

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO  
Form 10-Q  
November 02, 2007

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2007

**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)

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

**Iowa**  
(State of Incorporation)

**42-1447959**  
(I.R.S. Employer Identification No.)

**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**  
(Telephone)

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

**Title of each class**  
Common Stock, par value \$1

**Name of each exchange on which registered**  
New York Stock Exchange

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

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes  No

APPLICABLE TO CORPORATE ISSUERS:

Shares of common stock outstanding at October 31, 2007: 56,885,720

**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY****CONSOLIDATED BALANCE SHEETS****(Dollars in thousands, except per share data)**

	September 30, 2007 (Unaudited)	December 31, 2006
<b>Assets</b>		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2007 - \$5,037,465; 2006 - \$4,297,182)	\$ 4,885,762	\$ 4,177,029
Held for investment, at amortized cost (fair value: 2007 - \$4,929,991; 2006 - \$4,871,237)	5,290,679	5,128,146
Equity securities, available for sale, at fair value (cost: 2007 - \$98,618; 2006 - \$46,000)	89,839	45,512
Mortgage loans on real estate	1,827,050	1,652,757
Derivative instruments	350,364	381,601
Policy loans	421	419
Total investments	12,444,115	11,385,464
Cash and cash equivalents	9,237	29,949
Coinsurance deposits - related party	1,738,058	1,841,720
Accrued investment income	86,704	68,323
Deferred policy acquisition costs	1,207,562	1,088,890
Deferred sales inducements	539,856	427,554
Deferred income taxes	81,966	73,831
Income taxes recoverable	7,678	4,526
Other assets	48,944	69,866
Total assets	\$ 16,164,120	\$ 14,990,123

## AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

## CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

	September 30, 2007 (Unaudited)	December 31, 2006
<b>Liabilities and Stockholders Equity</b>		
Liabilities:		
Policy benefit reserves:		
Traditional life and accident and health insurance products	\$ 106,074	\$ 93,632
Annuity and single premium universal life products	14,288,236	13,114,299
Other policy funds and contract claims	123,817	128,579
Other amounts due to related parties	41,285	45,504
Notes payable	264,092	266,383
Subordinated debentures	268,299	268,489
Amounts due under repurchase agreements	306,657	385,973
Other liabilities	146,629	92,198
Total liabilities	15,545,089	14,395,057
Stockholders equity:		
Common stock, par value \$1 per share, 125,000,000 shares authorized; issued and outstanding: 2007 53,862,054 shares (excluding 3,023,666 treasury shares); 2006 53,500,926 shares (excluding 2,664,448 treasury shares)	53,862	53,501
Additional paid-in capital	388,932	389,644
Unallocated common stock held by ESOP: 2007 650,000 shares	(7,001)	
Accumulated other comprehensive loss	(49,365)	(38,769)
Retained earnings	232,603	190,690
Total stockholders equity	619,031	595,066
Total liabilities and stockholders equity	\$ 16,164,120	\$ 14,990,123

See accompanying notes to unaudited consolidated financial statements.

## AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Revenues:</b>				
Traditional life and accident and health insurance premiums	\$ 3,344	\$ 3,313	\$ 9,591	\$ 10,048
Annuity and single premium universal life product charges	12,576	10,756	33,023	29,096
Net investment income	183,732	173,272	528,809	504,839
Realized gains (losses) on investments	325	(273)	921	16
Change in fair value of derivatives	(10,709)	72,280	79,755	60,026
Total revenues	189,268	259,348	652,099	604,025
<b>Benefits and expenses:</b>				
Insurance policy benefits and change in future policy benefits	2,360	1,947	6,390	6,614
Interest credited to account balances	165,821	86,572	449,915	272,025
Amortization of deferred sales inducements	3,412	920	21,957	16,595
Change in fair value of embedded derivatives	(34,935)	113,925	(41,161)	65,368
Interest expense on notes payable	4,039	4,175	12,178	17,989
Interest expense on subordinated debentures	5,673	5,796	16,876	16,116
Interest expense on amounts due under repurchase agreements	4,764	10,997	11,842	25,328
Amortization of deferred policy acquisition costs	15,237	11,479	73,095	67,597
Other operating costs and expenses	11,582	9,527	37,076	29,638
Total benefits and expenses	177,953	245,338	588,168	517,270
Income before income taxes	11,315	14,010	63,931	86,755
Income tax expense	3,918	4,593	22,018	30,454
Net income	\$ 7,397	\$ 9,417	\$ 41,913	\$ 56,301
Earnings per common share	\$ 0.13	\$ 0.17	\$ 0.74	\$ 1.01
Earnings per common share assuming dilution	\$ 0.13	\$ 0.16	\$ 0.71	\$ 0.94

See accompanying notes to unaudited consolidated financial statements.

**AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

(Dollars in thousands)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2005	\$ 53,936	\$ 380,698	\$	\$ (27,306)	\$ 112,030	\$ 519,358
Comprehensive income:						
Net income for period					56,301	56,301
Change in net unrealized investment gains/losses				(13,168)		(13,168)
Total comprehensive income						43,133
Conversion of \$360 of subordinated debentures	44	316				360
Share-based compensation		114				114
Issuance of 268,195 shares of common stock under compensation plans, including excess income tax benefits	269	1,639				1,908
Balance at September 30, 2006	\$ 54,249	\$ 382,767	\$	\$ (40,474)	\$ 168,331	\$ 564,873
Balance at December 31, 2006	\$ 53,501	\$ 389,644	\$	\$ (38,769)	\$ 190,690	\$ 595,066
Comprehensive income:						
Net income for period					41,913	41,913
Change in net unrealized investment gains/losses				(10,596)		(10,596)
Total comprehensive income						31,317
Conversion of \$280 of subordinated debentures	34	246				280
Acquisition of 359,218 shares of common stock	(359)	(3,969)				(4,328)
Acquisition of 650,000 shares of common stock by ESOP			(7,001)			(7,001)
Share-based compensation		3,196				3,196
Issuance of 63,000 shares of common stock under compensation plans, including excess income tax benefits	63	438				501
Net issuance of 622,779 shares of common stock under stock option and warrant agreement	623	(623)				
Balance at September 30, 2007	\$ 53,862	\$ 388,932	\$ (7,001)	\$ (49,365)	\$ 232,603	\$ 619,031

Total comprehensive income for the third quarter of 2007 was \$24.3 million and was comprised of net income of \$7.4 million and a decrease in net unrealized depreciation of available for sale fixed maturity securities and equity securities of \$16.9 million.

Total comprehensive income for the third quarter of 2006 was \$63.5 million and was comprised of net income of \$9.4 million and a decrease in net unrealized depreciation of available for sale fixed maturity securities and equity securities of \$54.1 million.

*See accompanying notes to unaudited consolidated financial statements.*

## AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2007	2006
<b>Operating activities</b>		
Net income	\$ 41,913	\$ 56,301
Adjustments to reconcile net income to net cash provided by operating activities:		
Adjustments related to interest sensitive products:		
Interest credited to account balances	449,915	272,025
Amortization of deferred sales inducements	21,957	16,595
Annuity and single premium universal life product charges	(33,023)	(29,096)
Change in fair value of embedded derivatives	(41,161)	65,368
Increase in traditional life and accident and health insurance reserves	6,522	8,475
Policy acquisition costs deferred	(177,006)	(159,382)
Amortization of deferred policy acquisition costs	73,095	67,597
Amortization of discount on contingent convertible notes	795	6,185
Provision for depreciation and other amortization	953	1,611
Amortization of discount and premium on investments	(193,069)	(185,847)
Realized gains on investments	(921)	(16)
Change in fair value of derivatives	(79,755)	(60,026)
Deferred income taxes	(2,429)	22,001
Share-based compensation	3,196	114
Changes in other operating assets and liabilities:		
Accrued investment income	(18,381)	(21,144)
Income taxes recoverable	(3,152)	(11,161)
Other assets	493	(809)
Other policy funds and contract claims	(4,762)	3,306
Other amounts due to related parties	(17,095)	6,231
Other liabilities	(23,728)	(50,274)
Net cash provided by operating activities	4,357	8,054
<b>Investing Activities</b>		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	78,287	213,831
Fixed maturity securities - held for investment	28,147	
Equity securities, available for sale	18,133	19,162
Mortgage loans on real estate	131,340	71,218
Derivative instruments	368,101	145,299
Acquisition of investments:		
Fixed maturity securities - available for sale	(737,169)	(503,119)
Fixed maturity securities - held for investment		(176,169)
Equity securities, available for sale	(70,605)	(5,980)
Mortgage loans on real estate	(305,633)	(408,447)
Derivative instruments	(243,857)	(173,695)
Policy loans	(2)	(51)
Purchases of property, furniture and equipment	(683)	(188)
Net cash used in investing activities	(733,941)	(818,139)





## AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2007	2006
<b>Financing activities</b>		
Receipts credited to annuity and single premium universal life policyholder account balances	\$ 1,610,780	\$ 1,448,260
Coinsurance deposits - related party	144,354	137,419
Return of annuity and single premium universal life policyholder account balances	(972,797)	(1,220,369)
Financing fees incurred and deferred		(1,389)
Repayments of notes payable	(3,086)	(3,072)
Increase (decrease) in amounts due under repurchase agreements	(79,316)	303,143
Proceeds from issuance of subordinated debentures		40,000
Acquisition of common stock	(11,329)	
Excess tax benefits realized from exercise of stock options	148	769
Proceeds from issuance of common stock	353	1,139
Checks in excess of cash balance	19,765	32,974
Net cash provided by financing activities	708,872	738,874
Decrease in cash and cash equivalents	(20,712)	(71,211)
Cash and cash equivalents at beginning of period	29,949	112,395
Cash and cash equivalents at end of period	\$ 9,237	\$ 41,184
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during period for:		
Interest expense	\$ 36,366	\$ 48,053
Income taxes	26,600	17,138
Non-cash financing and investing activities:		
Premium and interest bonuses deferred as sales inducements	125,481	100,954
Conversion of subordinated debentures	280	360
Subordinated debentures issued to subsidiary trusts for common equity securities of the subsidiary trust		1,238

See accompanying notes to unaudited consolidated financial statements.

**AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2007**

**(Unaudited)**

**1. Organization and Significant Accounting Policies**

**Consolidation and Basis of Presentation**

The accompanying unaudited consolidated financial statements of American Equity Investment Life Holding Company (the Company) have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly the Company's financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three-month and nine-month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand the Company's financial position and results of operations, refer to the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

**Reclassifications**

Certain amounts in the unaudited consolidated financial statements for the periods ended September 30, 2006 have been reclassified to conform to the financial statement presentation for the periods ended September 30, 2007.

**Adopted Accounting Pronouncements**

In September 2005, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts* ( SOP 05-1 ). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred policy acquisition costs and deferred sales inducements on internal replacements of insurance contracts other than those specifically described in Statement of Financial Accounting Standards ( SFAS ) No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights or coverages that occurs by exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. SOP 05-1 is effective for internal replacements occurring in fiscal years beginning January 1, 2007. Retrospective application of SOP 05-1 to previously issued financial statements is not permitted. There was no impact on the unaudited consolidated financial statements upon the adoption of SOP 05-1.

In June 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). FIN 48 creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under FIN 48, a tax benefit can be recognized in the financial statements if it is more likely than not that the position will be sustained upon examination by taxing authorities who have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective and was adopted by the Company on January 1, 2007. The Company has no unrecognized tax benefits at January 1, 2007 or September 30, 2007. The Company's policy is to record the interest and penalties on tax obligations on the income tax expense line in the consolidated statements of income. There was no impact on the unaudited consolidated financial statements upon the adoption of FIN 48. As of September 30, 2007, the tax years that remain subject to examination for U.S. federal taxes and applicable state jurisdictions are tax years ended December 31, 2003 through December 31, 2006.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* ( SFAS 155 ), which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS 133 ) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ( SFAS 140 ). SFAS 155

simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. SFAS 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event beginning on January 1, 2007. There was no impact on the unaudited consolidated financial statements upon adoption.

## **New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value and expands the required disclosures about fair value measurements. SFAS 157 is effective beginning on January 1, 2008. The Company is continuing to evaluate SFAS 157 but does not believe that it will have a material impact on the consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be reported at fair value. Unrealized gains and losses on items for which the fair value option is elected shall be reported in net income. SFAS 159 also requires additional disclosures that are intended to facilitate comparisons between entities that choose different measurement attributes for similar assets and liabilities and between assets and liabilities in the financial statements of an entity that selects different measurement attributes for similar assets and liabilities. SFAS 159 is effective beginning on January 1, 2008. The Company is currently evaluating the impact SFAS 159 will have on the consolidated financial statements.

## **2. Contingencies**

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. The Company is 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. No class has been certified in any of the pending cases at this time. Although the Company has denied all allegations in these lawsuits and intends to vigorously defend against them, the lawsuits are in the early stages of litigation and neither their outcomes nor a range of possible outcomes can be determined at this time. However, the Company does not believe that these lawsuits will have a material adverse effect on its business, financial condition or results of operations.

In addition, the Company is from time to time subject to other legal proceedings and claims in the ordinary course of business, none of which management believes is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. There can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

## **3. Retirement and Share-based Compensation Plans**

## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

During the first quarter of 2007, the Company established the 2007 Independent Insurance Agent Stock Option Plan (the Plan). Under this Plan, agents of American Equity Investment Life Insurance Company may receive grants of options to acquire shares of the Company's common stock based upon their individual sales during 2007. The Plan authorizes grants of options to agents for up to 2,500,000 shares of the Company's common stock. As of September 30, 2007, there are no grants of options under the Plan.

The Company established the American Equity Investment Employee Stock Ownership Plan ( ESOP ) effective July 1, 2007. The principal purpose of the ESOP is to provide each eligible employee with an equity interest in the Company. Employees become eligible once they have completed a minimum of six months of service. The Company's contribution to the ESOP is determined by the Board of Directors.

In August 2007, the Company issued a loan to the ESOP in the amount of \$7.0 million to purchase 650,000 shares of common stock of the Company from David J. Noble, Chairman and Chief Executive Officer of the Company. The loan is to be repaid over a period of 20 years with annual interest payments due on December 31 of each year. Principal payments in the amount of \$1.7 million are due on December 31, 2012, 2017, and 2022 with the final principal payment due on August 31, 2027. The loan is eliminated in the consolidated financial statements. The shares purchased by the ESOP were pledged as collateral for this debt and are reported as unallocated common stock held by ESOP, a contra-equity account in stockholders' equity. For each plan year in which a payment or prepayment of principal or interest is made, the Company will release from the pledge the number of shares determined under the principal and interest method. Dividends on unallocated shares held by the ESOP will be used to repay indebtedness. As of September 30, 2007, there has been no allocation of shares or contributions to the ESOP by the Company.

#### 4. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
(Dollars in thousands, except per share data)				
<b>Numerator:</b>				
Net income numerator for earnings per common share	\$ 7,397	\$ 9,417	\$ 41,913	\$ 56,301
Interest on convertible subordinated debentures (net of income tax benefit)	262	266	790	802
Numerator for earnings per common share assuming dilution	\$ 7,659	\$ 9,683	\$ 42,703	\$ 57,103
<b>Denominator:</b>				
Weighted average common shares outstanding (1)	56,878,490	55,683,681	56,898,868	55,627,532
Effect of dilutive securities:				
Convertible subordinated debentures	2,766,034	2,807,363	2,778,011	2,820,929
Stock options	129,069	838,124	404,466	990,672
Deferred compensation agreements		984,945		1,149,507
Denominator for earnings per common share assuming dilution	59,773,593	60,314,113	60,081,345	60,588,640
Earnings per common share	\$ 0.13	\$ 0.17	\$ 0.74	\$ 1.01
Earnings per common share assuming dilution	\$ 0.13	\$ 0.16	\$ 0.71	\$ 0.94

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

Potentially dilutive common shares representing 31,500 shares and 25,000 shares of common stock for the three months ended September 30, 2007 and 2006, respectively, were excluded from the computation of diluted earnings per share for these periods because their effect would have been antidilutive.

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

Management's discussion and analysis reviews our unaudited consolidated financial position at September 30, 2007, and the unaudited consolidated results of operations for the periods ended September 30, 2007 and 2006, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2006.

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 under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors which may cause actual results to be materially different from those contemplated by the forward-looking statements. Such factors 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 and the lapse rate and profitability of policies;

customer response to new products and marketing initiatives;

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

increasing competition in the sale of annuities;

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

the risk factors or uncertainties listed from time to time in our private placement memorandums or filings with the SEC

**Overview**



## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

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.

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Annuity deposits by product type collected during the three months and nine months ended September 30, 2007 and 2006, were as follows:

Product Type	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
<b>Index annuities:</b>				
Index strategies	\$ 419,696	\$ 219,533	\$ 1,176,547	\$ 914,552
Fixed strategy	113,810	126,324	392,182	466,946
	533,506	345,857	1,568,729	1,381,498
<b>Fixed rate annuities:</b>				
Single-year rate guaranteed	9,746	17,966	37,840	62,029
Multi-year rate guaranteed	539	2,051	4,211	4,733
	10,285	20,017	42,051	66,762
<b>Total before coinsurance ceded</b>	<b>543,791</b>	<b>365,874</b>	<b>1,610,780</b>	<b>1,448,260</b>
Coinsurance ceded	386	490	1,461	2,324
<b>Net after coinsurance ceded</b>	<b>\$ 543,405</b>	<b>\$ 365,384</b>	<b>\$ 1,609,319</b>	<b>\$ 1,445,936</b>

Net annuity deposits after coinsurance ceded increased 49% during the three months ended September 30, 2007 and 11% during the nine months ended September 30, 2007 compared to the same periods in 2006. We attribute these increases 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. Our A.M. Best Company financial strength rating is a key element of our competitive position in the index and fixed annuity market. The outlook for our current rating is stable. We believe the rating upgrade has enhanced our competitive position and improved our prospects for sales increases in future periods. However, the degree to which this rating upgrade will effect future sales is unknown.

Earnings from products accounted for as deposit liabilities are primarily generated from the excess of net investment income earned over the interest credited to the policyholder, or the investment spread. In the case of index annuities, the investment spread consists of net investment income in excess of the cost of the options purchased to fund the index-based component of the policyholder's return and amounts credited as a result of minimum guarantees.

Our investment spread is summarized as follows:

	Nine Months Ended September 30,	
	2007	2006
Average yield on invested assets	6.09%	6.13%
<b>Cost of money:</b>		
Aggregate	3.44%	3.43%
Average net cost of money for index annuities	3.42%	3.28%
<b>Average crediting rate for fixed rate annuities:</b>		
Annually adjustable	3.28%	3.25%
Multi-year rate guaranteed	4.18%	4.94%
<b>Investment spread:</b>		
Aggregate	2.65%	2.70%
Index annuities	2.67%	2.85%

Fixed rate annuities:

Annually adjustable	2.81%	2.88%
Multi-year rate guaranteed	1.91%	1.19%

The cost of money and average crediting rates are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006. 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 included in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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, 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.

## Results of Operations

### *Three and Nine Months Ended September 30, 2007 and 2006*

**Net income** decreased 21% to \$7.4 million for the third quarter of 2007 and 26% to \$41.9 million for the nine months ended September 30, 2007 compared to \$9.4 million and \$56.3 million for the same periods in 2006. The comparability of the amounts is impacted by (i) the application of Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) to our index annuity business which we estimate decreased net income by \$8.3 million for the third quarter of 2007 and \$5.6 million for the nine months ended September 30, 2007 compared to decreases of \$9.4 million and \$4.2 million for the same periods in 2006 and (ii) the application of SFAS 133 to our contingent convertible senior notes which we estimate decreased net income by \$0.2 million for the third quarter of 2007 and \$0.5 million for the nine months ended September 30, 2007 compared to a decrease of \$0.1 million and an increase of \$5.3 million for the same periods in 2006. Excluding these amounts, net income for the third quarter of 2007 and the nine months ended September 30, 2007 would have been \$15.8 million and \$48.0 million, respectively, compared to \$19.0 million and \$55.2 million for the same periods in 2006. These decreases were principally due to higher amortization of deferred policy acquisition costs and deferred sales inducements and increased operating expenses as discussed below.

**Annuity and single premium universal life product charges** (surrender charges assessed against policy withdrawals and mortality and expense charges assessed against single premium universal life policyholder account balances) increased 17% to \$12.6 million for the third quarter of 2007 and 13% to \$33.0 million for the nine months ended September 30, 2007 compared to \$10.8 million and \$29.1 million for the same periods in 2006. The increases were principally due to increases 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 \$81.1 million and \$76.4 million for the three months ended September 30, 2007 and 2006, respectively, and \$225.6 million and \$200.9 million for the nine months ended September 30, 2007 and 2006, respectively. The average surrender charge collected on withdrawals subject to a surrender charge was 15.4% for the third quarter of 2007 and 14.5% for the nine months ended September 30, 2007 compared to 13.9% and 14.3% for the same periods in 2006.

**Net investment income** increased 6% to \$183.7 million in the third quarter of 2007 and 5% to \$528.8 million for the nine months ended September 30, 2007 compared to \$173.3 million and \$504.8 million for the same periods in 2006. These increases were principally attributable to the growth in our annuity business and corresponding increases in our invested assets, offset by decreases in the average yield earned on investments. Average invested assets (on an amortized cost basis) increased to \$11.6 billion for the nine months ended September 30, 2007 compared to \$11.0 billion for the nine months ended September 30, 2006, while the average yield earned on average invested assets was 6.09% for the nine months ended September 30, 2007 compared to 6.13% for the same period in 2006. The decline in the yield earned on average invested assets is attributable to an overall decline in yield on the mix of assets owned in the respective periods.

**Realized gains (losses) on investments** fluctuate from period to period due to changes in the interest rate and economic environment and the timing of the sale of investments. Realized gains and 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 in recognition of an other than temporary impairment. The components of realized gains (losses) on investments for the three months and nine months ended September 30, 2007 and 2006 are set forth as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
(Dollars in thousands)				
Available for sale fixed maturity securities:				
Gross realized gains	\$ 277	\$ 1,046	\$ 689	\$ 4,045
Gross realized losses				(3,053)
Write downs (other than temporary impairments)		(1,337)		(1,337)
	277	(291)	689	(345)
Equity securities:				
Gross realized gains	48	18	232	461
Gross realized losses				(100)
	48	18	232	361
	\$ 325	\$ (273)	\$ 921	\$ 16

**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 for the three months and nine months ended September 30, 2007 and 2006 are set forth as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
(Dollars in thousands)				
Call options:				
Change in unrealized gain (loss)	\$ (78,403)	\$ 75,350	\$ (93,352)	\$ 42,528
Gain on option expiration or early termination	68,670	(3,070)	173,499	17,498
Interest rate swaps	(976)		(392)	
	\$ (10,709)	\$ 72,280	\$ 79,755	\$ 60,026

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 three months and nine months ended September 30, 2007 and 2006 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
S&P 500 Index				
Point-to-point strategy	9.0 %	22.7%	1.4 %	9.6%
Monthly average strategy	8.6 %	12.9%	1.2 %	5.4%
Monthly point-to-point strategy	4.3 %	18.8%	4.3 %	8.0%
Lehman Brothers U.S. Aggregate and U.S.				
Treasury indices	4.2 %	6.3%	2.6 %	7.2%

## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the index annuity policies (participation rates and caps) 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. The increases in market volatility experienced in the past two quarters have resulted in increased option costs. We have partially mitigated these increases through adjustments to participation rates, asset fees and caps, and further adjustments are expected in the fourth quarter of 2007. See Critical Accounting Policies - Derivative Instruments - Index Products included in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Interest credited to account balances** increased 92% to \$165.8 million in the third quarter of 2007 and 65% to \$449.9 million for the nine months ended September 30, 2007 compared to \$86.6 million and \$272.0 million for the same periods in 2006. The components of interest credited to account balances are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Index credits on index policies	\$ 125,500	\$ 40,056	\$ 331,046	\$ 129,185
Interest credited (including changes in minimum guaranteed interest for index annuities)	40,321	46,516	118,869	142,840
	\$ 165,821	\$ 86,572	\$ 449,915	\$ 272,025

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 \$122.9 million and \$324.5 million for the three months and nine months ended September 30, 2007, respectively, compared to \$42.0 million and \$126.9 million for the same periods in 2006. The decreases in interest credited were due to reductions in the account balances 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 is 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 rate 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 12% during the nine months ended September 30, 2007 to \$11.7 billion from \$10.5 billion during the same period in 2006.

**Amortization of deferred sales inducements** increased 271% to \$3.4 million in the third quarter of 2007 and 32% to \$22.0 million for the nine months ended September 30, 2007 compared to \$0.9 million and \$16.6 million for the same periods in 2006. In general, amortization of deferred sales inducements has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium and interest bonus annuity products. Bonus products represented 86% and 75% of our total annuity deposits during the nine months ended September 30, 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. 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 derivative will not correspond to the change in fair value of the purchased options because the purchased 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 decreased amortization by \$5.8 million in the third quarter of 2007 and \$4.1 million for the nine months ended September 30, 2007 compared to decreases of \$5.9 million and \$2.6 million for the same periods in 2006. Excluding these amounts, amortization for the third quarter of 2007 would have been \$9.2 million and \$26.1 million for the nine months ended September 30, 2007 compared to \$6.8 million and \$19.3 million for the same periods in 2006. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.





**Change in fair value of embedded derivatives** was a decrease of \$34.9 million in the third quarter of 2007 and \$41.2 million for the nine months ended September 30, 2007 compared to increases of \$113.9 million and \$65.4 million for the same periods in 2006. The components of change in fair value of embedded derivatives are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(Dollars in thousands)			
Index annuities	\$ (34,935)	\$ 113,925	\$ (41,161)	\$ 80,596
Contingent convertible senior notes				(15,228)
	\$ (34,935)	\$ 113,925	\$ (41,161)	\$ 65,368

The changes related to the embedded derivatives within our index annuities resulted primarily from 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". The value of the embedded derivative is also impacted by changes in discount rates used in estimating future option costs and the growth in the host component of the embedded derivative. See Critical Accounting Policies - Derivative Instruments - Index Products included in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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 included in our Annual Report on Form 10-K for the year ended December 31, 2006. Effective June 8, 2006, this conversion option was no longer required to be bifurcated and recorded at fair value upon shareholder approval of an increase of authorized shares. The changes in the fair value of the conversion option embedded within these notes for the nine months ended September 30, 2006 coincides with the change in the per share price of our common stock during that period.

**Interest expense on notes payable** decreased 3% to \$4.0 million in the third quarter of 2007 and 32% to \$12.2 million for the nine months ended September 30, 2007 compared to \$4.2 million and \$18.0 million for the same periods in 2006. These decreases were primarily due to decreases in the amortization of the discount on our contingent convertible senior notes of \$0.3 million for the third quarter of 2007 and \$0.8 million for the nine months ended September 30, 2007 compared to \$0.2 million and \$6.2 million for the same periods 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 7 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Interest expense on subordinated debentures** decreased 2% to \$5.7 million in the third quarter of 2007 and increased 5% to \$16.9 million for the nine months ended September 30, 2007 compared to \$5.8 million and \$16.1 million for the same periods in 2006. The increase for the nine months ended September 30, 2007 was primarily due to the issuance of additional subordinated debentures of \$41.2 million during 2006. This increase was also due to an increase in weighted average interest rates on the outstanding subordinated debentures which were 8.38% and 8.28% for the nine months ended September 30, 2007 and 2006, respectively. The weighted average interest rates have increased 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 in Management's Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Interest expense on amounts due under repurchase agreements** decreased to \$4.8 million in the third quarter of 2007 and to \$11.8 million for the nine months ended September 30, 2007 compared to \$11.0 million and \$25.3 million for the same periods in 2006. These decreases were principally due to decreases in the borrowings outstanding which averaged \$364.0 million for the third quarter of 2007 and \$295.7 million for the nine months ended September 30, 2007 compared to \$790.6 million and \$655.7 million for the same periods in 2006, offset by changes in the weighted average interest rates on amounts borrowed which were 5.18% for the third quarter of 2007 and 5.35% for the nine months ended September 30, 2007 compared to 5.52% and 5.16% for the same periods in 2006.

**Amortization of deferred policy acquisition costs** increased 33% to \$15.2 million in the third quarter of 2007 and 8% to \$73.1 million for the nine months ended September 30, 2007 compared to \$11.5 million and \$67.6 million for the same periods in 2006. In general, amortization of deferred policy acquisition costs has been increasing each period due to the growth in our annuity

business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The anticipated increase in amortization from these factors has been affected by amortization associated with the application of SFAS 133 to our index annuity business. 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 decreased amortization by \$12.5 million in the third quarter of 2007 and \$8.7 million for the nine months ended September 30, 2007 compared to decreases of \$15.2 million and \$6.3 million for the same periods in 2006. Excluding these amounts, amortization for the third quarter of 2007 would have been \$27.7 million and \$81.8 million for the nine months ended September 30, 2007 compared to \$26.7 million and \$73.9 million for the same periods in 2006.

**Other operating costs and expenses** increased 22% to \$11.6 million in the third quarter of 2007 and 25% to \$37.1 million for the nine months ended September 30, 2007 compared to \$9.5 million and \$29.6 million for the same periods in 2006. These increases were attributable to increases in legal fees related to the defense of ongoing litigation of \$1.2 million in the third quarter of 2007 and \$5.1 million for the nine months ended September 30, 2007 and \$1.0 million in costs related to the development of an electronic document database that primarily occurred in the first and second quarters of 2007.

**Income tax expense** decreased 15% to \$3.9 million in the third quarter of 2007 and 28% to \$22.0 million for the nine months ended September 30, 2007 compared to \$4.6 million and \$30.5 million for the same periods in 2006. The decrease in income tax expense for the third quarter of 2007 was due to a decrease in pre-tax income. Income tax expense for the third quarter of 2006 was reduced by \$0.4 million due to the reversal of a state income tax contingency liability established in the prior year. The decrease in income tax expense for the nine months ended September 30, 2007 was due to a decrease in pre-tax income.

## **Financial Condition**

### *Investments*

Our investment strategy is to maintain a predominantly investment grade fixed income portfolio, provide adequate liquidity to meet our cash obligations to policyholders and others and maximize current income and total investment return through active investment management. Consistent with this strategy, our investments principally consist of fixed maturity securities and 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-agency securities and corporate securities rated investment grade by established nationally recognized rating organizations or in securities of comparable investment quality, if not rated.

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 due to changes in market interest rates and the accompanying changes in the reported value of securities classified as available for sale, with stockholders' equity increasing as interest rates decline and, conversely, decreasing as interest rates rise.

## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

Investments increased to \$12.4 billion at September 30, 2007 compared to \$11.4 billion at December 31, 2006 as a result of the growth in our annuity business discussed above. At September 30, 2007, the fair value of our available for sale fixed maturity and equity securities was \$160.5 million less than the amortized cost of those investments, compared to \$120.6 million at December 31, 2006. At September 30, 2007, the amortized cost of our fixed maturity securities held for investment exceeded the fair value by \$360.7 million, compared to \$256.9 million at December 31, 2006. The increase in the net unrealized investment losses at September 30, 2007 compared to December 31, 2006 is principally related to an increase in market interest rates and an increase in invested assets.

The composition of our investment portfolio is summarized as follows (dollars in thousands):

	September 30, 2007		December 31, 2006	
	Carrying Amount	Percent	Carrying Amount	Percent
<b>Fixed maturity securities:</b>				
United States Government full faith and credit	\$ 2,786		\$ 2,746	
United States Government sponsored agencies	8,140,901	65.4%	7,966,485	70.0%
Public utilities	148,080	1.2%	137,461	1.2%
Corporate securities	1,031,534	8.3%	643,850	5.6%
Redeemable preferred stocks	191,847	1.6%	135,933	1.2%
<b>Mortgage and asset-backed securities:</b>				
United States Government and agencies	75,085	0.6%	67,883	0.6%
Non-government	586,208	4.7%	350,817	3.1%
Total fixed maturity securities	10,176,441	81.8%	9,305,175	81.7%
Equity securities	89,839	0.7%	45,512	0.4%
Mortgage loans on real estate	1,827,050	14.7%	1,652,757	14.5%
Derivative instruments	350,364	2.8%	381,601	3.4%
Policy loans	421		419	
	\$ 12,444,115	100.0%	\$ 11,385,464	100.0%

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

At September 30, 2007 and December 31, 2006, 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 Positions	Amortized Cost	Unrealized Losses	Estimated Fair Value
<b>September 30, 2007</b>				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	2	\$ 939	\$ (15)	\$ 924
United States Government sponsored agencies	74	2,997,857	(72,262)	2,925,595
Public utilities	21	126,987	(7,282)	119,705
Corporate securities	109	791,405	(39,738)	751,667
Redeemable preferred stocks	24	105,293	(9,402)	95,891
Mortgage and asset-backed securities:				
United States Government and agencies	7	47,654	(1,324)	46,330
Non-government	34	470,036	(29,662)	440,374
	271	\$ 4,540,171	\$ (159,685)	\$ 4,380,486
Held for investment:				
United States Government sponsored agencies	88	\$ 5,215,308	\$ (360,688)	\$ 4,854,620
	88	\$ 5,215,308	\$ (360,688)	\$ 4,854,620
Equity securities, available for sale:				
Non-redeemable preferred stocks	17	\$ 66,514	\$ (6,792)	\$ 59,722
Common stocks	7	13,827	(2,108)	11,719
	24	\$ 80,341	\$ (8,900)	\$ 71,441
<b>December 31, 2006</b>				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	2	\$ 939	\$ (38)	\$ 901
United States Government sponsored agencies	73	2,997,612	(83,986)	2,913,626
Public utilities	15	84,300	(3,486)	80,814
Corporate securities	69	465,770	(17,354)	448,416
Redeemable preferred stocks	10	48,534	(1,623)	46,911
Mortgage and asset-backed securities:				
United States Government and agencies	8	64,968	(1,317)	63,651
Non-government	23	361,324	(17,191)	344,133
	200	\$ 4,023,447	\$ (124,995)	\$ 3,898,452
Held for investment:				
United States Government sponsored agencies	88	\$ 5,025,501	\$ (256,912)	\$ 4,768,589
	88	\$ 5,025,501	\$ (256,912)	\$ 4,768,589
Equity securities, available for sale:				
Non-redeemable preferred stocks	4	\$ 21,316	\$ (407)	\$ 20,909
Common stocks	2	3,210	(219)	2,991
	6	\$ 24,526	\$ (626)	\$ 23,900

The unrealized losses at September 30, 2007 and December 31, 2006 are primarily from our investments in United States Government agencies and United States Government agency mortgage-backed securities. These securities are relatively long in duration, making the value of such securities very sensitive to changes in market interest rates. The increase in unrealized losses at September 30, 2007 compared to December 31,

2006 is due to an increase in swap spreads on United States Government agency securities and an increase in credit spreads on corporate securities. Because we have the ability and intent to hold these investments until a recovery of amortized cost, which may be maturity, we do not consider these investments to be other than temporarily impaired at September 30, 2007.



Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

The amortized cost and estimated fair value of fixed maturity securities at September 30, 2007 and December 31, 2006, by contractual maturity, that were in an unrealized loss position are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage-backed and asset-backed securities provide for periodic payments throughout their lives, and are shown below as a separate line. At September 30, 2007, we had no exposure to subprime mortgage-backed securities and limited exposure to "Alt-A" mortgage-backed securities. Our "Alt-A" mortgage-backed securities are comprised of 16 securities with a total fair value of \$155.1 million with agency ratings of Aaa, of which 51% is in Aaa super senior tranches and the remainder is in Aaa tranches.

	Available-for-sale		Held for investment	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(Dollars in thousands)				
<b>September 30, 2007</b>				
Due after one year through five years	\$ 68,031	\$ 66,784	\$	\$
Due after five years through ten years	605,860	578,762		
Due after ten years through twenty years	2,001,673	1,956,474	349,046	343,500
Due after twenty years	1,346,917	1,291,762	4,866,262	4,511,120
	4,022,481	3,893,782	5,215,308	4,854,620
Mortgage-backed and asset-backed securities	517,690	486,704		
	\$ 4,540,171	\$ 4,380,486	\$ 5,215,308	\$ 4,854,620

<b>December 31, 2006</b>				
Due after one year through five years	\$ 56,075	\$ 55,348	\$	\$
Due after five years through ten years	371,683	355,800		
Due after ten years through twenty years	2,048,092	1,996,703	348,413	342,104
Due after twenty years	1,121,305	1,082,817	4,677,088	4,426,485
	3,597,155	3,490,668	5,025,501	4,768,589
Mortgage-backed and asset-backed securities	426,292	407,784		
	\$ 4,023,447	\$ 3,898,452	\$ 5,025,501	\$ 4,768,589

The table below presents our fixed maturity securities by NAIC designation and the equivalent ratings of the nationally recognized securities rating organizations (dollars in thousands).

NAIC Designation	Rating Agency Equivalent	September 30, 2007		December 31, 2006	
		Carrying Amount	Percent	Carrying Amount	Percent
1	Aaa/Aa/A	\$ 9,193,502	90.3%	\$ 8,643,440	92.9%
2	Baa	869,027	8.6%	556,218	6.0%
3	Ba	89,629	0.9%	88,896	0.9%
4	B	24,283	0.2%	12,022	0.1%
5	Caa and lower				
6	In or near default			4,599	0.1%
		\$ 10,176,441	100.0%	\$ 9,305,175	100.0%

At September 30, 2007 and December 31, 2006, the fair value of investments we owned that were non-investment grade was \$113.9 million and \$105.5 million, respectively. Non-investment grade securities represented 1.2% at September 30, 2007 and December 31, 2006, of the fair value of our fixed maturity securities. The unrealized losses on investments we owned that were non-investment grade at September 30, 2007 and December 31, 2006, were \$10.6 million and \$5.0 million, respectively. The unrealized losses on such securities at September 30, 2007 and December 31, 2006 represented 2.0% and 1.3%, respectively, of gross unrealized losses on fixed maturity securities.



## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to book value and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. We include these securities on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we have the ability and intent to hold these securities to maturity or until a market recovery is realized. At September 30, 2007, the amortized cost and estimated fair value of securities on the watch list are as follows (dollars in thousands):

General Description	Amortized Cost	Unrealized Losses	Estimated Fair Value	Months Below Amortized Cost
Corporate Bond U.S. Media Company	\$ 9,690	\$ (2,372)	\$ 7,318	18
Corporate Bond Reinsurance Company	14,027	(3,457)	10,570	24
Mortgage-Backed Security FHA/VA loans	2,813	(708)	2,105	24
Common & Preferred Stock Commercial Real Estate Finance Companies	10,685	(2,740)	7,945	3 - 7
	\$ 37,215	\$ (9,277)	\$ 27,938	

Our analysis of these securities and their credit performance at September 30, 2007 is as follows:

This U.S. media company has completed the first stage of a two-stage plan to go private. Standard & Poor's lowered this company's rating in August due to its highly leveraged capital structure and weakened credit measures. We have determined that an other than temporary impairment was not necessary as this company has a good market position, strong portfolio of assets and good cash flow generation capability.

This reinsurance company announced a majority sale of the company in March 2007 and received a significant capital infusion. In August 2007, this company announced that subprime asset-backed securities represented 28% of its total investment portfolio. We have determined that an other than temporary impairment was not necessary as the company's capitalization and liquidity have significantly improved due to the capital infusion and the exposure to subprime asset-backed securities have limited loss exposure as they are mainly higher rated tranches.

The mortgage-backed security consists of a pool of loans originated through the Federal Housing Authority (FHA) and Department of Veteran Affairs (VA). The FHA insurance and VA guarantee cover a significant percent of any losses incurred as a result of borrower defaults which enhances the credit levels for this pool of loans comparable to prime-quality residential mortgage-backed securities. We have determined that an other than temporary impairment was not necessary as current credit support by the FHA and VA is adequate to sustain projected losses.

The decline in market value of the commercial real estate securities is related to concerns over their access to capital to enable them to execute their business plans. We have determined that other than temporary impairments were not necessary as recent market actions by the Federal Reserve signal an improving credit environment that will support their business plans.

The securities on the watch list are current with respect to payments of principal and interest. We concluded that we have the intent and ability to hold these securities for a period of time sufficient to allow for a recovery in fair value and that there were no other than temporary impairments on these securities at September 30, 2007.

There were no other than temporary impairments during the nine months ended September 30, 2007. We recognized other than temporary impairment losses of \$1.3 million during the three months and nine months ended September 30, 2006 for the write down of two securities in the automotive industry due to deterioration in the issuer's operations and several downgrades of the issuer's credit rating. These securities were

## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

subsequently sold in the fourth quarter of 2006 at approximately their cost basis. During the nine months ended September 30, 2006, we sold two asset-backed securities backed by leases on airplanes concurrent with our decision to write down these securities due to continuing problems in the airline industry and deterioration of the underlying collateral which resulted in decreases in the amount of expected principal and interest payments. The write down/realized loss on these securities was \$2.5 million for the nine months ended September 30, 2006. We had previously written down these securities by \$10.5 million during 2001 - 2005 due to deterioration in the underlying collateral.

At September 30, 2007 and December 31, 2006, we held \$1.8 billion and \$1.7 billion, respectively, of mortgage loans with commitments outstanding of \$52.4 million at September 30, 2007. The portfolio consists of commercial mortgage loans diversified as to property type, location, and loan size. The loans are collateralized by the related properties. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and require diversification by geographic location and collateral type. As of September 30, 2007, there were no delinquencies or defaults in our mortgage loan portfolio. There was no valuation

Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

allowance at September 30, 2007 and December 31, 2006. The commercial mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows (dollars in thousands):

	September 30, 2007		December 31, 2006	
	Carrying Amount	Percent	Carrying Amount	Percent
<b>Geographic distribution</b>				
East	\$ 422,894	23.1%	\$ 364,977	22.1%
Middle Atlantic	127,714	7.0%	115,930	7.0%
Mountain	301,532	16.5%	267,808	16.2%
New England	44,706	2.5%	43,228	2.6%
Pacific	128,843	7.1%	132,085	8.0%
South Atlantic	304,007	16.6%	299,373	18.1%
West North Central	340,018	18.6%	290,592	17.6%
West South Central	157,336	8.6%	138,764	8.4%
	\$ 1,827,050	100.0%	\$ 1,652,757	100.0%
<b>Property type distribution</b>				
Office	\$ 554,237	30.4%	\$ 508,093	30.7%
Medical Office	97,178	5.3%	78,147	4.7%
Retail	415,179	22.7%	389,534	23.6%
Industrial/Warehouse	421,776	23.1%	381,248	23.1%
Hotel	106,278	5.8%	71,510	4.3%
Apartment	89,843	4.9%	91,190	5.5%
Mixed use/other	142,559	7.8%	133,035	8.1%
	\$ 1,827,050	100.0%	\$ 1,652,757	100.0%

*Liquidity*

The statutory capital and surplus of our life insurance subsidiaries at September 30, 2007 was \$1.0 billion. American Equity Investment Life Insurance Company ( American Equity Life ) made surplus note interest payments to us of \$3.1 million during the nine months ended September 30, 2007. For the remainder of 2007, up to approximately \$99.2 million can be distributed by American Equity Life as dividends without prior regulatory approval. Dividends 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 approximately \$182.0 million of statutory earned surplus at September 30, 2007.

The transfer of funds by American Equity Life is also restricted by a covenant in our revolving line of credit which requires American Equity Life to maintain a minimum risk-based capital ratio of 200%.

**New Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value and expands the required disclosures about fair value measurements. SFAS

## Edgar Filing: AMERICAN EQUITY INVESTMENT LIFE HOLDING CO - Form 10-Q

157 is effective beginning on January 1, 2008. We are continuing to evaluate SFAS 157 but do not believe that it will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be reported at fair value. Unrealized gains and losses on items for which the fair value option is elected shall be reported in net income. SFAS 159 also requires additional disclosures that are intended to facilitate comparisons between entities that choose different measurement attributes for similar assets and liabilities and between assets and liabilities in the financial statements of an entity that selects different measurement attributes for similar assets and liabilities. SFAS 159 is effective beginning on January 1, 2008. We are currently evaluating the impact SFAS 159 will have on our consolidated financial statements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to invest our available funds in a manner that will maximize shareholder value and fund future obligations to policyholders and debtors, subject to appropriate risk considerations. We seek to meet this objective through investments that: (i) consist predominately of investment grade fixed maturity securities; (ii) have projected returns which satisfy our spread targets; and (iii) have characteristics which support the underlying liabilities. Many of our products incorporate surrender charges, market interest rate adjustments or other features to encourage persistency.

We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs; and (vi) other factors. We have a portfolio of held for investment securities which consists principally of long duration bonds issued by U.S. government agencies. These securities are purchased to secure long-term yields which meet our spread targets and support the underlying liabilities.

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate subordinated debentures. Our floating rate trust preferred securities issued by Trust III, IV, VII, VIII, IX, X, XI (beginning on December 31, 2010) and XII bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was \$144.5 million at September 30, 2007, of which \$80 million had been swapped to fixed rates (see note 9 to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006). The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (participation rates, annual income caps or asset fees for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

A major component of our interest rate risk management program is structuring the investment portfolio with cash flow characteristics consistent with the cash flow characteristics of our insurance liabilities. We use computer models to simulate cash flows expected from our existing business under various interest rate scenarios. These simulations enable us to measure the potential gain or loss in fair value of our interest rate-sensitive financial instruments, to evaluate the adequacy of expected cash flows from our assets to meet the expected cash requirements of our liabilities and to determine if it is necessary to lengthen or shorten the average life and duration of our investment portfolio. The duration of a security is the time weighted present value of the security's expected cash flows and is used to measure a security's sensitivity to changes in interest rates. When the durations of assets and liabilities are similar, exposure to interest rate risk is minimized because a change in value of assets should be largely offset by a change in the value of liabilities.

If interest rates were to increase 10% (48 basis points) from levels at September 30, 2007, we estimate that the fair value of our fixed maturity securities would decrease by approximately \$436.7 million. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be an increase of \$67.2 million in the accumulated other comprehensive loss and a decrease to stockholders' equity. The computer models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit

concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2006.

At September 30, 2007, 81% of our fixed income securities have call features and 16% were subject to call redemption. Another 40% will become subject to call redemption through December 31, 2007. During the nine months ended September 30, 2007, we received \$40.5 million in net redemption proceeds related to the exercise of such call options. There were no bonds called during the nine months ended September 30, 2006. 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 the redeemed bonds. Such reinvestment risk typically



occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on our annuity liabilities, we have the ability to reduce crediting rates (participation rates, annual income caps or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At September 30, 2007, approximately 97% of our annuity liabilities were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies

With respect to our index annuities, we purchase call options on the applicable indices to fund the annual index credits on such annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for index products. For the nine months ended September 30, 2007 and 2006, the annual index credits to policyholders on their anniversaries were \$331.0 million and \$129.2 million, respectively. Proceeds received at expiration or gains recognized upon early termination of the options purchased to fund index credits were \$324.5 million and \$126.9 million, respectively. The difference between proceeds received at expiration or gains recognized upon early termination of the options and index credits is primarily due to credits attributable to minimum guaranteed interest self funded by us.

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

#### **Item 4. Controls and Procedures**

##### Evaluation of Disclosure Controls and Procedures

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

There have been no other significant changes in our internal control over financial reporting or in other factors could significantly affect internal control over financial reporting subsequent to the date of such evaluation.

#### **PART II. OTHER INFORMATION**

**Item 1. 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, the NASD, 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. No class has been certified in any of the pending cases at this time. Although we have denied all allegations in these lawsuits and intend to vigorously defend against them, the lawsuits are in the early stages of litigation and neither their outcomes nor a range of possible outcomes can be determined at this time. However, we do not believe that these lawsuits will have a material adverse effect on our business, financial condition, or results of operations.

In addition, we are from time to time subject to other legal proceedings and claims in the ordinary course of business, none of which we believe are likely to have a material adverse effect on our financial position, results of operations, or cash flows. There can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on our financial position, results of operations or cash flows.

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

The following table sets forth issuer purchases of equity securities for the quarter ended September 30, 2007.

	(a) Total Number of Shares (or Units) Purchased (1)	(b) Average Price Paid per Share (or Unit) (1)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
July 1, 2007 through July 31, 2007				282,207
August 1, 2007 through August 31, 2007	650,000	\$ 10.77	650,000	282,207
September 1, 2007 through September 30, 2007				282,207
<b>Total</b>	<b>650,000</b>	<b>\$ 10.77</b>	<b>650,000</b>	

(1) Activity in this table represents the following items:

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 under the NMO Deferred Compensation Plan.

Purchases of our common shares by the American Equity Investment Employee Stock Ownership Plan.

**Item 6. Exhibits**

- 10.26 American Equity Investment Life Holding Company Independent Insurance Agent Stock Option Plan
- 12.1 Ratio of Earnings to Fixed Charges
- 31.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

Date: November 2, 2007

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

By: /s/ D.J. Noble  
D.J. Noble, Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Wendy L. Carlson  
Wendy L. Carlson, Chief Financial Officer  
(Principal Financial Officer)

By: /s/ Ted M. Johnson  
Ted M. Johnson, Vice President - Controller  
(Principal Accounting Officer)