AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
May 06, 2011

FORM 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended March 31, 2011

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

For the transition period from ________ to ________

Commission File Number : 001-31911
American Equity Investment Life Holding Company
(Exact name of registrant as specified in its charter)

Iowa	42-1447959
(State of Incorporation)	(I.R.S. Employer Identification No.)
6000 Westown Parkway	
West Des Moines, Iowa	50266
(Address of principal executive offices)	(Zip Code)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $1	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $1
Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o
Indicate by check mark whether the registrant is a large accelerated filed, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (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 Exchange Act.) Yes o No x

APPLICABLE TO CORPORATE ISSUERS:
Shares of common stock outstanding at April 30, 2011: 59,497,039

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2011	December 31, 2010
	(Unaudited)	
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2011 - $15,588,780; 2010 - $15,621,894)	$15,745,405	$15,830,663
Held for investment, at amortized cost (fair value: 2011 - $1,527,349; 2010 - $781,748)	1,593,459	822,200
Equity securities, available for sale, at fair value (cost: 2011 - $62,787; 2010 - $61,185)	69,644	65,961
Mortgage loans on real estate	2,730,841	2,598,641
Derivative instruments	622,106	479,786
Other investments	23,357	19,680
Total investments	20,784,812	19,816,931
Cash and cash equivalents	746,737	597,766
Coinsurance deposits	2,657,102	2,613,191
Accrued investment income	197,648	167,645
Deferred policy acquisition costs	1,827,090	1,747,760
Deferred sales inducements	1,313,986	1,227,328
Deferred income taxes	192,518	143,253
Income taxes recoverable	—	6,134
Other assets	114,983	106,755
Total assets	$27,834,876	$26,426,763
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	$24,983,321	$23,655,807
Other policy funds and contract claims	268,676	222,860
Notes payable	334,000	330,835
Subordinated debentures	268,473	268,435
Income taxes payable	50,447	—
Other liabilities	968,782	1,010,779
Total liabilities	26,873,699	25,488,716
Stockholders' equity:		
Preferred stock, no par value, 2,000,000 shares authorized, 2011 and 2010 no shares issued and outstanding	—	—
Common stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding: 2011 - 57,688,425 shares (excluding 5,568,360 treasury shares);	57,688	56,968

2010 - 56,968,446 shares (excluding 5,874,392 treasury shares)		
Additional paid-in capital	459,498	454,454
Unallocated common stock held by ESOP; 2011 - 447,048 shares; 2010 - 447,048 shares	(4,551)	(4,815)
Accumulated other comprehensive income	67,579	81,820
Retained earnings	380,963	349,620
Total stockholders' equity	961,177	938,047
Total liabilities and stockholders' equity	$27,834,876	$26,426,763

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31, 2011	2010
Revenues:		
Traditional life and accident and health insurance premiums	$2,916	$3,287
Annuity product charges	16,962	15,518
Net investment income	292,128	242,910
Change in fair value of derivatives	148,653	82,015
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	(1,193)	9,903
OTTI losses on investments:		
Total OTTI losses	(5,100)	(12,584)
Portion of OTTI losses recognized in (from) other comprehensive income	(1,471)	9,361
Net OTTI losses recognized in operations	(6,571)	(3,223)
Total revenues	452,895	350,410
Benefits and expenses:		
Insurance policy benefits and change in future policy benefits	1,895	2,332
Interest sensitive and index product benefits	159,665	196,869
Amortization of deferred sales inducements	30,692	13,089
Change in fair value of embedded derivatives	128,303	63,875
Interest expense on notes payable	7,907	4,651
Interest expense on subordinated debentures	3,466	3,685
Interest expense on amounts due under repurchase agreements	4	—
Amortization of deferred policy acquisition costs	55,223	27,268
Other operating costs and expenses	17,474	15,985
Total benefits and expenses	404,629	327,754
Income before income taxes	48,266	22,656
Income tax expense	16,923	7,771
Net income	$31,343	$14,885
Earnings per common share	$0.53	$0.26
Earnings per common share - assuming dilution	$0.48	$0.25

See accompanying notes to unaudited consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2010	$56,968	$454,454	$(4,815)	$81,820	$349,620	$938,047
Other comprehensive income:						
Net income for the period	—	—	—	—	31,343	31,343
Change in net unrealized investment gains/losses	—	—	—	(14,660)	—	(14,660)
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	419	—	419
Other comprehensive income						17,102
Allocation of 24,492 shares of common stock by ESOP, including excess income tax benefits	—	37	264	—	—	301
Share-based compensation, including excess income tax benefits	—	2,630	—	—	—	2,630
Issuance of 719,979 shares of common stock under compensation plans, including excess income tax benefits	720	2,377	—	—	—	3,097
Balance at March 31, 2011	$57,688	$459,498	$(4,551)	$67,579	$380,963	$961,177
Balance at December 31, 2009	$56,203	$422,225	$(5,679)	$(30,456)	$312,330	$754,623
Other comprehensive income:						
Net income for period	—	—	—	—	14,885	14,885
Change in net unrealized investment gains/losses	—	—	—	41,770	—	41,770
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	(6,084)	—	(6,084)
Other comprehensive income						50,571
Acquisition of 6,300 shares of common stock	(6)	(44)	—	—	—	(50)
Allocation of 16,813 shares of common stock by ESOP, including excess income tax benefits	—	(24)	181	—	—	157
Share-based compensation, including excess income tax benefits	—	2,056	—	—	—	2,056
Issuance of 231,215 shares of common stock under compensation plans, including excess income tax	231	312	—	—	—	543

benefits						
Balance at March 31, 2010	$56,428	$424,525	$(5,498)	$5,230	$327,215	$807,900

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31, 2011	2010
Operating activities		
Net income	$31,343	$14,885
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	159,665	196,869
Amortization of deferred sales inducements	30,693	13,089
Annuity product charges	(16,962)	(15,518)
Change in fair value of embedded derivatives	128,303	63,875
Increase in traditional life and accident and health insurance reserves	24,356	2,677
Policy acquisition costs deferred	(117,501)	(64,441)
Amortization of deferred policy acquisition costs	55,223	27,268
Provision for depreciation and other amortization	4,515	2,345
Amortization of discounts and premiums on investments	(45,564)	(53,692)
Realized losses (gains) on investments and net OTTI losses recognized	7,764	(6,680)
Change in fair value of derivatives	(149,241)	(82,653)
Deferred income taxes	(41,597)	(21,440)
Share-based compensation	1,719	1,881
Change in accrued investment income	(30,003)	(17,590)
Change in income taxes recoverable/payable	56,581	127,782
Change in other assets	253	4,303
Change in other policy funds and contract claims	45,816	13,169
Change in collateral held for derivatives	122,437	(25,005)
Change in other liabilities	(28,408)	(1,971)
Other	317	143
Net cash provided by operating activities	239,709	179,296
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	1,732,408	1,074,998
Fixed maturity securities - held for investment	—	616,334
Equity securities - available for sale	—	23,014
Mortgage loans on real estate	52,768	26,058
Derivative instruments	97,878	135,601
Acquisition of investments:		
Fixed maturity securities - available for sale	(1,824,696)	(2,068,305)
Fixed maturity securities - held for investment	(760,505)	—
Equity securities - available for sale	(1,600)	(10,125)
Mortgage loans on real estate	(191,583)	(45,230)
Derivative instruments	(83,409)	(60,809)
Other investments	(33)	(26)
Purchases of property, furniture and equipment	(2,656)	(604)
Net cash used in investing activities	(981,428)	(309,094)

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

	Three Months Ended March 31, 2011	2010
Financing activities		
Receipts credited to annuity policyholder account balances	$1,341,844	$846,855
Coinsurance deposits	(16,207)	(139,240)
Return of annuity policyholder account balances	(438,371)	(382,706)
Financing fees incurred and deferred	(1,566)	—
Acquisition of common stock	—	(50)
Excess tax benefits realized from share-based compensation plans	935	199
Proceeds from issuance of common stock	3,052	533
Change in checks in excess of cash balance	1,003	(19,653)
Other	—	24
Net cash provided by financing activities	890,690	305,962
Increase in cash and cash equivalents	148,971	176,164
Cash and cash equivalents at beginning of period	597,766	528,002
Cash and cash equivalents at end of period	$746,737	$704,166
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$6,792	$3,911
Income taxes	1,000	390
Income tax refunds received	—	100,000
Non-cash operating activity:		
Deferral of sales inducements	106,249	61,206
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	3,781	2,905

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2010
(Unaudited)

1. Significant Accounting Policies
Consolidation and Basis of Presentation
The accompanying consolidated financial statements of American Equity Investment Life Holding Company (“we”, “us” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three month period ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2010.
During the three months ended March 31, 2011, we discovered a prior period error related to policy benefit reserves for our single premium immediate annuity products. Accordingly, we made an adjustment in the current period which resulted in a decrease of policy benefit reserves and a decrease in interest sensitive and index product benefits of $4.2 million. On an after-tax basis, the adjustment resulted in a $2.7 million increase in net income for the three months ended March 31, 2011.
Adopted Accounting Pronouncements
In January 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity is now required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. Clarification on existing disclosure requirements is also provided in this update relating to the level of disaggregation of information as to determining appropriate classes of assets and liabilities as well as disclosure requirements regarding valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This standard was effective for us on January 1, 2011, and has not had a material impact on our consolidated financial statements.
New Accounting Pronouncements
In October 2010, as a result of a consensus of the FASB Emerging Issues Task Force, the FASB issued an accounting standards update that modifies the definition of the types of costs incurred that can be capitalized in the acquisition of new and renewal insurance contracts. This guidance defines the costs that qualify for deferral as incremental direct costs that result directly from and are essential to successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. In addition, it lists certain costs as deferrable as those that are directly related to underwriting, policy issuance and processing, medical and inspection, and sales force contract selling as deferrable, as well as the portion of an employee's total compensation related directly to time spent performing those activities for actual acquired contracts and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. This amendment to current GAAP should be applied prospectively and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with retrospective application permitted. We are currently evaluating the impact of the guidance on our consolidated financial statements. See note 6 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010, for the policy issue costs that could be subject to non-deferral.

2. Fair Values of Financial Instruments

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

	March 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$15,745,405	$15,745,405	$15,830,663	$15,830,663
Held for investment	1,593,459	1,527,349	822,200	781,748
Equity securities, available for sale	69,644	69,644	65,961	65,961
Mortgage loans on real estate	2,730,841	2,791,645	2,598,641	2,670,009
Derivative instruments	622,106	622,106	479,786	479,786
Policy loans	567	567	558	558
Cash and cash equivalents	746,737	746,737	597,766	597,766
Coinsurance deposits	2,657,102	2,336,020	2,613,191	2,282,998
2015 notes hedges	71,864	71,864	66,595	66,595
Liabilities				
Policy benefit reserves - annuities	24,769,905	20,590,974	23,464,810	19,594,396
Notes payable	334,000	501,474	330,835	489,097
Subordinated debentures	268,473	254,655	268,435	213,369
2015 notes embedded derivatives	71,864	71,864	66,595	66,595
Interest rate swaps	1,456	1,456	1,976	1,976

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

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

Level 1— Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.

Level 2— Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.

Level 3— Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant would use in determining fair value.

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security, however there were no transfers between levels during the three months ended March 31, 2011.

Our assets and liabilities which are measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
March 31, 2011				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,335	$4,335	$—	$—
United States Government sponsored agencies	2,389,503	—	2,389,503	—
United States municipalities, states and territories	2,489,998	—	2,489,998	—
Corporate securities	7,959,187	64,862	7,894,325	—
Residential mortgage backed securities	2,902,382	—	2,899,681	2,701
Equity securities, available for sale: finance, insurance and real estate	69,644	48,223	19,821	1,600
Derivative instruments	622,106	—	622,106	—
Cash and cash equivalents	746,737	746,737	—	—
2015 notes hedges	71,864	—	71,864	—
	$17,255,756	$864,157	$16,387,298	$4,301
Liabilities				
Interest rate swaps	$1,456	$—	$1,456	$—
2015 notes embedded derivatives	71,864	—	71,864	—
Fixed index annuities - embedded derivatives	2,242,000	—	—	2,242,000
	$2,315,320	$—	$73,320	$2,242,000
December 31, 2010				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,388	$4,388	$—	$—
United States Government sponsored agencies	3,003,651	—	3,003,651	—
United States municipalities, states and territories	2,367,003	—	2,367,003	—
Corporate securities	7,577,064	71,230	7,505,834	—
Residential mortgage backed securities	2,878,557	—	2,875,855	2,702
Equity securities, available for sale: finance, insurance and real estate	65,961	46,925	19,036	—
Derivative instruments	479,786	—	479,786	—
Cash and cash equivalents	597,766	597,766	—	—
2015 notes hedges	66,595	—	66,595	—
	$17,040,771	$720,309	$16,317,760	$2,702
Liabilities				
Interest rate swaps	$1,976	$—	$1,976	$—
2015 notes embedded derivatives	66,595	—	66,595	—
Fixed index annuities - embedded derivatives	1,971,383	—	—	1,971,383
	$2,039,954	$—	$68,571	$1,971,383

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

Fixed maturity securities, equity securities, and short-term investments

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

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

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

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

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis of inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of March 31, 2011 and December 31, 2010.

Mortgage loans on real estate

The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using current competitive market interest rates currently being offered for similar loans which are not fair value exit prices.

Derivative instruments

The fair values of derivative instruments, primarily call options, are based upon the amount of cash that we will receive to settle each derivative instrument on the reporting date. These amounts are obtained from each of the counterparties using industry accepted valuation models and are adjusted for the nonperformance risk of each counterparty net of any collateral held. Inputs include market volatility and risk free interest rates and are used in income valuation techniques in arriving at a fair value for each option contract. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options purchased to fund our fixed index annuity policy liabilities.

Policy loans

We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived.

Cash and cash equivalents

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

2015 notes hedges

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

Policy benefit reserves and coinsurance deposits

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. We are not required to and have not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value.

Notes payable

The fair value of the convertible senior notes is based upon quoted market prices. Fair values of other notes payable are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

Subordinated debentures

Fair values for subordinated debentures are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

Interest rate swaps

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

2015 notes embedded derivatives

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

Fixed index annuities - embedded derivatives

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

The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Available for sale securities		
Beginning balance	$2,702	$17,918
Purchases	1,600	—
Principal returned	(188)	(158)
Accretion of discount	12	22
Total gains (losses) (realized/unrealized):		
Included in other comprehensive income (loss)	175	1,127

Net OTTI losses recognized in operations	—	—
Ending balance	$4,301	$18,909

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Fixed index annuities - embedded derivatives		
Beginning balance	$1,971,383	$1,375,866
Premiums less benefits	215,943	163,148
Change in unrealized gains, net	54,674	(12,897)
Ending balance	$2,242,000	$1,526,117

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

3. Investments

At March 31, 2011 and December 31, 2010, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
March 31, 2011				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,083	$278	$(26)	$4,335
United States Government sponsored agencies	2,397,874	5,068	(13,439)	2,389,503
United States municipalities, states and territories	2,533,833	22,083	(65,918)	2,489,998
Corporate securities	7,756,861	366,497	(164,171)	7,959,187
Residential mortgage backed securities	2,896,129	89,976	(83,723)	2,902,382
	$15,588,780	$483,902	$(327,277)	$15,745,405
Held for investment:				
United States Government sponsored agencies	$1,517,637	$169	$(46,081)	$1,471,725
Corporate security	75,822	—	(20,198)	55,624
	$1,593,459	$169	$(66,279)	$1,527,349
Equity securities, available for sale:				
Finance, insurance, and real estate	$62,787	$7,877	$(1,020)	$69,644
December 31, 2010				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,082	$324	$(18)	$4,388
United States Government sponsored agencies	2,994,174	11,123	(1,646)	3,003,651
United States municipalities, states and territories	2,397,622	22,765	(53,384)	2,367,003
Corporate securities	7,325,988	387,916	(136,840)	7,577,064
Residential mortgage backed securities	2,900,028	86,950	(108,421)	2,878,557
	$15,621,894	$509,078	$(300,309)	$15,830,663
Held for investment:				
United States Government sponsored agencies	$746,414	$—	$(15,309)	$731,105
Corporate security	75,786	—	(25,143)	50,643
	$822,200	$—	$(40,452)	$781,748
Equity securities, available for sale:				
Finance, insurance, and real estate	$61,185	$6,722	$(1,946)	$65,961

During the three months ended March 31, 2011 and 2010, we received $1.5 billion and $1.3 billion, respectively, in redemption proceeds related to calls of our callable United States Government sponsored agency securities and public and private corporate bonds, of which $616.3 million were classified as held for investment for the three months ended March 31, 2010. There were no calls of held for investment securities during the three months ended March 31, 2011. We reinvested proceeds from these redemptions primarily in United States Government sponsored agencies, United States municipalities, states and territories, corporate securities, and residential mortgage backed securities. At March 31, 2011, 37% of our fixed income securities have call features and 1% ($0.1 billion) of those securities were subject to call redemption. Another 22% ($3.8 billion) will become subject to call redemption during the next twelve months.

The amortized cost and fair value of fixed maturity securities at March 31, 2011, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our residential mortgage backed securities provide for periodic payments throughout their lives and are shown below as a separate line.

	Available-for-sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$36,754	$37,468	$—	$—
Due after one year through five years	394,166	436,490	—	—
Due after five years through ten years	1,862,941	2,029,935	—	—
Due after ten years through twenty years	3,463,416	3,470,211	—	—
Due after twenty years	6,935,374	6,868,919	1,593,459	1,527,349
	12,692,651	12,843,023	1,593,459	1,527,349
Residential mortgage backed securities	2,896,129	2,902,382	—	—
	$15,588,780	$15,745,405	$1,593,459	$1,527,349

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

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	$163,482	$213,545
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(94,182)	(122,336)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax benefit	(24,255)	(31,923)
Net unrealized gains reported as accumulated other comprehensive income	$67,579	$81,820

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade”. Based on the NAIC designations, we had 98% of our fixed maturity portfolio rated investment grade at March 31, 2011 and December 31, 2010.

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

	March 31, 2011		December 31, 2010	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$12,876,546	$12,879,124	$12,152,552	$12,246,954
2	3,984,690	4,100,086	3,892,680	4,012,076
3	293,391	264,229	368,680	323,113
4	17,926	18,026	19,820	19,178
5	5,589	6,173	6,089	6,262
6	4,097	5,116	4,273	4,828
	$17,182,239	$17,272,754	$16,444,094	$16,612,411

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The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 870 and 780 securities, respectively) have been in a continuous unrealized loss position, at March 31, 2011 and December 31, 2010:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
March 31, 2011						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$858	$(26)	$—	$—	$858	$(26)
United States Government sponsored agencies	1,810,087	(13,439)	—	—	1,810,087	(13,439)
United States municipalities, states and territories	1,658,830	(65,108)	8,118	(810)	1,666,948	(65,918)
Corporate securities:						
Finance, insurance and real estate	670,851	(26,521)	110,842	(11,283)	781,693	(37,804)
Manufacturing, construction and mining	1,078,807	(51,105)	21,931	(1,763)	1,100,738	(52,868)
Utilities and related sectors	1,026,357	(48,820)	15,365	(3,334)	1,041,722	(52,154)
Wholesale/retail trade	139,580	(6,762)	9,400	(1,077)	148,980	(7,839)
Services, media and other	284,892	(13,506)	—	—	284,892	(13,506)
Residential mortgage backed securities	251,963	(4,008)	910,363	(79,715)	1,162,326	(83,723)
	$6,922,225	$(229,295)	$1,076,019	$(97,982)	$7,998,244	$(327,277)
Held for investment:						
United States Government sponsored agencies	967,860	(46,081)	—	—	967,860	(46,081)
Corporate security:						
Insurance	—	—	55,624	(20,198)	55,624	(20,198)
	967,860	(46,081)	55,624	(20,198)	1,023,484	(66,279)
Equity securities, available for sale:						
Finance, insurance and real estate	$2,452	$(205)	$23,310	$(815)	$25,762	$(1,020)
December 31, 2010						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$548	$(18)	$—	$—	$548	$(18)
United States Government sponsored agencies	110,101	(1,646)	—	—	110,101	(1,646)
United States municipalities, states and territories	1,510,354	(51,989)	7,525	(1,395)	1,517,879	(53,384)
Corporate securities:						
Finance, insurance and real estate	626,363	(31,352)	114,128	(13,001)	740,491	(44,353)
Manufacturing, construction and mining	1,032,170	(33,893)	34,490	(2,333)	1,066,660	(36,226)

Utilities and related sectors	933,727	(34,657)	14,157	(4,552)	947,884	(39,209)
Wholesale/retail trade	153,699	(4,947)	9,175	(1,304)	162,874	(6,251)
Services, media and other	195,516	(10,801)	—	—	195,516	(10,801)
Residential mortgage backed securities	396,083	(14,100)	966,332	(94,321)	1,362,415	(108,421)
	$4,958,561	$(183,403)	$1,145,807	$(116,906)	$6,104,368	$(300,309)
Held for investment:						
United States Government sponsored agencies	$731,105	$(15,309)	$—	$—	$731,105	$(15,309)
Corporate security:						
Insurance	—	—	50,643	(25,143)	50,643	(25,143)
	$731,105	$(15,309)	$50,643	$(25,143)	$781,748	$(40,452)
Equity securities, available for sale:						
Finance, insurance and real estate	$14,583	$(1,199)	$16,253	$(747)	$30,836	$(1,946)

The following is a description of the factors causing the temporary unrealized losses by investment category as of March 31, 2011:

United States Government sponsored agencies; and United States municipalities, states and territories: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. During the last fifteen months spreads on agency securities have improved; however, long term interest rates have risen by a greater amount. These securities carry yields less than those available at March 31, 2011 as the result of these rising interest rates.

Corporate securities: The unrealized losses in these securities are due partially to a rise in interest rates in 2011 as well as the continuation of wider than historic credit spreads in certain sectors of the corporate bond market. While credit spreads narrowed, several sectors remain at spreads wider than pre-crisis levels, such as financial and select economic sensitive issuers. As the result of wider spreads, these issues carry yields less than those available in the market as of March 31, 2011.

Residential mortgage backed securities: At March 31, 2011, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $466.2 million and a fair value of $438.5 million. Despite recent improvements in the capital markets, the fair values of RMBS continue at prices below amortized cost. RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.

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

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

All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized gains/losses on investments for the three months ended March 31, 2011 and 2010 are as follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$(25,658)	$7,496
Investments carried at fair value:		
Fixed maturity securities, available for sale	$(52,144)	$137,007
Equity securities, available for sale	2,081	1,582
	(50,063)	138,589
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	28,154	(83,687)
Deferred income tax asset	7,668	(19,216)

	35,822	(102,903)
(Decrease) increase in net unrealized gains/losses on investments carried at fair value	$(14,241)	$35,686

Proceeds from sales of available for sale securities for the three months ended March 31, 2011 and 2010 were $40.5 million and $138.2 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the three months ended March 31, 2011 and 2010 were $1.7 billion and $801.6 million, respectively. Calls of held for investment fixed maturity securities for the three months ended March 31, 2010 were $616.3 million. There were no calls of held for investment fixed maturity securities during the three months ended March 31, 2011.

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Realized gains (losses) on investments, excluding net OTTI losses for the three months ended March 31, 2011 and 2010 are as follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Available for sale fixed maturity securities:		
Gross realized gains	$1,641	$7,894
Gross realized losses	—	(129)
	1,641	7,765
Equity securities:		
Gross realized gains	—	6,207
Mortgage loans on real estate:		
Impairment losses	(2,834)	(4,069)
	$(1,193)	$9,903

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

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

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

We determine whether other than temporary impairment losses should be recognized for debt and equity securities by assessing all facts and circumstances surrounding each security. Where the decline in market value of debt securities is attributable to changes in market interest rates or to factors such as market volatility, liquidity and spread widening, and we anticipate recovery of all contractual or expected cash flows, we do not consider these investments to be other than temporarily impaired because we do not intend to sell these investments and it is not more likely than not we will be required to sell these investments before a recovery of amortized cost, which may be maturity. For equity securities, we recognize an impairment charge in the period in which we do not have the intent and ability to hold the securities until recovery of cost or we determine that the security will not recover to book value within a reasonable period of time. We determine what constitutes a reasonable period of time on a security-by-security basis by considering all the evidence available to us, including the magnitude of any unrealized loss and its duration. In any event, this period does not exceed 18 months from the date of impairment for perpetual preferred securities for which there is evidence of deterioration in credit of the issuer and common equity securities. For perpetual preferred securities absent evidence of a deterioration in credit of the issuer we apply an impairment model, including an anticipated recovery period, similar to a debt security.

Other than temporary impairment losses on equity securities are recognized in operations. If we intend to sell a debt security or if it is more likely than not that we will be required to sell a debt security before recovery of its amortized cost basis, other than temporary impairment has occurred and the difference between amortized cost and fair value will be recognized as a loss in operations.

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

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

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

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

The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities which are all senior level tranches within the structure of the securities:

		Discount Rate		Default Rate		Loss Severity	
Sector	Vintage	Min	Max	Min	Max	Min	Max
Three months ended March 31, 2011							
Prime	2005	7.7 %	7.7 %	8 %	8 %	50 %	50 %
	2006	7.3 %	7.6 %	9 %	11 %	50 %	55 %
	2007	5.8 %	7.3 %	8 %	30 %	40 %	60 %
Alt-A	2005	6.0 %	7.7 %	18 %	18 %	50 %	50 %
	2006	6.0 %	6.0 %	30 %	30 %	50 %	50 %
	2007	6.2 %	7.4 %	29 %	41 %	50 %	60 %
Three months ended March 31, 2010							
Prime	2006	7.3 %	7.3 %	11 %	11 %	45 %	45 %
	2007	5.8 %	5.8 %	19 %	19 %	50 %	50 %
Alt-A	2005	6.8 %	7.4 %	12 %	26 %	45 %	50 %

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

The following table summarizes other than temporary impairments for the three months ended March 31, 2011 and 2010, by asset type:

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized in (from) Other Comprehensive Income	Net OTTI Losses in Operations
		(Dollars in thousands)		
Three months ended March 31, 2011				
Residential mortgage backed securities	24	$(5,100)	$(1,471)	$(6,571)
Three months ended March 31, 2010				
Residential mortgage backed securities	4	$(12,584)	$9,361	$(3,223)

The cumulative portion of other than temporary impairments determined to be credit losses which have been recognized in operations for debt securities are summarized as follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Cumulative credit loss at beginning of period	$(96,893)	$(82,930)
Credit losses on securities for which OTTI has not previously been recognized	(789)	(2,419)
Additional credit losses on securities for which OTTI has previously been recognized	(5,782)	(804)
Accumulated losses on securities that were disposed of during the period	1,213	1,622
	$(102,251)	$(84,531)

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security for securities that are part of our investment portfolio at March 31, 2011 and December 31, 2010:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
March 31, 2011				
Corporate fixed maturity securities	$3,200	$(2,151)	$5,748	$6,797
Residential mortgage backed securities	953,683	(199,450)	135,735	889,968
Equity securities:				
Finance, insurance and real estate	14,771	—	6,396	21,167
	$971,654	$(201,601)	$147,879	$917,932
December 31, 2010				
Corporate fixed maturity securities	$5,055	$(2,151)	$5,437	$8,341
Residential mortgage backed securities	904,704	(200,921)	124,240	828,023
Equity securities:				
Finance, insurance and real estate	14,771	—	5,783	20,554
	$924,530	$(203,072)	$135,460	$856,918

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio totaled $2.7 billion and $2.6 billion at March 31, 2011 and December 31, 2010, respectively, with commitments outstanding of $94.1 million at March 31, 2011. The portfolio consists of commercial mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	March 31, 2011		December 31, 2010	
	Carrying Amount	Percent	Carrying Amount	Percent
	(Dollars in thousands)			
Geographic distribution				
East	$653,566	23.8 %	$618,250	23.6 %
Middle Atlantic	182,514	6.6 %	172,443	6.6 %
Mountain	409,555	14.9 %	402,965	15.4 %
New England	42,225	1.5 %	42,695	1.6 %
Pacific	282,415	10.3 %	247,254	9.5 %
South Atlantic	505,099	18.4 %	496,606	19.0 %
West North Central	438,083	15.9 %	419,002	16.0 %
West South Central	234,326	8.6 %	215,650	8.3 %
	$2,747,783	100.0 %	$2,614,865	100.0 %
Loan loss allowance	(16,942)		(16,224)	
	2,730,841		2,598,641	
Property type distribution				
Office	$739,960	26.9 %	$683,404	26.1 %
Medical Office	168,376	6.1 %	166,930	6.4 %
Retail	613,582	22.3 %	589,369	22.5 %
Industrial/Warehouse	691,448	25.2 %	666,908	25.6 %
Hotel	150,241	5.5 %	151,516	5.8 %
Apartment	149,019	5.4 %	131,682	5.0 %
Mixed use/other	235,157	8.6 %	225,056	8.6 %
	$2,747,783	100.0 %	$2,614,865	100.0 %
Loan loss allowance	(16,942)		(16,224)	
	2,730,841		2,598,641	

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. A mortgage loan is impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. In addition, we analyze the mortgage loan portfolio for the need of a general loan allowance for probable losses on all other loans. If we determine that the value of any specific mortgage loan is impaired, the carrying amount of the mortgage loan will be reduced to its fair value, based upon the present value of expected future cash flows from the loan discounted at the loan's effective interest rate, or the fair value of the underlying collateral less estimated costs to sell. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions. Based upon this process and analysis, we increased our general loan loss allowance by $0.1 million to $3.1 million during the first quarter of 2011. No general loan loss allowance was necessary at March 31, 2010.

Our specific allowance for credit losses on mortgage loans totaled $13.8 million and $13.2 million at March 31, 2011 and December 31, 2010, respectively, on mortgage loans with total outstanding balances of $36.3 million and $31.0 million as of March 31, 2011 and December 31, 2010, respectively. One loan during each of the three months ended March 31, 2011 and 2010, was satisfied by taking ownership of the real estate serving as collateral. These loans had an aggregate principal amounts outstanding of $5.9 million and $2.9 million, for which specific loan loss allowances totaling $2.1 million and $0.2 million, respectively, were established and recognized in periods prior to foreclosure.

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

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Impaired mortgage loans with allowances	$36,275	$31,027
Impaired mortgage loans with no allowance for losses	73,831	81,994
Allowance for probable loan losses	(13,842)	(13,224)
Net carrying value of impaired mortgage loans	$96,264	$99,797

Our financing receivables currently consist of one portfolio segment which is our commercial mortgage loan portfolio. These are mortgage loans with collateral consisting of commercial real estate and borrowers consisting mostly of limited liability partnerships or limited liability corporations with some personal guarantors. Credit loss experience in our mortgage loan portfolio has been limited to the most recent fiscal years. In 2009, we experienced our first credit loss from our mortgage loan portfolio.

Since 2008, we have consistently had a population of mortgage loans that we have been carrying with workout terms (e.g. short-term interest only periods, short-term suspended payments, etc.) and a population of mortgage loans that have been in a delinquent status (i.e. more than 60 days past due). It is from this population that we have been recognizing some impairment loss due to nonpayment and eventual satisfaction of the loan by taking ownership of the collateral real estate, which in most cases the fair value of the collateral less estimated costs to sell such collateral has been less than the outstanding principal amount of the mortgage loan.

Beginning in 2010, we calculated a general loan loss allowance on the cumulative outstanding principal on loans making up the group of loans currently in workout terms and loans currently more than 60 days past due. We apply a factor to the total outstanding principal of these loans that is calculated as the average specific impairment loss for the most recent 4 quarters divided by the sum of the average of the total outstanding principal of delinquent loans for the most recent 4 quarters and the average of the total outstanding principal of loans in workout for the most recent 4 quarters. If any of the loans within our general loan loss allowance are deemed to be at a higher risk (factors such as single tenant, bankruptcy of borrower, etc.) we apply a factor to the higher risk loans that is double that of what we calculated.

The following table presents a rollforward of our valuation allowance for Commercial Mortgage Loans for the three months ended March 31, 2011 (dollars in thousands):

	Three months ended March 31, 2011
Allowance for Credit Losses:	
Beginning allowance balance	$(16,224)
Charge-offs	2,116
Recoveries	—
Provision for credit losses	(2,834)
Ending allowance balance	$(16,942)

The following table presents the ending balances of our allowance by basis of impairment and the totals of the loans that were evaluated for impairment at March 31, 2011 and December 31, 2010:

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Ending allowance balance by type of impairment:		
Individually evaluated for impairment	$(13,842)	$(13,224)

Collectively evaluated for impairment	(3,100)	(3,000)
Ending allowance balance	$(16,942)	$(16,224)
Financing Receivables:		
Individually evaluated for impairment	36,275	31,027
Collectively evaluated for impairment	73,831	81,994

The amount of charge-offs include the amount of allowance that has been established for loans that we were in the process of satisfying the outstanding principal of certain loans by taking ownership of the collateral. When the property is taken it is recorded at its fair value and the mortgage loan is recorded as fully paid, with any allowance for credit loss that has been established charged off. There could be other situations that develop where we have established a larger specific loan loss allowance than is needed based on increases in the fair value of collateral supporting collateral dependent loans, or improvements in the financial position of a borrower so that a loan would become reliant on cash flows from debt service instead of dependent upon sale of the collateral. Charge-offs of the allowance would be recognized in those situations as well.

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

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

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Credit Exposure--By Payment Activity		
Performing	$2,637,677	$2,501,843
In workout	66,112	68,477
Delinquent	10,002	20,482
Collateral dependent	33,992	24,063
	$2,747,783	$2,614,865

Mortgage loans are considered delinquent when they become 60 days past due. When loans become 90 days past due, become collateral dependent or enter a period with no debt service payments required we place them on non-accrual status and discontinue recognizing interest income. If payments are received on a delinquent loan, interest income is recognized to the extent it would have been recognized if normal principal and interest would have been received timely. If payments are received to bring a delinquent loan current we will resume accruing interest income on that loan. Outstanding principal of loans in a non-accrual status at March 31, 2011 and December 31, 2010 totaled $51.0 and $41.0 million, respectively.

Aging of financing receivables as of March 31, 2011 and December 31, 2010:

	30 - 59 Days	60 - 89 Days	90 Days and Over	Total Past Due	Current	Collateral Dependent Receivables	Total Financing Receivables
	(Dollars in thousands)						
March 31, 2011							
Commercial mortgage loans	$9,243	$—	$10,002	$19,245	$2,694,546	$33,992	$2,747,783
December 31, 2010							
Commercial mortgage loans	$3,002	$9,169	$11,313	$23,484	$2,567,318	$24,063	$2,614,865

Financing receivables summarized in the following table represent all loans that we are either not currently collecting or those we feel it is probable we will not collect all amounts due according to the contractual terms of the loan agreements (all loans that we have worked with the borrower to alleviate short-term cash flow issues and loans delinquent for more than 60 days at the reporting date).

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
March 31, 2011					
Mortgage loans with an allowance	$22,433	$36,275	$(13,842)	$27,754	$148
Mortgage loans with no related allowance	73,831	73,831	—	74,224	1,184
	$96,264	$110,106	$(13,842)	$101,978	$1,332
December 31, 2010					
Mortgage loans with an allowance	$17,803	$31,027	$(13,224)	$24,062	$656
Mortgage loans with no related allowance	81,994	81,994	—	82,535	4,921
	$99,797	$113,021	$(13,224)	$106,597	$5,577

We have not experienced any troubled debt restructures in our commercial mortgage loan portfolio.

5. Derivative Instruments

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the unaudited consolidated balance sheets are as follows:

	March 31, 2011	December 31, 2010
	(Dollars in thousands)	
Assets		
Derivative Instruments		
Call options	$622,106	$479,786
Other Assets		
2015 notes hedges	71,864	66,595
	$693,970	$546,381
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$2,242,000	$1,971,383
Other liabilities		
2015 notes embedded derivatives	71,864	66,595
Interest rate swaps	1,456	1,976
	$2,315,320	$2,039,954

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Change in fair value of derivatives:		
Call options	$143,452	$83,302
2015 notes hedges	5,269	—

Interest rate swaps	(68)	(1,287)
	$148,653	$82,015
Change in fair value of embedded derivatives:		
2015 notes embedded derivatives	$5,269	$—
Fixed index annuities	123,034	63,875
	$128,303	$63,875

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

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

The notional amount and maximum amount of loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts are as follows:

			March 31, 2011		December 31, 2010	
Counterparty	Credit Rating (S&P)	Credit Rating (Moody's)	Notional Amount	Fair Value	Notional Amount	Fair Value
			(Dollars in thousands)			
Bank of America	A+	Aa3	$937,662	$45,103	$588,650	$25,704
BNP Paribas	AA	Aa2	992,069	45,757	786,561	34,772
Bank of New York	AA-	Aa2	18,082	185	18,082	111
Credit Suisse	A+	Aa1	2,361,933	133,027	2,462,920	95,910
Barclays	AA-	Aa3	2,175,573	102,371	1,728,218	72,751
SunTrust	BBB+	A3	—	—	50,540	3,164
Wells Fargo (Wachovia)	NR	Aa2	1,923,835	95,258	1,745,775	76,250
J.P. Morgan	AA-	Aa1	2,817,155	151,377	2,858,902	133,368
UBS	A+	Aa3	831,833	46,331	921,596	37,756
HSBC	AA	Aa2	82,817	2,697	—	—
			$12,140,959	$622,106	$11,161,244	$479,786

As of March 31, 2011 and December 31, 2010, we held $503.6 million and $381.2 million, respectively, of cash and cash equivalents received from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of economic loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $118.7 million and $108.1 million at March 31, 2011 and December 31, 2010, respectively.

We entered into interest rate swaps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures and our revolving line of credit. See notes 9 and 10 in our Annual Report on Form 10-K for the year ended December 31, 2010 for more information on our revolving line of credit and subordinated debentures. The terms of the interest rate swaps provide that we pay a fixed rate of interest and receive a floating rate of interest. The interest rate swaps are not effective hedges under accounting guidance for derivative instruments and hedging activities. Therefore, we record the interest rate swaps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swaps are as follows:

Maturity Date	Notional Amount	Receive Rate	Pay Rate	Counterparty	March 31, 2011 Fair Value	December 31, 2010 Fair Value
					(Dollars in thousands)	
April 7, 2011	20,000	*LIBOR (a)	5.23	Bank of America	(49)	(99)
October 15, 2011	15,000	**LIBOR	1.54	SunTrust	(149)	(193)
October 31, 2011	30,000	**LIBOR	1.51	SunTrust	(289)	(374)
October 31, 2011	30,000	**LIBOR	1.61	SunTrust	(312)	(405)
October 31, 2011	75,000	**LIBOR	1.77	SunTrust	(657)	(905)
	$170,000				$(1,456)	$(1,976)

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

6. Notes Payable

The liability and equity components of the 2024 notes and 2029 notes are accounted for separately in the consolidated balance sheets. The liability component of the 2015 notes and the liability and equity components of the 2024 notes and 2029 notes are as follows:

	March 31, 2011			December 31, 2010		
	September 2015 Notes	December 2029 Notes	December 2024 Notes	September 2015 Notes	December 2029 Notes	December 2024 Notes
	(Dollars in thousands)					
Notes payable:						
Principal amount of liability component	$200,000	$115,839	$74,494	$200,000	$115,839	$74,494
Unamortized discount	(33,776)	(21,171)	(1,386)	(35,335)	(22,306)	(1,857)
Net carrying amount of liability component	$166,224	$94,668	$73,108	$164,665	$93,533	$72,637
Additional paid-in capital:						
Carrying amount of equity component		$15,586	$22,637		$15,586	$22,637
Amount by which the if-converted value exceeds principal	$9,920	$41,005	$—	$800	$34,191	$—

The discount is being amortized over the expected life of the notes, which is December 15, 2011 for the 2024 notes, December 15, 2014 for the 2029 notes and September 15, 2015 for the 2015 notes. The expected life of the notes are based on the dates at which we may redeem the notes or the holders may require us to repurchase the notes. The effective interest rates are 8.9%, 8.5% and 11.9% on the 2015 notes, 2024 notes and 2029 notes, respectively. The interest cost recognized in operations for the convertible senior notes, inclusive of the coupon and amortization of the discount and debt issue costs was $7.8 million and $4.2 million for the three months ended March 31, 2011 and 2010, respectively.

We are required to include the dilutive effect of the 2024 and 2029 notes in our diluted earnings per share calculation. Because these notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the fair value of our common stock at the end of the reporting period exceeds the conversion price per share of $14.24 for the 2024 notes and $9.69 for the 2029 notes. At March 31, 2011 the conversion premium of the 2029 notes was dilutive and the effect has been included in diluted earnings per share for the three months ended March 31, 2011. The 2015 notes and the 2015 notes hedges are excluded from the dilutive effect in our diluted earnings per share calculation as they are currently to be settled only in cash. The 2015 warrants could have a dilutive effect on our earnings per share to the extent that the price of our common stock exceeds the strike price of the 2015 warrants.

During the first quarter 2011, we terminated our existing $150 million revolving line of credit agreement and entered into a $160 million revolving line of credit agreement with seven banks. The revolving period of the $160 million facility is three years. The interest rate is floating at a rate based on our election that will be equal to the alternate base rate (as defined in the credit agreement) plus the applicable margin or the adjusted LIBOR rate (as defined in the credit agreement) plus the applicable margin. We also pay a commitment fee on the available unused portion of the credit facility. The applicable margin and commitment fee rate are based on our credit rating and can change throughout the period of the credit facility. Based upon our current credit rating, the applicable margin is 2.00% for alternate base rate borrowings and 3.00% for adjusted LIBOR rate borrowings and the commitment fee is 0.50%. The commitment fee for the three months ended March 31, 2011 was $0.1 million. Under this agreement, we are required to maintain a minimum risk-based capital ratio at American Equity Life, a maximum ratio of debt to total capital, a minimum cash coverage ratio, and a minimum level of statutory surplus at American Equity Life.

7. Contingencies

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

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in two lawsuits, one class action and one purported class action, involving allegations of improper sales practices and similar claims as described below. In February 2011, we entered into a settlement with the plaintiffs in the class action lawsuit, which is subject to final court approval and is more fully described below. The pending purported class action lawsuit referred to below is in the pre-litigation and discovery 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. While we are uncertain as to the ultimate outcome of the pending purported class action lawsuit, there can be no assurance that such litigation, or any other pending or future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

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

The plaintiffs in the SLO Case represent a class of individuals who are California residents age 65 and older and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. The named plaintiffs in this case are: Chalys M. Stephens and John P. Stephens. Following a mediation conducted on January 21, 2011, we reached a settlement in principal with the plaintiffs. Preliminary approval of the settlement was issued by the court on March 1, 2011, with the fairness hearing for final court approval scheduled for May 9, 2011. Although we anticipate final court approval of the settlement, there can be no assurance of such final approval. The settlement, if final court approval is received, will provide a total settlement benefit of $36 million to past and present policyholders who are members of the class and, if awarded by the court, will provide for attorneys' fees payable to the plaintiff's counsel up to $11 million, litigation expenses in an amount up to $950,000, and incentives of $25,000 payable to each of the two class representatives. These amounts were recorded as an other liability in the consolidated balance sheet at March 31, 2011 and December 31, 2010. The net charge to operations of the settlement (after related reductions in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes) was $27.3 million for the year ended December 31, 2010.

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

8. Earnings Per Share

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands, except per share data)	
Numerator:		
Net income - numerator for earnings per common share	$31,343	$14,885
Interest on convertible subordinated debentures (net of income tax benefit)	258	259
Numerator for earnings per common share - assuming dilution	$31,601	$15,144
Denominator:		
Weighted average common shares outstanding (1)	59,182,019	58,224,964
Effect of dilutive securities:		
Convertible subordinated debentures	2,727,084	2,734,528
Convertible senior notes	2,981,680	—
Stock options and deferred compensation agreements	820,192	178,158
Denominator for earnings per common share - assuming dilution	65,710,975	61,137,650
Earnings per common share	$0.53	$0.26
Earnings per common share - assuming dilution	$0.48	$0.25

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

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

Period	Number of Shares	Range of Exercise Prices
Three months ended March 31, 2011	2,500	$14.34
Three months ended March 31, 2010	1,918,789	$8.75 - $14.34

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

Management's discussion and analysis reviews our unaudited consolidated financial position at March 31, 2011, and the unaudited consolidated results of operations for the three month periods ended March 31, 2011 and 2010, and where appropriate, factors that may affect future financial performance. This discussion should be read in conjunction with our unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2010.

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 Federal income tax laws and regulations which may affect the relative income tax advantages of our products;
- increasing competition in the sale of annuities;
- regulatory changes or actions, including those relating to regulation of financial services affecting (among other things) bank sales and underwriting of insurance products and regulation of the sale, underwriting and pricing of products; and
- the risk factors or uncertainties listed from time to time in our filings with the SEC.

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

Overview

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

Annuity deposits by product type collected during the three months ended March 31, 2011 and 2010, were as follows:

Product Type	Three Months Ended March 31, 2011	2010
	(Dollars in thousands)	
Fixed index annuities:		
Index strategies	$778,582	$403,124
Fixed strategy	357,472	337,782

	1,136,054	740,906
Fixed rate annuities:		
Single-year rate guaranteed	128,743	52,768
Multi-year rate guaranteed	77,047	53,181
	205,790	105,949
Total before coinsurance ceded	1,341,844	846,855
Coinsurance ceded	65,877	189,122
Net after coinsurance ceded	$1,275,967	$657,733

Annuity deposits before coinsurance ceded increased 58% during the first quarter of 2011 compared to the same period in 2010. We attribute this increase to several factors, including the highly competitive rates of our products, 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, lower interest rates on competing products such as bank certificates of deposit and product enhancements including a new generation of guaranteed income withdrawal benefit riders. In addition, we continue to benefit from the actions of several competitors who have been less aggressive in marketing their products than in prior periods. The extent to which this trend will continue is uncertain.

As reported in our previous filings, we undertook several actions in 2010 and 2009 to manage our statutory capital position to facilitate growth. These actions included a restructuring of commission payments to agents, amendments to a reinsurance agreement to expand such agreement to cover certain policy forms that were not in existence when the agreement was executed and the entry into two funds withheld coinsurance agreements. To help support further sales growth in 2011, we entered into a $50 million "financing" reinsurance transaction in the first quarter of 2011 that provided $31.8 million in after tax statutory surplus benefit. We believe our existing statutory capital and surplus and the statutory surplus we expect to generate internally through statutory earnings will support a higher level of new business than in previous years. However, while we have the capital resources to accept more business than was sold in 2010 and 2009, our capacity is not unlimited and sales growth must be matched with available resources to maintain desired financial strength ratings from credit rating agencies and in particular, A.M. Best Company. Should sales growth accelerate to levels that cannot be support by internal capital generation, we would intend to obtain capital from external sources to facilitate such growth.

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

	Three Months Ended March 31,			
	2011		2010	
Average yield on invested assets	5.96	%	6.13	%
Cost of money:				
Aggregate	2.82	%	2.96	%
Cost of money for fixed index annuities	2.77	%	2.91	%
Average crediting rate for fixed rate annuities:				
Annually adjustable	3.19	%	3.26	%
Multi-year rate guaranteed	3.69	%	3.78	%
Investment spread:				
Aggregate	3.14	%	3.17	%
Fixed index annuities	3.19	%	3.22	%
Fixed rate annuities:				
Annually adjustable	2.77	%	2.87	%
Multi-year rate guaranteed	2.27	%	2.35	%

The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits 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 - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010.

Our profitability depends in large part upon the amount of assets under our management, investment spreads we earn on our policyholder account balances, our ability to manage our investment portfolio to maximize returns and minimize risks such as interest rate changes and defaults or impairment of investments, our ability to manage interest rates credited to policyholders and costs of the options purchased to fund the annual index credits on our fixed index annuities, our ability to manage the costs of acquiring new business (principally commissions to agents and bonuses credited to policyholders) and our ability to manage our operating expenses.

Results of Operations

Three Months Ended March 31, 2011 and 2010

Net income increased 111% to $31.3 million in the first quarter of 2011 compared to $14.9 million for the same period in 2010.

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 24% for the three months ended March 31, 2011 compared to March 31, 2010. Our investment spread measured in dollars was $146.0 million for the first quarter of 2011 compared to $116.1 million for the same period in 2010.

Our investment spread measured on a percentage basis was 3.14% in the first quarter of 2011 compared to 3.17% for same period in 2010. The decrease in investment spread for the three months ended March 31, 2011 resulted from a decline in the average yield in investments, offset in part, by a smaller decline in the aggregate cost of money on our fixed index annuities. The lower cost of money for fixed index annuities during 2011 was due to lower costs of options purchased to fund the annual index credits on fixed index annuities and lower rates for the fixed rate strategy in fixed index annuities. The decrease in the average yield on invested assets was primarily attributable to lower yields on investments purchased in 2010 and the first quarter of 2011.

During the three months ended March 31, 2011, we discovered a prior period error related to policy benefit reserves for our single premium immediate annuity products. We evaluated the materiality of the error from qualitative and quantitative perspectives and concluded it was not material to any prior periods. The correction of the error in the current period could be considered material to the results of operations for the three months ended March 31, 2011, but is not material to the projected results of operations for the year ended December 31, 2011. Accordingly, we made an adjustment in the current period which resulted in a decrease of policy benefit reserves and a decrease in interest sensitive and index product benefits of $4.2 million. On an after-tax basis, the adjustment resulted in a $2.7 million increase in net income for the three months ended March 31, 2011.

Operating income (a non-GAAP financial measure) increased 19% to $30.6 million in the first quarter of 2011 compared to $25.8 million for the same period in 2010.

In addition to net income, we have consistently utilized operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains (losses) on investments, including net other than temporary impairment ("OTTI") losses recognized in operations and fair value changes in derivatives and embedded derivatives. Because these items fluctuate from period to period in a manner unrelated to core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and evaluation of operating income together with net income, provides information that may enhance an investor's understanding of our underlying results and profitability.

Operating income is not a substitute for net income determined in accordance with GAAP. The adjustments made to derive operating income are important to understanding our overall results from operations and, if evaluated without proper context, operating income possesses material limitations. As an example, we could produce a low level of net income in a given period, despite strong operating performance, if in that period we generate significant net realized losses from our investment portfolio. We could also produce a high level of net income in a given period, despite poor operating performance, if in that period we generate significant net realized gains from our investment portfolio. As an example of another limitation of operating income, it does not include the decrease in cash flows expected to be collected as a result of credit loss OTTI. Therefore, our management and board of directors also separately review net realized investment gains (losses) and analyses of our net investment income, including impacts related to OTTI write-downs, in connection with their review of our investment portfolio. In addition, our management and board of directors examine net income as part of their review of our overall financial results. The adjustments made to net income to arrive at operating income for the three months ended March 31, 2011 and 2010 are set forth in the table that follows:

	Three Months Ended March 31,

	2011	2010
	(Dollars in thousands)	
Operating Income	$30,574	$25,783
Reconciliation to net income:		
Net income	$31,343	$14,885
Net realized losses (gains) and net OTTI losses on investments, net of offsets	2,472	(2,369)
Net effect of derivatives, embedded derivatives and other index annuity, net of offsets	(3,241)	13,267
Operating income	$30,574	$25,783

Net realized gains on investments and net impairment losses recognized in operations fluctuate from period to period 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. The amounts disclosed above are net of related reductions in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

Amounts attributable to the fair value accounting for fixed index annuity derivatives and embedded derivatives fluctuate from period to period based upon changes in the fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in the interest rates used to discount the embedded derivative liability. The amounts disclosed above are net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for living income benefit riders) increased 9% to $17.0 million for the first quarter of 2011 compared to $15.5 million for the same period in 2010. The increase was principally attributable to an increase in the amount of fees assessed for lifetime income benefit riders which were $3.5 million and $1.6 million for the three months ended March 31, 2011 and 2010, respectively. The increase in these fees for 2011 is attributable to a larger volume of business in force subject to the fee. Withdrawals from annuity and single premium universal life policies subject to surrender charges were $105.1 million and $105.2 million for the three months ended March 31, 2011 and 2010, respectively. The average surrender charge collected on withdrawals subject to a surrender charge was 12.7% and 13.1% for the three months ended March 31, 2011 and 2010, respectively.

Net investment income increased 20% to $292.1 million in the first quarter of 2011 compared to $242.9 million for the same period in 2010. The increase was principally attributable to the growth in our annuity business and a corresponding increase in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 24% to $19.6 billion for the three months ended March 31, 2011 compared to $15.9 billion for the same period in 2010, while the average yield earned on average invested assets was 5.96% and 6.13% for the three months ended March 31, 2011 and 2010, respectively. The decrease in yield earned on average invested assets was primarily attributable to lower yields on investments purchased in 2010 and the first quarter of 2011. In addition, net investment income and average yield for both quarterly periods were negatively impacted by a lag in reinvestment of proceeds from bonds called for redemption during the quarters into new assets causing excess liquidity. Based on yields received for purchases of fixed maturity securities during the first quarter of 2011 and 2010, we estimate that approximately $2.5 million and $4.9 million, respectively, in net investment income was foregone as a result of the excess liquidity and the average yield on invested assets for the first quarter of 2011 and 2010 would have been 6.01% and 6.25%, respectively, if such income had been earned.

Change in fair value of derivatives (principally call options purchased to fund annual index credits on fixed 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:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Call options:		
Gain (loss) on option expiration	$32,118	$78,381
Change in unrealized gain/loss	111,334	4,921
2015 notes hedges	5,269	—
Interest rate swaps	(68)	(1,287)
	$148,653	$82,015

The differences between the change in fair value of derivatives between periods 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 three months ended March 31, 2011 and 2010 is as follows:

	Three Months Ended March 31,	
	2011	2010
S&P 500 Index		
Point-to-point strategy	8.4% - 25.3%	19.7% - 68.6%

Monthly average strategy	0.0% - 10.4%	1.5% - 51.2%
Monthly point-to-point strategy	0.0% - 12.1%	0.0% - 23.4%
Fixed income (bond index) strategies	4.0% - 8.8%	0.0% - 9.8%

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the fixed 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 fixed index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. Costs for options purchased during the three months ended March 31, 2011 decreased compared to the same period in 2010 due to lower caps for the policies for which options were purchased and lower volatility in equity markets. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010.

Concurrently with the issuance of the 2015 notes, we entered into hedge transactions (the “2015 notes hedges”) to provide the cash needed to meet our cash obligations in excess of the principal amount of the 2015 notes upon conversion of the 2015 notes. The fair value of the 2015 notes hedges changes based upon changes in the price of our common stock which increased in 2011. Similarly, the fair value of the conversion option obligation to the holders of the 2015 notes changes based upon changes in the price of our common stock and the conversion option obligation is accounted for as an embedded derivative liability with changes in fair value reported in the Change in fair value of embedded derivatives. The amount for the change in fair value of the 2015 notes hedges equals the amount for the change in the related embedded derivative liabilities and there is an offsetting expense in the change in fair value of embedded derivatives. See Note 9 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010 for a discussion of the 2015 notes hedges.

Net realized gains (losses) on investments, excluding OTTI losses include gains and losses on the sale of securities and impairment losses on mortgage loans on real estate which fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments. The components of realized gains (losses) on investments for the three months ended March 31, 2011 and 2010 are set forth in the table that follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Available for sale fixed maturity securities:		
Gross realized gains	$1,641	$7,894
Gross realized losses	—	(129)
	1,641	7,765
Equity securities:		
Gross realized gains	—	6,207
Mortgage loans on real estate:		
Impairment losses	(2,834)	(4,069)
	$(1,193)	$9,903

Gross realized gains in 2011 and 2010 are due to tax planning strategies to generate taxable capital gains that will permit deductions of capital losses for income tax purposes. See Financial Condition - Investments for additional discussion of impairment losses recognized on mortgage loans on real estate.

Net OTTI losses recognized in operations increased to $6.6 million in the first quarter of 2011 compared to $3.2 million for the same period in 2010. The impairments recognized in the first quarter of 2011 were all residential mortgage backed securities and were principally due to our ongoing analysis of expected cash flow projections. See Financial Condition - Investments for additional discussion of write downs of securities for other than temporary impairments.

Interest sensitive and index product benefits decreased 19% to $159.7 million in the first quarter of 2011 compared to $196.9 million for the same period in 2010. The components of interest credited to account balances are summarized as follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in thousands)	
Index credits on index policies	$87,394	$133,559
Interest credited (including changes in minimum guaranteed interest for index annuities)	68,782	62,198
Living income benefit rider	3,489	1,112
	$159,665	$196,869

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 of the call options purchased to fund the annual index credits were $88.0 million and $125.8 million for the three months ended March 31, 2011 and 2010, respectively. The increase in interest credited was due to an increase in the average amount of annuity liabilities outstanding receiving a fixed rate of interest. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 24% during the three months ended March 31, 2011 to $20.8 billion from $16.8 billion during the same period in 2010.

Amortization of deferred sales inducements increased 134% to $30.7 million in the first quarter of 2011 compared to $13.1 million for the same period in 2010. 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 bonus annuity products. Bonus products represented 95% of our net annuity deposits during the three months ended March 31, 2011 and 2010. The anticipated increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business and amortization associated with net realized gains on investments and net OTTI losses recognized in operations.

Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options) because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected life of the contracts which typically exceeds ten years. The gross profit adjustments resulting from fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business increased amortization by $2.0 million in the first quarter of 2011 and decreased amortization by $10.9 million in the first quarter of 2010. The gross profit adjustments from net realized gains on investments and net OTTI losses recognized in operations decreased amortization by $1.6 million for the three months ended March 31, 2011 and increased amortization by $1.3 million for the same period in 2010. Excluding the amortization amounts attributable to fair value accounting for derivatives and embedded derivatives, net realized gains (losses) on investments and net OTTI losses recognized in operations, amortization for the three months ended March 31, 2011 would have been $30.3 million compared to $22.8 million for the same period in 2010. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010.

Change in fair value of embedded derivatives was an increase of $128.3 million in the first quarter of 2011 and $63.9 million for the same period in 2010. The 2011 increase includes $5.3 million for the increase in the fair value of the 2015 notes embedded conversion derivative. As discussed previously, this amount was offset by an increase in the fair value of the 2015 notes hedges. The remainder of the 2011 increase and the 2010 increase 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; and (iii) the growth in the host component of the policy liability. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010. The primary reason for the increase in the change in fair value of the embedded derivatives in the first quarter of 2011 was an increase in the expected index credits on the next policy anniversary dates which correlated with the increase in the change in fair value of derivatives for the first quarter of 2011 discussed above. The primary reason for the increase in the change in fair value of the embedded derivatives in the first quarter of 2010 was decreases in the discount rates used in estimating our liability for policy growth.

Interest expense on notes payable increased 70% to $7.9 million in the first quarter of 2011 compared to $4.7 million for the same period in 2010. This increase was primarily due to the September 2010 issuance of $200.0 million principal amount of 3.50% convertible senior notes. The increase in interest expense on the 3.50% convertible notes was partially offset by a decrease in interest expense on borrowings under our revolving lines of credit with banks. The weighted average interest on the bank credit facility was 1.03% for the three months ended March 31, 2010 and average borrowings outstanding were $150.0 million. We had no borrowings outstanding on our revolving lines of credit during the three months ended March 31, 2011.

Interest expense on subordinated debentures decreased 6% to $3.5 million in the first quarter of 2011 compared to $3.7 million for the same period in 2010. This decrease was primarily due to decreases in the weighted average interest rate on the outstanding subordinated debentures which were 5.07% and 5.41% for the first quarter of 2011 and 2010, respectively. The weighted average interest rates have decreased because $169.6 million principal amount of the subordinated debentures have a floating rate of interest based upon the three month London Interbank Offered Rate plus an applicable margin. See Financial Condition - Liabilities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2010.

Interest expense on amounts due under repurchase agreements was immaterial for the first quarter of 2011. There were no amounts outstanding during the first quarter of 2010. The weighted average interest rate and average borrowings outstanding for the three months ended March 31, 2011 were 0.30% and $6.0 million , respectively.

Amortization of deferred policy acquisition costs increased 103% to $55.2 million in the first quarter of 2011 compared to $27.3 million for the same period in 2010. 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 fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business and amortization associated with net realized gains on investments and net OTTI losses recognized in operations.

As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The gross profit adjustments resulting from fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business increased amortization by $3.7 million in the first quarter of 2011 and decreased amortization by $18.7 million for the same period in 2010. The gross profit adjustments from net realized gains on investments and net OTTI losses recognized in operations decreased amortization by $2.3 million for the three months ended March 31, 2011 and increased amortization by $1.8 million for the same period in 2010. Excluding the amortization amounts attributable to fair value accounting for derivatives, net realized gains on investments and net OTTI losses recognized in operations, amortization for the three months ended March 31, 2011 would have been $53.8 million compared to $44.2 million for the same period in 2010.

Other operating costs and expenses increased 9% to $17.5 million in the first quarter of 2011 compared to $16.0 million for the same period in 2010. This increase was primarily attributable to fees and risk charges on reinsurance of $1.1 million and state insurance taxes and fees of $0.6 million. The increase in fees and risk charges on reinsurance was due to a reinsurance treaty entered into on March 31, 2011. State insurance taxes and fees increased due to growth in taxable income apportioned to applicable states.

Income tax expense increased 118% to $16.9 million in the first quarter of 2011 compared to $7.8 million for the same period in 2010. This increase was primarily due to the increase in income before income taxes. The effective tax rates were 35.1% and 34.3% for the three months ended March 31, 2011 and 2010, respectively. The effective tax rate for the first quarter of 2010 was less than the applicable statutory federal income tax rate of 35% due to state income tax benefits attributable to losses in the non-life subgroup.

Financial Condition

Investments

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

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

The composition of our investment portfolio is summarized in the table below:

	March 31, 2011			December 31, 2010		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Fixed maturity securities:						
United States Government full faith and credit	$4,335	—	%	$4,388	—	%
United States Government sponsored agencies	3,907,140	18.8	%	3,750,065	18.9	%
United States municipalities, states and territories	2,489,998	12.0	%	2,367,003	12.0	%
Corporate securities	8,035,009	38.7	%	7,652,850	38.6	%
Residential mortgage backed securities	2,902,382	14.0	%	2,878,557	14.5	%
Total fixed maturity securities	17,338,864	83.5	%	16,652,863	84.0	%
Equity securities	69,644	0.3	%	65,961	0.4	%
Mortgage loans on real estate	2,730,841	13.1	%	2,598,641	13.1	%
Derivative instruments	622,106	3.0	%	479,786	2.4	%
Other investments	23,357	0.1	%	19,680	0.1	%
	$20,784,812	100.0	%	$19,816,931	100.0	%

During the three months ended March 31, 2011 and 2010, we received $1.5 billion and $1.3 billion, respectively, in redemption proceeds related to calls of our callable United States Government sponsored agency securities and public and private corporate bonds, of which $616.3 million were classified as held for investment for the three months ended March 31, 2010. There were no calls of held for investment securities during the three months ended March 31, 2011. We reinvested proceeds from these redemptions primarily in United States Government sponsored agencies, United States municipalities, states and territories, corporate securities, and residential mortgage backed securities. At March 31, 2011, 37% of our fixed income securities have call features and 1% ($0.1 billion) of those securities were subject to call redemption. Another 22% ($3.8 billion) will become subject to call redemption during the next twelve months.

Fixed Maturity Securities

Our fixed maturity security portfolio is managed to minimize risks such as interest rate changes and defaults or impairments while earning a sufficient and stable return on our investments. Historically, we have had a high percentage of our fixed maturity securities in U.S. Government sponsored agency securities (for the most part Federal Home Loan Mortgage Corporation and Federal National Mortgage Association). While U.S. Government sponsored agency securities are of high credit quality, the call features have resulted in our excess cash position. These calls resulted from the low interest rate and tight agency spread environment. Since 2007, when we had almost 80% of our fixed maturity portfolio invested in callable agencies, we have reallocated a significant portion of our fixed maturities from the callable agency securities to other highly rated, long-term securities. The largest portion of our fixed maturity securities are now in investment grade (NAIC designation 1 or 2) publicly traded or privately placed corporate securities. We have also built a portfolio of residential mortgage backed securities ("RMBS") that provide our investment portfolio a source of regular cash flow and higher yielding assets than our agency securities. Additionally, in 2009 we began building a portfolio of taxable bonds issued by municipalities, states and territories of the United States that provide us with attractive yields while consistent with our aversion to credit risk.

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

Rating Agency Rating	March 31, 2011 Carrying Amount	Percent		December 31, 2010 Carrying Amount	Percent	
	(Dollars in thousands)					
Aaa/Aa/A	$12,154,165	70.1	%	$11,599,255	69.6	%
Baa	3,881,390	22.4	%	3,725,920	22.4	%
Total investment grade	16,035,555	92.5	%	15,325,175	92.0	%
Ba	281,832	1.6	%	294,200	1.8	%
B	64,098	0.4	%	69,033	0.4	%
Caa and lower	903,293	5.2	%	959,437	5.8	%
In or near default	54,086	0.3	%	5,018	—	%
Total below investment grade	1,303,309	7.5	%	1,327,688	8.0	%
	$17,338,864	100	%	$16,652,863	100.0	%

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

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

In November 2010, the NAIC membership approved continuation of a process developed in 2009 to assess non-agency RMBS for the 2010 filing year that does not rely on NRSRO ratings. The NAIC retained the services of PIMCO Advisory to model each non-agency RMBS owned by U.S. insurers at year-end 2010. PIMCO Advisory has provided 5 prices for each security for life insurance companies to utilize in determining the NAIC designation for each RMBS based on each insurer's statutory book value price. This process is used to determine the level of RBC requirements for non-agency RMBS.

The table below presents our fixed maturity securities by NAIC designation:

NAIC Designation	March 31, 2011 Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount		December 31, 2010 Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount	
	(Dollars in thousands)					(Dollars in thousands)				
1	$12,876,546	$12,879,124	$12,925,036	74.6	%	$12,152,552	$12,246,954	$12,262,263	73.6	%
2	3,984,690	4,100,086	4,100,086	23.6	%	3,892,680	4,012,076	4,012,076	24.1	%
3	293,391	264,229	284,427	1.6	%	368,680	323,113	348,256	2.1	%
4	17,926	18,026	18,026	0.1	%	19,820	19,178	19,178	0.1	%
5	5,589	6,173	6,173	0.1	%	6,089	6,262	6,262	0.1	%
6	4,097	5,116	5,116	—	%	4,273	4,828	4,828	—	%
	$17,182,239	$17,272,754	$17,338,864	100.0	%	$				