B | 7,953 | 0.2% | (4,765) | 0.8% |
| 5 | Caa and lower | 5,472 | 0.2% | (4,016) | 0.7% |
| 6 | In or near default | 1,620 | 0.0% | (30) | 0.0% |
| Total below investment grade | | 239,048 | 6.7% | (77,208) | 13.1% |
| | | $ 3,584,486 | 100.0% | $ (589,733) | 100.0% |
| **December 31, 2007** | | | | | |
| 1 | Aaa/Aa/A | $ 7,880,771 | 92.0% | $ (213,369) | 79.2% |
| 2 | Baa | 617,543 | 7.2% | (44,981) | 16.7% |
| Total investment grade | | 8,498,314 | 99.2% | (258,350) | 95.9% |
| 3 | Ba | 44,680 | 0.5% | (5,470) | 2.0% |
| 4 | B | 20,310 | 0.2% | (3,587) | 1.3% |
| 5 | Caa and lower | 7,647 | 0.1% | (2,111) | 0.8% |
| 6 | In or near default | | | | |
| Total below investment grade | | 72,637 | 0.8% | (11,168) | 4.1% |
| | | $ 8,570,951 | 100.0% | $ (269,518) | 100.0% |

Table of Contents

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 394 and 352 securities, respectively) have been in a continuous unrealized loss position, at December 31, 2008 and 2007:

| | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| | (Dollars in thousands) | | | | | |
| **December 31, 2008** | | | | | | |
| Fixed maturity securities: | | | | | | |
| Available for sale: | | | | | | |
| United States Government full faith and credit | $ | $ | $ 18,645 | $ (129) | $ 18,645 | $ (129) |
| United States Government sponsored agencies | 60,475 | (57) | 298,925 | (1,076) | 359,400 | (1,133) |
| Corporate securities, including redeemable preferred stocks: | | | | | | |
| Finance, insurance and real estate | 205,148 | (44,478) | 146,226 | (46,761) | 351,374 | (91,239) |
| Manufacturing, construction and mining | 294,428 | (37,589) | 65,578 | (27,978) | 360,006 | (65,567) |
| Utilities and related sectors | 192,110 | (22,816) | 116,173 | (32,307) | 308,283 | (55,123) |
| Wholesale/retail trade | 120,056 | (16,557) | 11,825 | (9,680) | 131,881 | (26,237) |
| Services, media and other | 119,297 | (22,425) | 79,664 | (16,787) | 198,961 | (39,212) |
| Mortgage and asset-backed securities | 1,117,973 | (221,480) | 297,442 | (67,157) | 1,415,415 | (288,637) |
| | $2,109,487 | $(365,402) | $1,034,478 | $(201,875) | $3,143,965 | $(567,277) |
| Held for investment: | | | | | | |
| United States Government sponsored agencies | $ | $ | $ 360,016 | $ (4,984) | $ 360,016 | $ (4,984) |
| Redeemable preferred stock: | | | | | | |
| Finance, insurance and real estate | | | 58,049 | (17,472) | 58,049 | (17,472) |
| | $ | $ | $ 418,065 | $ (22,456) | $ 418,065 | $ (22,456) |
| Equity securities, available for sale | $ 30,093 | $ (14,360) | $ 20,358 | $ (11,618) | $ 50,451 | $ (25,978) |
| **December 31, 2007** | | | | | | |
| Fixed maturity securities: | | | | | | |
| Available for sale: | | | | | | |
| United States Government full faith and credit | $ 16,987 | $ (1,708) | $ | $ | $ 16,987 | $ (1,708) |
| United States Government sponsored agencies | 134,683 | (317) | 2,067,137 | (29,773) | 2,201,820 | (30,090) |
| Corporate securities, including redeemable preferred stocks: | | | | | | |
| Finance, insurance and real estate | 148,988 | (15,387) | 191,961 | (21,120) | 340,949 | (36,507) |
| Manufacturing, construction and mining | 109,378 | (2,877) | 85,911 | (9,782) | 195,289 | (12,659) |
| | 83,552 | (2,642) | 88,025 | (7,445) | 171,577 | (10,087) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Utilities and related sectors | | | | | | |
| Wholesale/retail trade | 24,027 | (91) | 54,447 | (3,927) | 78,474 | (4,018) |
| Services, media and other | 76,233 | (2,149) | 33,072 | (4,210) | 109,305 | (6,359) |
| Mortgage and asset-backed securities | 114,401 | (1,336) | 356,137 | (23,410) | 470,538 | (24,746) |
| | $ 708,249 | $ (26,507) | $ 2,876,690 | $ (99,667) | $ 3,584,939 | $ (126,174) |
| Held for investment: | | | | | | |
| United States Government sponsored agencies | $ | $ | $ 4,777,405 | $ (133,206) | $ 4,777,405 | $ (133,206) |
| Redeemable preferred stock: | | | | | | |
| Finance, insurance and real estate | | | | | | |