

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO  
Form 10-K  
March 03, 2014

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

FORM 10-K  
(Mark One)

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-31911

American Equity Investment Life Holding Company  
(Exact name of registrant as specified in its charter)

Iowa 42-1447959  
(State or other jurisdiction of Incorporation) (I.R.S. Employer Identification No.)

6000 Westown Parkway 50266  
West Des Moines, Iowa (Zip Code)

(Address of principal executive offices)  
Registrant's telephone number, including area code: (515) 221-0002

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

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

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

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

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

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

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

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

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
		(Do not check if a smaller reporting company)	

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes  No   
Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was \$967,404,076 based on the closing price of \$15.70 per share, the closing price of the common stock on the New York Stock Exchange on June 28, 2013.

Shares of common stock outstanding as of February 28, 2014: 71,806,543

Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the annual meeting of shareholders to be held June 5, 2014, which will be filed within 120 days after December 31, 2013, are incorporated by reference into Part III of this report.

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PART I

Item 1. Business

Introduction

We are a leader in the development and sale of fixed index and fixed rate annuity products. We were incorporated in the state of Iowa on December 15, 1995. We are a full service underwriter of fixed annuity and life insurance products through our wholly-owned life insurance subsidiaries, American Equity Investment Life Insurance Company ("American Equity Life"), American Equity Investment Life Insurance Company of New York and Eagle Life Insurance Company ("Eagle Life"). Our business consists primarily of the sale of fixed index and fixed rate annuities and, accordingly, we have only one business segment. Our business strategy is to focus on growing our annuity business and earn predictable returns by managing investment spreads and investment risk. We are currently licensed to sell our products in 50 states and the District of Columbia. Throughout this report, unless otherwise specified or the context otherwise requires, all references to "American Equity", the "Company", "we", "our" and similar references are to American Equity Investment Life Holding Company and its consolidated subsidiaries.

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

Annuity Market Overview

Our target market includes the group of individuals ages 45-75 who are seeking to accumulate tax-deferred savings. We believe that significant growth opportunities exist for annuity products because of favorable demographic and economic trends. According to the U.S. Census Bureau, there were approximately 39 million Americans age 65 and older in 2010, representing 13% of the U.S. population. By 2030, this sector of the population is expected to increase to 20% of the total population. Our fixed index and fixed rate annuity products are particularly attractive to this group as a result of the guarantee of principal with respect to those products, competitive rates of credited interest, tax-deferred growth, guaranteed lifetime income and alternative payout options.

According to Wink's Sales and Market Report published by Wink, Inc., total industry sales of fixed index annuities increased 6.3% to \$27.1 billion for the first three quarters of 2013 from \$25.5 billion for the first three quarters of 2012, and increased 4.9% to \$34.0 billion in 2012 from \$32.4 billion in 2011. Total industry sales of fixed index annuities have increased 35% over the five year period from 2007 to 2012, which we believe is attributable to more Americans reaching retirement age and seeking products that will provide principal protection and guaranteed lifetime income. Our wide range of fixed index and fixed rate annuity products has enabled us to enjoy favorable growth during volatile equity and bond markets.

Strategy

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

Enhance our Current Independent Agency Network. We believe that our successful relationships with approximately 45 national marketing organizations represent a significant competitive advantage. Our objective is to improve the productivity and efficiency of our core distribution channel by focusing our marketing and recruiting efforts on those independent agents capable of selling \$1 million or more of annuity premium annually. This level of production qualifies them for our Gold Eagle program which was introduced at the beginning of 2007. We believe the Gold Eagle program has been effective as evidenced by the number of qualified Gold Eagle agents ranging from 945 to as many as 1,227 during the last three calendar years. Our Gold Eagle agents accounted for 61% of total production in 2013, 59% of total production in 2012 and 57% of total production in 2011. Gold Eagle qualifiers receive a combination of cash and equity-based incentives as motivation for producing business for us. Beginning in 2014, Gold Eagle agents will need to sell at least \$2 million of annuity premium to receive the cash and equity-based incentives under the Gold Eagle program. The equity-based incentive compensation component of our Gold Eagle program is unique in our

industry and distinguishes us from our competitors. Our continuing focus on relationships and efficiency will ultimately reduce our independent agents to a core group of professional annuity producers. We will also be alert for opportunities to establish relationships with national marketing organizations and agents not presently associated with us and will strive to provide all of our marketers with the highest quality service possible.

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

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Use our Expertise to Achieve Targeted Spreads on Annuity Products. Historically, we have had a successful track record in achieving the targeted spreads on our annuity products. This historical success has been challenged in the current extended low interest rate environment. However, we intend to continue to leverage our experience and expertise in managing the investment spread during a range of interest rate environments to achieve, or work towards achieving, our targeted spreads.

Maintain our Profitability Focus and Improve Operating Efficiency. We are committed to improving our profitability by advancing the scope and sophistication of our investment management and spread capabilities and continuously seeking out efficiencies within our operations. We have implemented competitive incentive programs for our national marketing organizations, agents and employees to stimulate performance.

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

Focus on High Quality Service to Agents and Policyholders. We have maintained high quality personal service as one of our highest priorities since the inception of our business and continue to strive for an unprecedented level of timely and accurate service to both our agents and policyholders. Examples of our high quality service include answering our phone calls by a live person and issuing policies within 24 hours of receiving the application if the paperwork is in good order. We believe high quality service is one of our strongest competitive advantages.

Expand our Distribution Channels. We formed Eagle Life with the vision of developing a network of broker/dealers, banks and registered investment advisors that have the ability to distribute fixed index and fixed annuity products in large volume. We believe this to be the most effective means of building a core distribution channel of selling firms with representatives capable of selling \$1 million or more of annuity premium annually.

**Products**

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

Product Type	Year Ended December 31, 2013		2012		2011			
	Deposits Collected	Deposits as a % of Total	Deposits Collected	Deposits as a % of Total	Deposits Collected	Deposits as a % of Total		
	(Dollars in thousands)							
Fixed index annuities:								
Index strategies	\$2,861,977	68	% \$2,225,902	56	% \$2,839,295	56	%	
Fixed strategy	1,020,447	24	% 1,208,324	31	% 1,377,987	27	%	
	3,882,424	92	% 3,434,226	87	% 4,217,282	83	%	
Fixed rate annuities	277,922	7	% 348,049	9	% 567,229	11	%	
Single premium immediate annuities	52,142	1	% 164,657	4	% 305,603	6	%	
	\$4,212,488	100	% \$3,946,932	100	% \$5,090,114	100	%	

**Fixed Index Annuities**

Fixed index annuities allow policyholders to earn index credits based on the performance of a particular index without the risk of loss of their principal. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more index based strategies and a traditional fixed rate strategy. Approximately 97%, 97% and 95% of our fixed index annuity sales for the years ended December 31, 2013, 2012 and 2011, respectively, were "premium bonus" products. The initial annuity deposit on these policies is increased at issuance by a specified premium bonus ranging from 5% to 10%. Generally, the surrender charge and bonus vesting provisions of our policies are structured such that we have comparable protection from early termination between

bonus and non-bonus products.

The annuity contract value is equal to the sum of premiums paid, premium bonuses and interest credited ("index credits"), which is based upon an overall limit (or "cap") or a percentage (the "participation rate") of the annual appreciation (based in certain situations on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. Caps and participation rates limit the amount of annual interest the policyholder may earn in any one contract year and may be adjusted by us annually subject to stated minimums. Caps generally range from 1% to 12% and participation rates range from 10% to 100%. In addition, some products have a spread or "asset fee" generally ranging from 1.5% to 3.5%, which is deducted from annual interest to be credited. For products with asset fees, if the annual appreciation in the index does not exceed the asset fee, the policyholder's index credit is zero. The minimum guaranteed contract values are equal to 87.5% of the premium collected plus interest credited at an annual rate ranging from 1% to 3.5%.

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### Fixed Rate Annuities

Fixed rate deferred annuities include annual reset and multi-year rate guaranteed products. Our annual reset fixed rate annuities have an annual interest rate (the "crediting rate") that is guaranteed for the first policy year. After the first policy year, we have the discretionary ability to change the crediting rate once annually to any rate at or above a guaranteed minimum rate. Our multi-year rate guaranteed annuities are similar to our annual reset products except that the initial crediting rate is guaranteed for up to a seven-year period before it may be changed at our discretion. The guaranteed rate on our fixed rate deferred annuities ranges from 1% to 4% and the initial guaranteed rate on our multi-year rate guaranteed policies ranges from 1.8% to 5%.

The initial crediting rate is largely a function of the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to crediting rates, we take into account the yield on our investment portfolio, annuity surrender and withdrawal assumptions, competitive industry pricing and crediting rate history for particular groups of annuity policies with similar characteristics. As of December 31, 2013, crediting rates on our outstanding fixed rate deferred annuities generally ranged from 1.1% to 5%. The average crediting rate on our outstanding fixed rate deferred annuities at December 31, 2013 was 3.05%.

We also sell single premium immediate annuities ("SPIAs"). Our SPIAs are designed to provide a series of periodic payments for a fixed period of time or for life, according to the policyholder's choice at the time of issue. The amounts, frequency and length of time of the payments are fixed at the outset of the annuity contract. SPIAs are often purchased by persons at or near retirement age who desire a steady stream of payments over a future period of years. The implicit interest rate on SPIAs is based on market conditions when the policy is issued. The implicit interest rate on our outstanding SPIAs averaged 2.30% at December 31, 2013.

### Withdrawal Options—Fixed Index and Fixed Rate Annuities

Policyholders are typically permitted penalty-free withdrawals up to 10% of the contract value in each year after the first year, subject to limitations. Withdrawals in excess of allowable penalty-free amounts are assessed a surrender charge during a penalty period which ranges from 5 to 17 years for fixed index annuities and 3 to 15 years for fixed rate annuities from the date the policy is issued. This surrender charge initially ranges from 4.7% to 20% for fixed index annuities and 8.25% to 25% for fixed rate annuities of the contract value and generally decreases by approximately one-half to two percentage points per year during the surrender charge period. For certain policies the premium bonus is considered in the establishment of the surrender charge percentages. For other policies there is a vesting schedule ranging from 10 to 14 years that applies to the premium bonus and any interest earned on that premium bonus. Surrender charges and bonus vesting are set at levels aimed at protecting us from loss on early terminations and reducing the likelihood of policyholders terminating their policies during periods of increasing interest rates. This practice lengthens the effective duration of the policy liabilities and enhances our ability to maintain profitability on such policies. The policyholder may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years or a combination of these payment options.

Beginning in July 2007, substantially all of our fixed index annuity policies were issued with a lifetime income benefit rider. This rider provides an additional liquidity option to policyholders. With the lifetime income benefit rider a policyholder can elect to receive guaranteed payments for life from their contract without requiring them to annuitize their contract value. The amount of the living income benefit available is determined by the growth in the policy's income account value as defined in the rider (4.0% to 8.0%), which is selected by the policyholder at the time of purchase, and the policyholder's age at the time the policyholder elects to begin receiving living income benefit payments. Living income benefit payments may be stopped and restarted at the election of the policyholder. During 2013, we introduced new versions of our lifetime income benefit rider that had an optional wellbeing benefit or optional death benefit. Policyholders have the choice of selecting a rider with a base level of benefit for no explicit fee or paying a fee for a rider that has a higher level of benefits. Rider fees range from 0.30% to 1.00%.

### Life Insurance

These products include traditional ordinary and term, universal life and other interest-sensitive life insurance products. We have approximately \$2.3 billion of life insurance in force as of December 31, 2013. We intend to continue



offering life insurance products for individual and group markets. Premiums related to this business accounted for 1% or less of revenues for the years ended December 31, 2013, 2012 and 2011.

#### Investments/Spread Management

Investment activities are an integral part of our business, and net investment income is a significant component of our total revenues. Profitability of many of our products is significantly affected by spreads between interest yields on investments, the cost of options to fund the annual index credits on our fixed index annuities and rates credited on our fixed rate annuities. We manage the index-based risk component of our fixed index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect the change in the cost of such options which varies based on market conditions. All options are purchased to fund the index credits on our fixed index annuities on their respective anniversary dates, and new options are purchased at each of the anniversary dates to fund the next annual index credits. All credited rates on non-multi-year rate guaranteed fixed rate deferred annuities may be changed annually, subject to minimum guarantees. Changes in caps, participation rates and asset fees on fixed index annuities and crediting rates on fixed rate annuities may not be sufficient to maintain targeted investment spreads in all economic and market environments. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or to maintain caps, participation rates, asset fees and crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

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For additional information regarding the composition of our investment portfolio and our interest rate risk management, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Investments, Quantitative and Qualitative Disclosures About Market Risk and Note 3 to our audited consolidated financial statements.

Marketing

We market our products through a variable cost brokerage distribution network of approximately 45 national marketing organizations and, through them, approximately 27,000 independent agents. We emphasize high quality service to our agents and policyholders along with the prompt payment of commissions to our agents. We believe this has been significant in building excellent relationships with our existing agency force.

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

The insurance distribution system is comprised of insurance brokers and marketing organizations. We are pursuing a strategy to increase the efficiency of our distribution network by strengthening our relationships with key national and regional marketing organizations and are alert for opportunities to establish relationships with organizations not presently associated with us. These organizations typically recruit agents for us by advertising our products and our commission structure through direct mail advertising or seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing our products. We compensate marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited by such organizations. We also conduct incentive programs for marketing organizations and agents from time to time, including equity-based programs for our leading national marketers and those agents qualifying for our Gold Eagle program. For additional information regarding our equity-based programs for our leading national marketers and independent agents, see Note 11 to our audited consolidated financial statements. We generally do not enter into exclusive arrangements with these marketing organizations.

Eagle Life's fixed index and fixed annuities are being distributed pursuant to selling agreements with the applicable broker dealer, bank or registered investment advisor. Relationships with these firms are facilitated by wholesalers who promote Eagle Life and are compensated based upon the sales of the firms that they have contracted with Eagle Life. One of our national marketing organizations accounted for more than 10% of the annuity deposits and insurance premiums collected during 2013, and we expect this organization to continue as a marketer for American Equity Life with a focus on selling our products. The states with the largest share of direct premiums collected during 2013 were: Florida (9.9%), California (9.1%), Texas (7.6%), Illinois (6.7%), and Pennsylvania (5.6%).

Competition and Ratings

We operate in a highly competitive industry. Our annuity products compete with fixed index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank products and other investment and retirement funding alternatives offered by asset managers, banks, and broker-dealers. Our insurance products compete with products of other insurance companies, financial intermediaries and other institutions based on a number of features, including crediting rates, policy terms and conditions, service provided to distribution channels and policyholders, ratings, reputation and distributor compensation.

The sales agents for our products use the ratings assigned to an insurer by independent rating agencies as one factor in determining which insurer's annuity to market. The degree to which ratings adjustments have affected and will affect our sales and persistency is unknown. Following is a summary of American Equity Life's financial strength ratings:

Financial Strength Rating Outlook Statement

A.M. Best Company

January 2011—current

A-

Stable

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November 2008—January 2011	A-	Negative
August 2006—October 2008	A-	Stable
Standard & Poor's		
June 2013—Current	BBB+	Positive
October 2011—June 2013	BBB+	Stable
September 2010—October 2011	BBB+	Positive
July 2010—September 2010	BBB+	Stable
July 2008—July 2010	BBB+	Negative
Fitch Ratings		
May 2013—Current	BBB+	Stable

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

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

In February 2014, A.M. Best affirmed its rating outlook on the U.S. life/annuity sector as stable, which has been A.M. Best's outlook on our industry since 2010. In January 2014, Standard & Poor's issued its outlook on the U.S. life insurance sector as stable, which changed from their cautious outlook in late 2012. Standard & Poor's cites insurers' strong credit characteristics and improving economic conditions as reasons for their stable outlook. They also state that interest rates remain low but appear on the verge of increasing as the U.S. economy is likely to continue gaining momentum through a resilient private sector, housing rebound and a strengthening job market. The rating agencies have heightened the level of scrutiny they apply to insurance companies, increased the frequency and scope of their credit reviews and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels.

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

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

FitchRating's insurer financial strength ratings currently range from "AAA (exceptionally strong)" to "C (distressed)." Ratings of "BBB-" and higher are considered to be "secure," and those of "BB+" and lower are considered to be "vulnerable."

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

### Reinsurance

### Coinsurance

American Equity Life has two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), covering 70% of certain of our fixed index and fixed rate annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003, and 20% of those contracts issued from January 1, 2004 to July 31, 2004. The business reinsured under these agreements may not be recaptured. Coinsurance deposits (aggregate policy benefit reserves transferred to EquiTrust under these agreements) were \$0.9 billion and \$1.0 billion at December 31, 2013 and 2012, respectively. We remain liable to policyholders with respect to the policy liabilities ceded to EquiTrust should EquiTrust fail to meet the obligations it has reinsured. EquiTrust has received a financial strength rating of "B+" (Good) with a stable outlook from A.M. Best Company. None of the coinsurance deposits with

EquiTrust are deemed by management to be uncollectible.

American Equity Life has two coinsurance agreements with Athene Life Re Ltd. ("Athene"), an unauthorized life reinsurer domiciled in Bermuda. One agreement ceded 20% of certain of our fixed index annuities issued from January 1, 2009 through March 31, 2010. The business reinsured under this agreement is not eligible for recapture until the end of the month following seven years after the date of issuance of the policy. The other agreement cedes 80% of our multi-year rate guaranteed annuities issued on or after July 1, 2009. The business reinsured under this agreement may not be recaptured. Coinsurance deposits (aggregate policy benefit reserves transferred to Athene under these agreements) were \$2.1 billion and \$1.9 billion at December 31, 2013 and 2012, respectively. We remain liable to policyholders with respect to the policy liabilities ceded to Athene should Athene fail to meet the obligations it has reinsured. The annuity deposits that have been ceded to Athene are being held in a trust and American Equity Life is named as the sole beneficiary of the trust. The assets in the trust are required to remain at a value that is sufficient to support the current balance of policy benefit liabilities of the ceded business on a statutory basis. If the value of the trust account would ever reach a point where it is less than the amount of the ceded policy benefit liabilities on a statutory basis, Athene is required to either establish a letter of credit or deposit securities in a trust for the amount of any shortfall. None of the coinsurance deposits with Athene are deemed by management to be uncollectible. Effective January 1, 2014, American Equity Life is also an intermediary for reinsurance of 80% of Eagle Life's fixed index and multi-year rate guaranteed annuities to Athene. The reinsurance agreements specify that the coinsurance percentage for Eagle Life's fixed index annuities decreases to 50% for policies issued between January 1, 2016 and December 31, 2018, and to 20% for policies issued on or after January 1, 2019. Eagle Life remains liable to policyholders with respect to the policy liabilities ceded to Athene should Athene fail to meet the obligations

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it has reinsured. The Eagle Life annuity deposits ceded to Athene will be held in the trust referred to above for the benefit of American Equity Life and Eagle Life. None of Eagle Life's coinsurance deposits with Athene are deemed by management to be uncollectible.

### Financing Arrangements

American Equity Life has two reinsurance transactions with Hannover Life Reassurance Company of America, ("Hannover"), which are treated as reinsurance under statutory accounting practices and as financing arrangements under U.S. generally accepted accounting principles ("GAAP"). The statutory surplus benefits under these agreements are eliminated under GAAP and the associated charges are recorded as risk charges and included in other operating costs and expenses in the consolidated statements of operations. The transactions became effective March 31, 2011 (the "2011 Hannover Transaction") and July 1, 2013 (the "2013 Hannover Transaction"). The 2011 Hannover Transaction terminates on March 31, 2016, and the statutory surplus benefit is reduced over a five year period and is eliminated upon termination.

The 2011 Hannover Transaction is a coinsurance and yearly renewable term reinsurance agreement for statutory purposes and provided \$49.2 million in net pretax statutory surplus benefit at inception in 2011. Pursuant to the terms of this agreement, pretax statutory surplus was reduced by \$11.3 million, \$11.8 million and \$9.2 million in 2013, 2012 and 2011, respectively, and is expected to be reduced as follows: 2014—\$10.8 million, 2015—\$10.3 million and 2016—\$2.5 million. These amounts include risk charges equal to 1.25% of the pretax statutory surplus benefit as of the end of each calendar quarter.

The 2013 Hannover Transaction is a yearly renewable term reinsurance agreement for statutory purposes covering 45.6% of waived surrender charges related to penalty free withdrawals, deaths and lifetime income benefit rider payments as well as lifetime income benefit rider payments in excess of policy fund values on certain business. We may recapture the risks reinsured under this agreement as of the end of any quarter after June 30, 2016. However, the agreement, as amended, makes it punitive to us if we do not recapture the business ceded no later than the first quarter of 2018. The reserve credit recorded on a statutory basis by American Equity Life was \$288.2 million at December 31, 2013. We pay quarterly reinsurance premiums under this agreement with an experience refund calculated on a quarterly basis and a risk charge equal to 1.25% of the pretax statutory surplus benefit as of the end of each calendar quarter. The 2013 Hannover Transaction replaces a similar reinsurance agreement with Hannover that was recaptured simultaneously with entering into the 2013 Hannover Transaction. The reserve credit recorded on a statutory basis by American Equity Life was \$180.3 million at December 31, 2012 under the recaptured agreement.

### Indemnity Reinsurance

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

The maximum loss retained by us on all life insurance policies we have issued was \$0.1 million or less as of December 31, 2013. American Equity Life's reinsured business under indemnity reinsurance agreements is primarily ceded to two reinsurers. Reinsurance related to life and accident and health insurance that was ceded by us to these reinsurers was immaterial.

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

### Regulation

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

- grant and revoke licenses to transact business;
- regulate and supervise trade practices and market conduct;
- establish guaranty associations;
- license agents;
- approve policy forms;

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

Our life subsidiaries are subject to periodic examinations by state regulatory authorities. The Iowa Insurance Division has begun a financial examination of American Equity Investment Life Insurance Company for the period ending December 31, 2013. In 2014, the New York Insurance Department completed an examination of American Equity Investment Life Insurance Company of New York as of December 31, 2010. There were no adjustments to American Equity Investment Life Insurance Company of New York's 2010 statutory financial statements as a result of this examination. The New York Insurance Department has indicated that they will begin a financial examination of American Equity Investment Life Insurance Company of New York for the period ending December 31, 2013 in 2014.

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The payment of dividends or the distributions, including surplus note payments, by our life subsidiaries is subject to regulation by each subsidiary's state of domicile's insurance department. Currently, American Equity Life may pay dividends or make other distributions without the prior approval of the Iowa Insurance Commissioner, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's statutory net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory surplus at the preceding December 31. For 2014, up to \$195.0 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Commissioner. In addition, dividends and surplus note payments may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. American Equity Life had \$926.7 million of statutory earned surplus at December 31, 2013.

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

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

Historically, the federal government has not directly regulated the business of insurance. However, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation can significantly affect the insurance business.

Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") generally provides for enhanced federal supervision of financial institutions, including insurance companies in certain circumstances, and financial activities that represent a systemic risk to financial stability or the U.S. economy. Under the Dodd-Frank Act, a Federal Insurance Office has been established within the U.S. Treasury Department to monitor all aspects of the insurance industry and its authority may extend to our business, although the Federal Insurance Office is not empowered with any general regulatory authority over insurers. The director of the Federal Insurance Office serves in an advisory capacity to the newly established Financial Stability Oversight Council and will have the ability to recommend that an insurance company be subject to heightened prudential standards by the Federal Reserve, if it is determined that financial distress at the company could pose a threat to financial stability in the U.S. The Dodd-Frank Act also provides for the preemption of state laws when inconsistent with certain international agreements.

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

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



- own risk solvency assessment;
- product approvals;
- agent licensing;
- underwriting practices; and
- life insurance and annuity sales practices.

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

The NAIC's RBC requirements provide for four levels of regulatory attention depending on the ratio of a company's total adjusted capital to its RBC. Adjusted capital is defined as the total of statutory capital and surplus, asset valuation reserve and certain other adjustments. Calculations using the NAIC formula at December 31, 2013, indicated that American Equity Life's ratio of total adjusted capital to the highest level at which regulatory action might be initiated was 344%.

Our life subsidiaries also may be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. These assessments may be deferred or forgiven under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium taxes. Assessments related to business reinsured for periods prior to the effective date of the reinsurance are the responsibility of the ceding companies. In 2013, the amount of expense recognized due to guaranty fund assessments was larger than normal as we incurred \$8.5 million due to guaranty fund assessments related to the insolvency of Executive Life Insurance Company of New York.

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Federal Income Tax

The annuity and life insurance products that we market generally provide the policyholder with a federal income tax advantage, as compared to certain other savings investments such as certificates of deposit and taxable bonds, in that federal income taxation on any increases in the contract values (i.e., the "inside build-up") of these products is deferred until it is received by the policyholder. With other savings investments, the increase in value is generally taxed each year as it is realized. Additionally, life insurance death benefits are generally exempt from income tax. From time to time, various tax law changes have been proposed that could have an adverse effect on our business, including the elimination of all or a portion of the income tax advantage described above for annuities and life insurance. If legislation were enacted to eliminate the tax deferral for annuities, such a change would have an adverse effect on our ability to sell non-qualified annuities. Non-qualified annuities are annuities that are not sold to an individual retirement account or other qualified retirement plan.

Beginning in 2013, distributions from non-qualified annuity policies are now considered "investment income" for purposes of the newly enacted Medicare tax on investment income contained in the Health Care and Education Reconciliation Act of 2010. As a result, in certain circumstances a 3.8% tax ("Medicare Tax") may be applied to some or the entire taxable portion of distributions from non-qualified annuities to individuals whose income exceeds certain threshold amounts. This tax may have an adverse effect on our ability to sell non-qualified annuities to individuals whose income exceeds these threshold amounts.

Employees

As of December 31, 2013, we had 416 full-time employees. We have experienced no work stoppages or strikes and consider our relations with our employees to be excellent. None of our employees are represented by a union.

ITEM 1A. RISK FACTORS

We are exposed to significant financial and capital risk, including changing interest rates, credit spreads and equity prices which may have an adverse effect on sales of our products, profitability, investment portfolio and reported book value per share.

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

Interest rate and credit spread risk. Our interest rate risk is related to market price and changes in cash flow.

Substantial and sustained increases and decreases in market interest rates can materially and adversely affect the profitability of our products, our ability to earn predictable returns, the fair value of our investments and the reported value of stockholders' equity. A rise in interest rates, in the absence of other countervailing changes, will decrease the unrealized gain position of our investment portfolio and may result in an unrealized loss position. With respect to our available for sale fixed maturity securities, such declines in value (net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements) reduce our reported stockholders' equity and book value per share.

If interest rates rise dramatically within a short period of time, our business may be exposed to disintermediation risk. Disintermediation risk is the risk that our policyholders may surrender all or part of their contracts in a rising interest rate environment, which may require us to sell assets in an unrealized loss position. Alternatively, we may increase crediting rates to retain business and reduce the level of assets that may need to be sold at a loss. However, such action would reduce our investment spread and net income.

Due to the long-term nature of our annuity liabilities, sustained declines in long-term interest rates may result in increased redemptions of our fixed maturity securities that are subject to call redemption prior to maturity by the issuer or prepayments of commercial mortgage loans and expose us to reinvestment risk. If we are unable to reinvest the proceeds from such redemptions into investments with credit quality and yield characteristics of the redeemed or prepaid investments, our net income and overall financial performance may be adversely affected. We have a certain ability to mitigate this risk by lowering crediting rates on our products subject to certain restrictions as discussed below.

Our exposure to credit spreads is related to market price and changes in cash flows related to changes in credit spreads. If credit spreads widen significantly it could result in greater investment income on new investments but

would also indicate growing concern about the ability of credit issuers to service their debt which could result in additional other than temporary impairments. If credit spreads tighten significantly it could result in reduced net investment income from new purchases of fixed maturity securities or fundings of commercial mortgage loans. Credit risk. We are subject to the risk that the issuers of our fixed maturity securities and other debt securities and borrowers on our commercial mortgages, will default on principal and interest payments, particularly if a major downturn in economic activity occurs. An increase in defaults on our fixed maturity securities and commercial mortgage loan portfolios could harm our financial strength and reduce our profitability. Credit and cash flow assumption risk is the risk that issuers of securities, mortgagees on mortgage loans or other parties, including derivatives counterparties, default on their contractual obligations or experience adverse changes to their contractual cash flow streams. We attempt to minimize the adverse impact of this risk by monitoring portfolio diversification by asset class, creditor, industry, and by complying with investment limitations governed by state insurance laws and regulations as applicable. We also consider all relevant objective information available in estimating the cash flows related to residential and commercial mortgage backed securities.

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We use derivative instruments to fund the annual credits on our fixed index annuities. We purchase derivative instruments, consisting primarily of one-year call options, from a number of counterparties. Our policy is to acquire such options only from counterparties rated "A-" or better by a nationally recognized rating agency and the maximum credit exposure to any single counterparty is subject to concentration limits. In addition, we have entered into credit support agreements which allow us to require posting of collateral by our counterparties to secure their obligations to us under the derivative instruments. If our counterparties fail to honor their obligations under the derivative instruments, our revenues may not be sufficient to fund the annual index credits on our fixed index annuities. Any such failure could harm our financial strength and reduce our profitability.

**Liquidity risk.** We could have difficulty selling our commercial mortgage loans because they are less liquid than our publicly traded securities. If we require significant amounts of cash on short notice, we may have difficulty selling these loans at attractive prices or in a timely manner, or both.

Fluctuations in interest rates and investment spread could adversely affect our financial condition, results of operations and cash flows.

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

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

Persistent environment of low interest rates affects and may continue to negatively affect our results of operations and financial condition.

Prolonged periods of low interest rates may have a negative impact on our ability to sell our fixed index annuities as consumers look for other savings instruments with potentially higher yields to fund retirement. In times of low interest rates, such as we have been experiencing since 2010 and which we may continue to experience in 2014, it is difficult to offer attractive rates and benefits to customers while maintaining profitability, which may limit sales growth of interest sensitive products.

Sustained declines in interest rates may subject us to lower returns on our invested assets, and we have had to and may have to continue to invest the cash we receive from premiums and interest or return of principal on our investments in instruments with yields less than those we currently own. This may reduce our future net investment income and compress the spread on our annuity products. Further, borrowers may prepay fixed maturity securities in order to borrow at lower market rates. Any related prepayment fees are recorded in net investment income and may create income statement volatility.

An environment of rising interest rates may materially affect our liquidity and financial condition.

Periods of rising interest rates may cause increased policy surrenders, withdrawals and requests for policy loans on deferred annuity products, as policyholders seek investments with higher returns, commonly referred to as disintermediation. This may lead to net cash outflows and the resulting liquidity demands may require us to sell investment assets when the prices of those assets are adversely affected by the increase in interest rates, which may result in realized investment losses. Further, a portion of our investment portfolio consists of commercial mortgage

loans and privately placed securities, which are relatively illiquid, thus increasing our liquidity risk in the event of disintermediation. We may also be required to accelerate the amortization of deferred policy acquisition costs and deferred sales inducements related to surrendered contracts, which would adversely affect our results of operations. During such times, we may offer higher crediting rates on new sales of annuity products and increase crediting rates on existing annuity products to maintain or enhance product competitiveness. We may not be able to purchase enough higher yielding assets necessary to fund higher crediting rates and maintain our desired spread, which could result in lower profitability on our business. Alternatively, if we seek to maintain profitability of our products in rising interest rate environments it may be difficult to position our products to offer attractive rates and benefits to customers which may limit sales growth of interest sensitive products.

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

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

Defaults on commercial mortgage loans and volatility in performance may adversely affect our business, financial condition and results of operations.

Commercial mortgage loans have faced heightened delinquency and default risk since 2010 due to recent economic conditions which have had a negative impact on the performance of the underlying collateral, resulting in declining values and an adverse impact on the obligors of such instruments. An increase in the default rate of our commercial mortgage loan investments could have an adverse effect on our business, financial condition and results of operations. In addition, the carrying value of commercial mortgage loans is negatively impacted by such factors. The carrying value of commercial mortgage loans is stated at outstanding principal less any loan loss allowances recognized.

Considerations in determining allowances include, but are not limited to, the following: (i) declining debt service coverage ratios and increasing loan to value ratios; (ii) bankruptcy filings of major tenants or affiliates of the borrower on the property; (iii) catastrophic events at the property; and (iv) other subjective events or factors, including whether the terms of the debt will be restructured. There can be no assurance that management's assessment of loan loss allowances on commercial mortgage loans will not change in future periods, which could lead to investment losses. We remain vulnerable to market uncertainty and continued financial instability of national, state and local governments. Continued difficult conditions in the global capital markets and economy could deteriorate in the near future and affect our financial position and our level of earnings from our operations.

Recovery from the most recent recession in the United States has proven to be slow and long-term. Although unemployment rates and average household income levels have improved during 2013 there is continuing market uncertainty which has directly and materially affected our investment portfolio. One of the strategies used by the U.S. government to stimulate the economy has been to keep interest rates low and increase the supply of United States dollars. While these strategies have appeared to be somewhat successful, any future economic downturn or market disruption could negatively impact our ability to invest funds.

Specifically, if market conditions deteriorate in 2014 or beyond:

- our investment portfolio could incur additional other than temporary impairments;
  - our commercial mortgage loans could experience a greater amount of loss;
- due to potential downgrades in our investment portfolio, we could be required to raise additional capital to sustain our current business in force and new sales of our annuity products, which may be difficult in a distressed market. If capital would be available, it may be at terms that are not favorable to us;
- we may be required to limit growth in sales of our annuity products;
  - and/or

our liquidity could be negatively affected and we could be forced to limit our operations and our business could suffer, as we need liquidity to pay our policyholder benefits, operating expenses, dividends on our capital stock, and to service our debt obligations.

The principal sources of our liquidity are annuity deposits, investment income and proceeds from the sale, maturity and call of investments. Additional sources of liquidity in normal markets also include a variety of short and long-term

instruments, including long-term debt and capital securities.

Governmental initiatives intended to improve global and local economies may be accompanied by other initiatives, including new capital requirements or other regulations, that could materially affect our business, results of operations, financial condition and liquidity in ways that we cannot predict.

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

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

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

While we compete with numerous other companies, we view the following as our most significant competitors:

•Allianz Life Insurance Company of North America;

•Security Benefit Life;

•Great American Life Insurance Company;

•Athene USA Corp;

•EquiTrust Life Insurance Company;

•Midland National Life Insurance Company; and

•North American Company for Life and Health Insurance.

Our ability to compete depends in part on returns and other benefits we make available to our policyholders through our annuity contracts. We will not be able to accumulate and retain assets under management for our products if our investment results underperform the market or the competition, since such underperformance likely would result in lower rates to policyholders which could lead to withdrawals and reduced sales.

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

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

Our life insurance subsidiaries cede certain policies to other insurance companies through reinsurance agreements. American Equity Life has entered into two coinsurance agreements with EquiTrust covering \$0.9 billion of policy benefit reserves at December 31, 2013 and American Equity Life has two coinsurance agreements with Athene Life Re Ltd. ("Athene"), an unauthorized life reinsurer domiciled in Bermuda, covering \$2.1 billion of policy benefit reserves at December 31, 2013. Since Athene is an unauthorized reinsurer, the annuity deposits that have been ceded to Athene are held in a trust and American Equity Life is named as the sole beneficiary of the trust. The assets in the trust are required to remain at a value that is sufficient to support the current balance of policy benefit liabilities of the ceded business on a statutory basis. If the value of the assets in the trust would ever reach a point where it is less than the amount of the ceded policy benefit liabilities on a statutory basis, Athene is required to either establish a letter of credit or deposit securities in a trust for the amount of any shortfall. We remain liable with respect to the policy liabilities ceded to EquiTrust and Athene should either fail to meet the obligations assumed by them.

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



Any disruption in our ability to maintain our reinsurance program may hinder our ability to manage our regulatory capital.

No assurances can be made that reinsurance will remain continuously available to us to the same extent and on the same terms as are currently available. If we were unable to maintain our current level of reinsurance or purchase new reinsurance protection in amounts that we consider sufficient and at prices that we consider acceptable, we would have to accept an increase in our net liability exposure or a decrease in our statutory surplus, reduce the amount of business we write or develop other alternatives to reinsurance.

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We may experience volatility in net income due to the application of fair value accounting to our derivative instruments.

All of our derivative instruments, including certain derivative instruments embedded in other contracts, are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings. This impacts certain revenues and expenses we report for our fixed index annuity business as follows:

We must present the call options purchased to fund the annual index credits on our fixed index annuity products at fair value. The fair value of the call options is based upon the amount of cash that would be required to settle the call options obtained from the counterparties adjusted for the nonperformance risk of the counterparty. We record the change in fair value of these options as a component of our revenues. The change in fair value of derivatives includes the gains or losses recognized at expiration of the option term or upon early termination and changes in fair value for open positions.

The contractual obligations for future annual index credits are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in equity market performance and changes in the interest rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values. We record the change in fair value of these embedded derivatives as a component of our benefits and expenses in our consolidated statements of operations.

The application of fair value accounting for derivatives and embedded derivatives in future periods to our fixed index annuity business may cause substantial volatility in our reported net income.

Our results of operations and financial condition depend on the accuracy of management assumptions and estimates. Assumptions and estimates are made regarding expenses and interest rates, tax liability, contingent liabilities, investment performance and other factors related to our business and anticipated results. We rely on these assumptions and estimates when determining period end accruals, future earnings and various components of our consolidated balance sheet. All assumptions and estimates utilized incorporate many factors, none of which can be predicted with certainty. Our actual experiences, as well as changes in estimates, are used to prepare our consolidated statement of operations. To the extent our actual experience and changes in estimates differ from original estimates, our results of operations and financial condition could be materially adversely affected.

The calculations we use to estimate various components of our consolidated balance sheet and consolidated statement of operations are necessarily complex and involve analyzing and interpreting large quantities of data. The assumptions and estimates required for these calculations involve judgment and by their nature are imprecise and subject to changes and revisions over time. Accordingly, our results may be adversely affected from time to time by actual results differing from assumptions, by changes in estimates and by changes resulting from implementing more sophisticated administrative systems and procedures that facilitate the calculation of more precise estimates.

We may face unanticipated losses if there are significant deviations from our assumptions regarding the probabilities that our annuity contracts will remain in force from one period to the next.

The expected future profitability of our annuity products is based in part upon expected patterns of premiums, expenses and benefits using a number of assumptions, including those related to the probability that a policy or contract will remain in force, or persistency, and mortality. Since no insurer can precisely determine persistency or mortality, actual results could differ significantly from assumptions, and deviations from estimates and assumptions could have a material adverse effect on our business, financial condition or results of operations. For example, actual persistency that is lower than our assumptions could have an adverse impact on future profitability, especially in the early years of a policy or contract primarily because we would be required to accelerate the amortization of expenses we deferred in connection with the acquisition of the policy.

In addition, we set initial crediting rates for our annuity products based upon expected claims and payment patterns, using assumptions for, among other factors, mortality rates of our policyholders. The long-term profitability of these products depends upon how our actual experience compares with our pricing assumptions. For example, if mortality rates are lower than our pricing assumptions, we could be required to make more payments under certain annuity contracts in addition to what we had projected.

If our estimated gross profits change significantly from initial expectations we may be required to expense our deferred policy acquisition costs and deferred sales inducements in an accelerated manner, which would reduce our profitability.

Deferred policy acquisition costs represent costs that vary with and primarily relate to the acquisition of new business. Deferred sales inducements are contract enhancements such as first-year premium and interest bonuses that are credited to policyholder account balances. These costs are capitalized when incurred and are amortized over the life of the contracts. Current amortization of these costs is generally in proportion to expected gross profits from interest margins and, to a lesser extent, from surrender charges. Unfavorable experience with regard to expected expenses, investment returns, mortality or withdrawals may cause acceleration of the amortization of these costs resulting in an increase of expenses and lower profitability.

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

We have experienced rapid growth since our formation in December 1995. We intend to continue to grow by recruiting new independent agents, increasing the productivity of our existing agents, expanding our insurance distribution network, developing new products, and continuing to develop new incentives for our sales agents. Future growth will impose significant added responsibilities on our management, including the need to identify, recruit, maintain and integrate additional employees, including management. There can be no assurance that we will be successful in expanding our business or that our systems, procedures and controls will be adequate to support our operations as they expand. In addition, due to our rapid growth and resulting increased size, it may be necessary to expand the scope of our investing activities to asset classes in which we historically have not invested or have not had significant exposure. If we are unable to adequately manage our investments in these classes, our financial condition or operating results in the future could be less favorable than in the past. Further, we have utilized reinsurance in the past to support our growth. The future availability and cost of reinsurance is uncertain. Our failure to manage growth effectively, or our inability to recruit, maintain and integrate additional qualified employees and independent agents, could have a material adverse effect on our business, financial condition or results of operations. In addition, due to our rapid growth, our historical growth rates are not likely to accurately reflect our future growth rates or our growth potential. We cannot assure you that our future revenues will increase or that we will continue to be profitable.

The loss of key employees could disrupt our operations.

Our success depends in part on the continued service of key executives and our ability to attract and retain additional executives and employees. We do not have employment agreements with our executive officers. The loss of key employees, or our inability to recruit and retain additional qualified personnel, could cause disruption in our business and prevent us from fully implementing our business strategies, which could materially and adversely affect our business, growth and profitability.

Our operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems. Any failure of our information technology or communications systems may result in a materially adverse effect on our results of operations and corporate reputation.

While systems and processes are designed to support complex transactions and avoid systems failure, fraud, information security failures, processing errors and breaches of regulation, any failure could lead to a materially adverse effect on our results of operations and corporate reputation. In addition, we must commit significant resources to maintain and enhance our existing systems in order to keep pace with industry standards and customer preferences. If we fail to keep up-to-date information systems, we may not be able to rely on information for product pricing, risk management and underwriting decisions. In addition, even though backup and recovery systems and contingency plans are in place, we cannot assure investors that interruptions, failures or breaches in security of these processes and systems will not occur, or if they do occur, that they can be adequately addressed. The occurrence of any of these events could have a materially adverse effect on our business, results of operations and financial condition.

An information technology failure or security breach may disrupt our business, damage our reputation and adversely affect our results of operations, financial condition and cash flows.

We use information technology ("IT") to store, retrieve, evaluate and utilize customer and company data and information. Our business is highly dependent on our ability to access IT systems to perform necessary business functions such as providing customer support, making changes to existing policies, filing and paying claims, managing our investment portfolios and producing financial statements. While we have policies, procedures, automation and backup plans designed to prevent or limit the effect of failure, our IT may be vulnerable to disruptions or breaches as a result of natural disasters, man-made disasters, criminal activity, pandemics or other events beyond our control. The failure of our IT for any reason could disrupt our operations, result in the loss of customers and may adversely affect our business, results of operations and financial condition.

We retain confidential information within our IT, and we rely on sophisticated commercial technologies to maintain the security of those systems. Anyone who is able to circumvent our security measures and penetrate our IT could access, view, misappropriate, alter, or delete any information in the systems, including personally identifiable policyholder information and proprietary business information. In addition, an increasing number of states and foreign

countries require that persons be notified if a security breach results in the disclosure of personally identifiable customer information. Any compromise of the security of our computer systems that results in inappropriate disclosure of personally identifiable customer information could damage our reputation in the marketplace, deter people from purchasing our products, subject us to significant civil and criminal liability and require us to incur significant technical, legal and other expenses.

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

We distribute our annuity products through a variable cost distribution network which includes approximately 45 national marketing organizations and over 27,000 independent agents. We must attract and retain such marketers and agents to sell our products. Insurance companies compete vigorously for productive agents. We compete with other life insurance companies for marketers and agents primarily on the basis of our financial position, support services, compensation and product features. Such marketers and agents may promote products offered by other life insurance companies that may offer a larger variety of products than we do. Our competitiveness for such marketers and agents also depends upon the long-term relationships we develop with them. If we are unable to attract and retain sufficient marketers and agents to sell our products, our ability to compete and our revenues would suffer.

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

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

Changes in state and federal regulation may affect our profitability.

We are subject to regulation under applicable insurance statutes, including insurance holding company statutes, in the various states in which our life insurance subsidiaries transact business. Our life insurance subsidiaries are domiciled in Iowa and New York. We are currently licensed to sell our products in 50 states and the District of Columbia.

Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies or their holding companies. As increased scrutiny has been placed upon the insurance regulatory framework, a number of state legislatures have considered or enacted legislative proposals that alter, and in many cases increase, state authority to regulate insurance companies and holding company systems.

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

The NAIC and state insurance regulators continually reexamine existing laws and regulations. The NAIC may develop and recommend adoption of new or modify existing Model Laws and Regulations. State insurance regulators may impose those recommended changes, or others, in the future.

Our life insurance subsidiaries are subject to state insurance regulations based on the NAIC's risk-based capital requirements which are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. Our life insurance subsidiaries also may be required, under solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities for insolvent insurance companies. Although the federal government does not directly regulate the insurance business, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation, can significantly affect the insurance business. In addition, legislation has been enacted which could result in the federal government assuming some role in the regulation of the insurance industry.

In July 2010, the Dodd-Frank Act was enacted and signed into law. The Dodd-Frank Act made extensive changes to the laws regulating the financial services industry and requires various federal agencies to adopt a broad range of new rules and regulations. Among other things, the Dodd-Frank Act imposes a comprehensive new regulatory regime on the over-the-counter ("OTC") derivatives marketplace. This legislation subjects swap dealers and "major swap participants" (as defined in the legislation and further clarified by the rulemaking) to substantial supervision and regulation, including capital standards, margin requirements, business conduct standards, recordkeeping and reporting requirements. It also requires central clearing for certain derivatives transactions that the U.S. Commodities Futures Trading Commission ("CFTC") determines must be cleared and are accepted for clearing by a "derivatives clearing organization" (subject to certain exceptions) and provides the CFTC with authority to impose position limits across markets. Many of the key concepts, definitions, processes and issues surrounding regulation of the OTC derivatives have been left to the relevant regulators to address and many of these regulations have yet to be proposed. The Dodd-Frank Act and any such regulations may subject us to additional restrictions on our hedging positions which may have an adverse effect on our ability to hedge risks associated with our business, including our fixed index annuity business, or on the cost of our hedging activity.

The Dodd-Frank Act also created a Financial Stability and Oversight Council ("FSOC"). The FSOC may designate by a 2/3 vote whether certain insurance companies and insurance holding companies pose a grave threat to the financial stability of the United States, in which case such companies would become subject to prudential regulation by the Board of Governors of the U.S. Federal Reserve (the "Federal Reserve Board") (including capital requirements, leverage limits, liquidity requirements and examinations). The Federal Reserve Board may limit such company's ability to enter into merger transactions, restrict its ability to offer financial products, require it to terminate one or more activities, or impose conditions on the manner in which it conducts activities.

The Dodd-Frank Act also established a Federal Insurance Office under the U.S. Treasury Department to monitor all aspects of the insurance industry and of lines of business other than certain health insurance, certain long-term care insurance and crop insurance. The director of the Federal Insurance Office is a non-voting member of FSOC and can provide guidance regarding insurance company designations as systemically important. The Dodd-Frank Act also provides for the pre-emption of state laws in certain instances involving the regulation of reinsurance and other limited insurance matters. The Dodd-Frank Act requires extensive rule-making and other future regulatory action, which in some cases will take a period of years to implement. It is not possible at this time to assess the impact on our business of the establishment of the Federal Insurance Office and the FSOC. However, the regulatory framework at the state and federal level applicable to our insurance products is evolving. The changing regulatory framework could affect the design of such products and our ability to sell certain products. Any changes in these laws and regulations could materially and adversely affect our business, financial condition or results of operations.

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We cannot predict the requirements of any regulations ultimately adopted under the Dodd-Frank Act, the effect that such regulations will have on financial markets or on our business, the additional costs associated with compliance with such regulations, or any changes to our operations that may be necessary to comply with the Dodd-Frank Act, any of which could have a material adverse affect on our business, results of operations, cash flows or financial condition.

The regulatory framework at the state and federal level applicable to our insurance products is evolving. The changing regulatory framework could affect the design of such products and our ability or the ability of our agents to sell certain products. Any changes in these laws and regulations could materially and adversely affect our business, financial condition or results of operations.

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

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

Additionally, life insurance death benefits are generally exempt from income tax.

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

Beginning in 2013, distributions from non-qualified annuity policies are now considered "investment income" for purposes of the newly enacted Medicare tax on investment income contained in the Health Care and Education Reconciliation Act of 2010. As a result, in certain circumstances a 3.8% tax ("Medicare Tax") may be applied to some or all of the taxable portion of distributions from non-qualified annuities to individuals whose income exceeds certain threshold amounts. This tax may have an adverse effect on our ability to sell non-qualified annuities to individuals whose income exceeds these threshold amounts.

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

We are occasionally involved in litigation, both as a defendant and as a plaintiff. In addition, state regulatory bodies, such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, Inc. ("FINRA"), the Department of Labor and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, the Employee Retirement Income Security Act of 1974, as amended, and laws governing the activities of broker-dealers. Companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We recently entered into a settlement with respect to a purported class action lawsuit involving allegations that generally attack the suitability of sales of deferred annuity products to persons over the age of 65. While settlement has been approved by the district court and the case dismissed, such ruling remains subject to appeal. The settlement is contingent upon final court approval and appeal. See Note 13 to our audited consolidated financial statements.

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

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



Financial strength ratings are important factors in establishing the competitive position of life insurance and annuity companies. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. A ratings downgrade, or the potential for a ratings downgrade, could have a number of adverse effects on our business. For example, distributors and sales agents for life insurance and annuity products use the ratings as one factor in determining which insurer's annuities to market. A ratings downgrade could cause those distributors and agents to seek alternative carriers. In addition, a ratings downgrade could materially increase the number of policy or contract surrenders we experience, as well as our ability to obtain reinsurance or obtain reasonable pricing on reinsurance. Financial strength ratings are measures of an insurance company's ability to meet contractholder and policyholder obligations and generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to agents, policyholders and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell or hold securities.

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## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

We lease commercial office space in one building in West Des Moines, Iowa, for our principal offices under an operating lease that expires on November 30, 2026. We also lease our office in Pell City, Alabama, pursuant to an operating lease that expires on December 31, 2014. We are fully utilizing these facilities and believe both locations to be sufficient to house our operations for the foreseeable future.

## Item 3. Legal Proceedings

See Note 13 to our audited consolidated financial statements.

## Item 4. Mine Safety Disclosures

None

## PART II

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

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

	High	Low
2013		
First Quarter	\$15.03	\$12.33
Second Quarter	\$16.60	\$14.03
Third Quarter	\$21.42	\$15.64
Fourth Quarter	\$26.46	\$20.01
2012		
First Quarter	\$13.09	\$10.13
Second Quarter	\$12.95	\$10.00
Third Quarter	\$12.41	\$10.62
Fourth Quarter	\$12.40	\$10.56

As of February 19, 2014, there were approximately 16,641 holders of our common stock. In 2013 and 2012, we paid an annual cash dividend of \$0.18 and \$0.15, respectively, per share on our common stock. We intend to continue to pay an annual cash dividend on such shares so long as we have sufficient capital and/or future earnings to do so.

However, we anticipate retaining most of our future earnings, if any, for use in our operations and the expansion of our business. Any further determination as to dividend policy will be made by our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition and future prospects and such other factors as our board of directors may deem relevant.

Since we are a holding company, our ability to pay cash dividends depends in large measure on our subsidiaries' ability to make distributions of cash or property to us. Iowa insurance laws restrict the amount of distributions American Equity Life can pay to us without the approval of the Iowa Insurance Commissioner. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 12 to our audited consolidated financial statements, which are incorporated by reference in this Item 5.

## Issuer Purchases of Equity Securities

There were no issuer purchases of equity securities for the quarter ended December 31, 2013.

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## Item 6. Selected Consolidated Financial Data

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

	Year ended December 31,				
	2013	2012	2011	2010	2009
	(Dollars in thousands, except per share data)				
<b>Consolidated Statements of Operations Data:</b>					
<b>Revenues</b>					
Premiums and other considerations	\$45,347	\$76,675	\$118,912	\$75,558	\$37,954
Annuity product charges	103,591	89,006	76,189	69,075	63,358
Net investment income	1,383,927	1,286,923	1,218,780	1,036,106	932,172
Change in fair value of derivatives	1,076,015	221,138	(114,728 )	168,862	216,896
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	40,561	(6,454 )	(18,641 )	23,726	51,279
Net OTTI losses recognized in operations	(6,234 )	(14,932 )	(33,976 )	(23,867 )	(86,771 )
<b>Total revenues</b>	<b>2,610,692</b>	<b>1,652,356</b>	<b>1,246,536</b>	<b>1,349,168</b>	<b>1,214,213</b>
<b>Benefits and expenses</b>					
Insurance policy benefits and change in future policy benefits	53,071	81,481	115,291	70,115	39,300
Interest sensitive and index product benefits	1,272,867	808,479	775,097	734,930	342,772
Change in fair value of embedded derivatives	133,968	286,899	(105,194 )	130,950	529,508
Amortization of deferred sales inducements and policy acquisition costs	618,581	252,076	215,259	196,261	128,008
Interest expense on notes payable and subordinated debentures	50,958	41,937	45,610	37,031	30,672
Other operating costs and expenses	91,915	95,495	67,559	114,615	57,789
<b>Total benefits and expenses</b>	<b>2,221,360</b>	<b>1,566,367</b>	<b>1,113,622</b>	<b>1,283,902</b>	<b>1,128,049</b>
Income before income taxes	389,332	85,989	132,914	65,266	86,164
Income tax expense	136,049	28,191	46,666	22,333	17,634
<b>Net income</b>	<b>\$253,283</b>	<b>\$57,798</b>	<b>\$86,248</b>	<b>\$42,933</b>	<b>\$68,530</b>
<b>Per Share Data:</b>					
Earnings per common share	\$3.86	\$0.94	\$1.45	\$0.73	\$1.22
Earnings per common share—assuming dilution	3.38	0.89	1.37	0.68	1.18
Dividends declared per common share	0.18	0.15	0.12	0.10	0.08
<b>Non-GAAP Financial Measures (a):</b>					
<b>Reconciliation of net income to operating income:</b>					
Net income	\$253,283	\$57,798	\$86,248	\$42,933	\$68,530
Net realized gains (losses) and net OTTI losses on investments, net of offsets	(11,702 )	8,648	18,354	379	(1,339 )
Change in fair value of derivatives and embedded derivatives - index annuities, net of offsets	(98,704 )	31,246	30,086	38,114	29,961

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Change in fair value of derivatives and embedded derivatives - debt, net of income taxes	(1,192	) 2,915	(1,035	) 53	(9	)
Extinguishment of debt, net of income taxes	21,716	—	—	171	687	
Effect of counterparty default, net of offsets	—	—	—	—	3,948	
Litigation reserve, net of offsets	19	9,580	—	27,297	—	
Operating income	\$163,420	\$110,187	\$133,653	\$108,947	\$101,778	
Operating income per common share	\$2.49	\$1.80	\$2.25	\$1.86	\$1.81	
Operating income per common share—assuming dilution	2.18	1.69	2.12	1.70	1.75	

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	As of and for the Year Ended December 31,				
	2013	2012	2011	2010	2009
	(Dollars in thousands, except per share data)				
<b>Consolidated Balance Sheet Data:</b>					
Total investments	\$ 30,346,654	\$ 27,537,210	\$ 24,383,451	\$ 19,816,931	\$ 15,374,110
Total assets	39,621,499	35,133,478	30,874,719	26,426,763	21,312,004
Policy benefit reserves	35,789,655	31,773,988	28,118,716	23,655,807	19,336,221
Notes payable	549,958	309,869	297,608	330,835	316,468
Subordinated debentures	246,050	245,869	268,593	268,435	268,347
Accumulated other comprehensive income (loss) ("AOCI")	46,196	686,807	457,229	81,820	(30,456 )
Total stockholders' equity	1,384,687	1,720,237	1,408,679	938,047	754,623
<b>Other Data:</b>					
Life subsidiaries' statutory capital and surplus and asset valuation reserve	1,995,658	1,741,638	1,655,205	1,456,679	1,239,651
Life subsidiaries' statutory net gain from operations before income taxes and realized capital gains (losses)	305,628	182,057	344,538	322,133	253,146
Life subsidiaries' statutory net income	205,112	79,644	167,925	172,865	116,895
Book value per share (b)	19.40	27.46	23.82	16.07	13.08
Book value per share, excluding AOCI (b)	18.75	16.49	16.09	14.67	13.61

In addition to net income, we have consistently utilized operating income, operating income per common share and operating income per common share—assuming dilution, non-GAAP financial measures commonly used in the life insurance industry, as economic measures to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains and losses on investments including net OTTI losses recognized in operations, fair value changes in derivatives and embedded derivatives, loss on extinguishment of debt, the effect of counterparty default on expired call options and changes in litigation reserves. Because these items fluctuate from year to year in a manner unrelated to core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and evaluation of operating income together with net income provides information that may enhance an investor's understanding of our underlying results and profitability.

Book value per share and book value per share excluding AOCI is calculated as total stockholders' equity and total stockholders' equity excluding AOCI divided by the total number of shares of common stock outstanding. AOCI fluctuates from year to year due to unrealized changes in the fair value of available for sale investments. Common shares outstanding include shares held by the NMO Deferred Compensation Trust and exclude unallocated shares held by our employee stock ownership plan—see Note 11 to our audited consolidated financial statements.

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

Management's discussion and analysis reviews our consolidated financial position at December 31, 2013 and 2012, and our consolidated results of operations for the three years in the period ended December 31, 2013, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our audited consolidated financial statements, notes thereto and selected consolidated financial data appearing elsewhere in this report.

Cautionary Statement Regarding Forward-Looking Information

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

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

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

Executive Summary

Since our formation in 1995, we have emphasized industry leading customer service to both our distribution force and our policyholders. We believe this to be a major part of our ability to attract production from our independent agent network as well as maintain a low rate of policy surrenders. Excellent customer service teamed with our ability to design innovative insurance products that provide principal protection and tax deferred growth have continued to result in significant sales of our annuity products. In 2013, our sales increased 7% to \$4.2 billion which has resulted in cash and investments in excess of \$31 billion at December 31, 2013. Our sales for the last five years have ranged from \$3.7 billion to \$5.1 billion and we have exceeded \$4 billion in sales in three of those years. We have applied a conservative investment strategy to the annuity deposits we continue to manage which has provided reliable returns on our invested assets. Our profitability has also been driven by maintaining an efficient operation.

We are currently in the midst of an unprecedented period of low interest rates. In response to this persistent low interest rate environment, we have been reducing policyholder crediting rates for new annuities and existing annuities since the fourth quarter of 2011. Spread results for 2013 and 2012 reflect the benefit from these reductions; however, the reductions in cost of money were offset by continued lower yields available on investments including those purchased with the reinvestment of proceeds from calls of callable bonds in our investment portfolio. We expect to continue to manage policyholder crediting rates with the objective of restoring our investment spread to our 3.00% target. We have on average 0.60% of room to reduce rates before we would reach minimum guaranteed rates on our entire book of business.

Our investment spread in 2013 and 2012 (see Our Business and Profitability) was impacted by shortfalls in investment income from excess liquidity resulting from a lag in the reinvestment of proceeds of government agency bonds called for redemption. The callable government agency securities have been a cornerstone of our investment portfolio since

our formation. Through the years they have provided acceptable yields that met our spread requirements without any risk-based capital charges. We went through several cycles of calls on these securities and each time we have reinvested a portion of the call redemption proceeds into new callable government agency securities. This kept cash balances low but perpetuated the call risk. In 2011, we had \$3.1 billion in such securities called and purchased \$3.7 billion for a \$600 million net purchase of callable government agency securities. However, in 2012, we only purchased \$948.9 million compared to \$4.3 billion in calls. Consequently, we managed excess cash and other short-term investments throughout 2012 and into the third quarter of 2013 when we became fully invested. See Results of Operations—Net investment income for additional information regarding our excess liquidity.

In 2013, we issued \$400 million of senior unsecured notes due 2021 (the "2021 Notes") and retired \$184 million aggregate principal amount of three convertible note issues. The total consideration paid to retire the convertible notes included \$219 million of cash and 5.5 million shares of our common stock. In the short-term, these convertible debt retirements reduced net income and book value per share. However, these retirements are expected to provide long-term benefit by eliminating potential additional dilution from further increases in our stock price. At December 31, 2013, we had \$206 million of net proceeds remaining from the 2021 Notes offering which we intend to use to retire the \$160 million aggregate principal amount of convertible notes that were outstanding at December 31, 2013. The form and timing of additional convertible debt retirements will be dependent upon market conditions and other factors and there can be no assurance that any such transactions will be completed prior to the December 2014 call date for our 5.25% Contingent Convertible Senior Notes due 2029 (the "2029 notes") or the September 2015 maturity date for our 3.50% Convertible Senior Notes due 2015 (the "2015 notes").

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## Our Business and Profitability

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

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

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

	Year Ended December 31,		
	2013	2012	2011
Average yield on invested assets	4.98%	5.28%	5.80%
Aggregate cost of money	2.26%	2.58%	2.77%
Aggregate investment spread	2.72%	2.70%	3.03%

## Impact of:

Investment yield - additional prepayment income	0.06%	0.06%	—%
Cost of money benefit from over hedging	0.02%	0.01%	0.06%

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. 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.

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.



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## Results of Operations for the Three Years Ended December 31, 2013

Annuity deposits by product type collected during 2013, 2012 and 2011, were as follows:

Product Type	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Fixed index annuities:			
Index strategies	\$2,861,977	\$2,225,902	\$2,839,295
Fixed strategy	1,020,447	1,208,324	1,377,987
	3,882,424	3,434,226	4,217,282
Fixed rate annuities:			
Single-year rate guaranteed	71,944	98,821	169,304
Multi-year rate guaranteed	205,978	249,228	397,925
Single premium immediate annuities	52,142	164,657	305,603
	330,064	512,706	872,832
Total before coinsurance ceded	4,212,488	3,946,932	5,090,114
Coinsurance ceded	182,616	203,734	326,531
Net after coinsurance ceded	\$4,029,872	\$3,743,198	\$4,763,583

Annuity deposits before coinsurance ceded increased 7% during 2013 compared to 2012 and decreased 22% during 2012 compared to 2011. We attribute the continuing significant sales of our products to several factors including the highly competitive rates on 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 lifetime withdrawal benefit riders. We attribute the decrease in annuity deposits in 2012 compared to 2011 to certain competitors who were more aggressive in their product pricing. In addition, sales for 2011 benefited from higher demand in advance of rate decreases implemented during that period. The extent to which our high level of sales will be sustained in future periods is uncertain.

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 growth than in previous years. However, while we have the capital resources to accept more business than was sold in 2013, 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 supported by internal capital generation, we would intend to obtain capital from external sources to facilitate such growth.

Net income, in general, has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 14% to \$29.5 billion for the year ended December 31, 2013 compared to \$26.0 billion in 2012 and 16% for the year ended December 31, 2012 compared to \$22.4 billion in 2011. Our investment spread measured in dollars was \$695.6 million, \$596.7 million, and \$585.9 million for the years ended December 31, 2013, 2012 and 2011. As previously mentioned, our investment spread in 2013 and 2012 has been negatively impacted by both the extended low interest rate environment and our excess liquidity due to calls of our United States government agency securities (see Net investment income). In addition, net income for the year ended December 31, 2013 was positively impacted by a decrease in the change in fair value of index annuity embedded derivatives due to an increase in the discount rates used to estimate our embedded derivative liabilities (see Change in fair value of embedded derivatives).

Net income for 2012 was negatively affected by the prospective adoption on January 1, 2012, of an accounting standards update that defines the types of costs that are deferrable with policy acquisition. This resulted in \$9.1 million of costs that were expensed as incurred during the year ended December 31, 2013, which under the accounting method in effect for the years ended December 31, 2011, would have been capitalized as deferred policy acquisition costs and amortized in future periods. This change in accounting, including the impact on related amortization expense, resulted in a \$5.8 million decrease in net income for the year ended December 31, 2012.



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We periodically revise the key assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements retrospectively through an unlocking process when estimates of current or future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. The impact of unlocking on our results of operations, including the impact of account balance true ups and adjustments to future period assumptions for interest margins and surrenders, was as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Increased (decreased) amortization of deferred sales inducements	\$(11,138 )	\$(199 )	\$(4,979 )
Increased (decreased) amortization of deferred policy acquisition costs	(18,519 )	3,738	(9,132 )
Increased (decreased) net income	19,099	(2,243 )	9,088

Net income for 2013 and 2012 was positively impacted by a revision of assumptions used in determining liabilities for living income benefit riders. This revision was consistent with unlocking for deferred policy acquisition costs and deferred sales inducements. The impact decreased interest sensitive and index product benefits by \$1.8 million and \$2.2 million and increased net income by \$1.1 million and \$1.4 million for the years ended December 31, 2013 and 2012, respectively.

In 2013, we retired \$184 million aggregate principal amount of three issues of convertible notes. The loss on retirement was \$32.5 million (\$21.7 million after income taxes). In connection with the retirement of the 2015 notes, we entered into early termination agreements for a corresponding amount of the related 2015 notes hedges and the 2015 warrants which resulted in a \$3.4 million decrease in net income for 2013 (see Note 5 to our audited consolidated financial statements).

In 2012, we established an estimated litigation liability of \$17.5 million (\$9.6 million after offsets for income taxes and adjustments to deferred policy acquisition costs and deferred sales inducements) based upon developments in mediation discussions concerning potential settlement terms of a purported class action lawsuit. See Note 13 to our audited consolidated financial statements.

During 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 2011 is not material to the results of operations for the year ended December 31, 2011. Accordingly, we made an adjustment in the first quarter of 2011 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 year December 31, 2011.

Operating income, a non-GAAP financial measure (see reconciliation to net income in Item 6. Selected Consolidated Financial Data) increased 48% to \$163.4 million in 2013 and decreased 18% to \$110.2 million in 2012 from \$133.7 million in 2011.

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

Operating income is not a substitute for net income determined in accordance with GAAP. The adjustments made to derive operating income are important to understanding our overall results from operations and, if evaluated without proper context, operating income possesses material limitations. As an example, we could produce a low level of net income in a given period, despite strong operating performance, if in that period we experience significant net realized losses from our investment portfolio. We could also produce a high level of net income in a given period, despite poor

operating performance, if in that period we generate significant net realized gains from our investment portfolio. As an example of another limitation of operating income, it does not include the decrease in cash flows expected to be collected as a result of credit loss OTTI. Therefore, our management 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.

Net realized gains (losses) on investments and net impairment losses recognized in operations fluctuate from year to year based upon changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. The amounts disclosed in the reconciliation in Item 6. Selected Consolidated Financial Data are net of related reductions in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

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Amounts attributable to the fair value accounting for fixed index annuity derivatives and embedded derivatives fluctuate from year to year 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 in the reconciliation in Item 6. Selected Consolidated Financial Data are net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs and income taxes. The significant changes in the impact from this item disclosed in the reconciliation in Item 6. Selected Consolidated Financial Data relate primarily to changes in the discount rates used to estimate our embedded derivative liabilities, which increased in 2013 as a result of an increase in the general level of interest rates during 2013, and decreased in 2009 through 2012 as a result of decreases in the general level of interest rates during those years.

The impact of unlocking on operating income, including the impact of account balance true ups and adjustments to future period assumptions for interest margins and surrenders, was as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Increased (decreased) amortization of deferred sales inducements	\$(12,575 )	\$2,451	\$(7,301 )
Increased (decreased) amortization of deferred policy acquisition costs	(20,460 )	7,288	(12,106 )
Increased (decreased) operating income	21,274	(6,285 )	12,498

The revision of assumptions in 2013 and 2012 used in determining liabilities for living income benefit riders had the same effect on operating income as it had on net income as discussed previously.

Premiums and other considerations decreased 41% to \$45.3 million in 2013 and 36% to \$76.7 million in 2012 from \$118.9 million in 2011. These revenues are comprised of life insurance premiums and premiums from life contingent single premium immediate annuities including life contingent supplemental contracts issued upon annuitization of deferred annuities. Life insurance premiums have remained consistent throughout the periods presented while premiums from life contingent single premium immediate annuities (\$34.8 million, \$63.8 million and \$106.8 million in 2013, 2012 and 2011, respectively) have decreased over the periods because we have adjusted the rates offered on these products to be less competitive in the low interest rate environment.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 16% to \$103.6 million in 2013 and 17% to \$89.0 million in 2012 from \$76.2 million in 2011. The components of annuity product charges are set forth in the table that follows:

	Year Ended December 31,			
	2013	2012	2011	
	(Dollars in thousands)			
Surrender charges	\$49,193	\$45,190	\$49,973	
Lifetime income benefit riders (LIBR) fees	54,398	43,816	26,216	
	\$103,591	\$89,006	\$76,189	
Withdrawals from annuity policies subject to surrender charges	\$342,087	\$335,552	\$378,892	
Average surrender charge collected on withdrawals subject to surrender charges	14.4	% 13.4	% 13.1	%
Fund values on policies subject to LIBR fees	\$9,904,857	\$8,108,573	\$5,593,631	
Weighted average per policy LIBR fee	0.55	% 0.54	% 0.47	%

The increases in annuity product charges were primarily attributable to increases in fees assessed for lifetime income benefit riders due to a larger volume of business in force subject to the fee. See Interest sensitive and index product benefits below for corresponding expense recognized on lifetime income benefit riders. The increase in surrender charges in 2013 was primarily attributable to surrender charges of \$4.7 million deducted from California

policyholders surrendering their policies as a condition of receiving certain benefits in a national class action lawsuit settlement. The decrease in surrender charges in 2012 was primarily attributable to reductions in withdrawals subject to a surrender charge. The lower amount of withdrawals in 2013 and 2012 was influenced by the continuing low interest rate environment.

Net investment income increased 8% to \$1.4 billion in 2013 and 6% to \$1.3 billion in 2012 from \$1.2 billion in 2011. The increases were principally attributable to the growth in our annuity business and corresponding increases in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 14% to \$27.8 billion in 2013 and 16% to \$24.4 billion in 2012 compared to \$21.0 billion in 2011. The average yield earned on average invested assets was 4.98%, 5.28% and 5.80% for 2013, 2012 and 2011, respectively.

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The decrease in yield earned on average invested assets in 2013 and 2012 was attributable to yields on investments purchased in those periods and 2011 being lower than the overall portfolio yield. In addition, net investment income and average yield were negatively impacted by a lag in reinvestment of proceeds from bonds called for redemption during 2013, 2012 and 2011 into new assets causing excess liquidity held in low yielding cash and other short-term investments. The average balance held in cash and short-term investments was \$1.0 billion, \$1.7 billion and \$387.0 million in 2013, 2012 and 2011, respectively. The average yield on our cash and short-term investments was 0.38% in 2013 and 0.25% in 2012. Additionally, net investment income and average yield was positively impacted by prepayment and fee income received resulting in additional net investment income in 2013 and 2012 of \$15.7 million and \$14.8 million, respectively. There was no prepayment and fee income impact for 2011.

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

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Call options:			
Gain on option expiration	\$554,218	\$80,782	\$155,359
Change in unrealized gain (loss)	377,785	147,828	(248,941 )
2015 notes hedges	145,751	(2,488 )	(21,002 )
2015 warrants	(9,568 )	—	—
Interest rate swap	4,973	(4,261 )	(144 )
Interest rate caps	2,856	(723 )	—
	\$1,076,015	\$221,138	\$(114,728 )

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

	Year Ended December 31,		
	2013	2012	2011
S&P 500 Index			
Point-to-point strategy	1.5 - 11.5%	0.0 - 12.8%	0.0% - 25.0%
Monthly average strategy	0.0 - 15.7%	0.0 - 19.3%	0.0% - 15.5%
Monthly point-to-point strategy	0.0 - 21.7%	0.0 - 18.0%	0.0% - 16.5%
Fixed income (bond index) strategies	0.0 - 8.0%	1.6 - 10.0%	1.3% - 10.0%

The change in fair value of derivatives is also influenced by the aggregate costs of options purchased. The aggregate cost of options has increased primarily due to an increased amount of fixed index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities. The fair value of the 2015 notes hedges changes based upon changes in the price of our common stock, interest rates, stock price volatility, dividend yield and the time to expiration of the 2015 notes hedges. Similarly, the fair value of the conversion option obligation to the holders of the 2015 notes changes based upon these same factors and the conversion option obligation is accounted for as an embedded derivative liability with changes in fair value reported in the Change in fair value of embedded derivatives. The amount of the change in fair value of the 2015 notes hedges has historically been equal to the amount of the change in the related embedded derivative liability and there has been an offsetting expense in the change in fair value of embedded derivatives. Due to the partial unwind agreements we entered into, the amount of the change in fair value of the 2015 notes hedges was \$3.8 million more than the amount of the change in the related embedded derivative liability for the year ended December 31, 2013. See Notes 5 and 9 to

our audited consolidated financial statements for a discussion of the unwind agreements, the 2015 notes hedges and the 2015 notes embedded derivative liability.

The 2015 warrants were to be settled in shares of our common stock and accordingly were classified as equity in our consolidated balance sheets, and the changes in fair value of the 2015 warrants were not recognized in the consolidated financial statements. In conjunction with the retirement of a portion of the 2015 notes and related early termination of a corresponding portion of the 2015 notes hedges, a corresponding amount of the 2015 warrants were also terminated prior to maturity and settled in cash rather than shares of our common stock. Accordingly, changes in the fair value of the 2015 warrants that were terminated in 2013 prior to maturity from the dates the early termination agreements were executed through the dates of settlement are included in the consolidated statement of operations for the year ended December 31, 2013. See Notes 5 and 9 to our audited consolidated financial statements for a discussion of the 2015 warrants.



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

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Available for sale fixed maturity securities:			
Gross realized gains	\$39,079	\$10,906	\$12,614
Gross realized losses	(6,170	) (562	) (1,423
	32,909	10,344	11,191
Equity securities:			
Gross realized gains	9,571	562	966
Other investments:			
Gain on sale of real estate	2,144	5,149	377
Loss on sale of real estate	(1,317	) —	—
Impairment losses on real estate	(1,195	) (5,677	) (405
	(368	) (528	) (28
Mortgage loans on real estate:			
Increase in allowance for credit losses	(5,621	) (16,832	) (30,770
Recovery of specific allowance	4,070	—	—
	(1,551	) (16,832	) (30,770
	\$40,561	\$(6,454	) \$(18,641

Losses in 2013 were realized primarily due to strategies to reposition the fixed maturity security portfolio that resulted in improved net investment income, risk or duration profiles as they pertain to our asset liability management. Two corporate issues were sold at a loss in 2013 due to our fundamental, long-term concern with the issuer's ability to meet its future financial obligations. See Note 4 to our audited consolidated financial statements for additional discussion of allowance for credit losses recognized on mortgage loans on real estate.

Net OTTI losses recognized in operations decreased to \$6.2 million in 2013 and decreased to \$14.9 million in 2012 from \$34.0 million in 2011. The impairments recognized in 2012 and 2011 were primarily on residential mortgage backed securities and were principally due to changes of assumptions regarding loss severity of a number of securities we hold which affected our ongoing analysis of expected cash flow projections. See Financial Condition—Investments and Note 3 to our audited consolidated financial statements for additional discussion of write downs of securities for other than temporary impairments.

Insurance policy benefits and changes in future policy benefits decreased 35% to \$53.1 million in 2013 and 29% to \$81.5 million in 2012 from \$115.3 million in 2011. These expenses include amounts for life insurance policies and life contingent single premium immediate annuities including life contingent supplemental contracts issued upon annuitization of deferred annuities. Amounts for life insurance policies have remained consistent throughout the periods presented while amounts related to life contingent single premium immediate annuities (\$46.1 million, \$73.4 million and \$107.4 million in 2013, 2012 and 2011, respectively) have decreased over the periods primarily because the related premiums have decreased as discussed above under Premiums and other considerations.

Interest sensitive and index product benefits increased 57% to \$1.3 billion in 2013 and 4% to \$808.5 million in 2012 from \$775.1 million in 2011. The components of interest sensitive and index product benefits are summarized as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		

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Index credits on index policies	\$908,717	\$447,393	\$448,248
Interest credited (including changes in minimum guaranteed interest for fixed index annuities)	310,369	319,121	302,031
Lifetime income benefit riders	53,781	41,965	24,818
	\$1,272,867	\$808,479	\$775,097

The amount of 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 \$910.4 million, \$447.2 million and \$454.2 million for the years ended December 31, 2013, 2012 and 2011, respectively. The decrease in interest credited for 2013 was due to a decrease in the average rate credited to the annuity liabilities outstanding receiving a fixed rate of interest. The increase in interest credited for 2012 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

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(net of annuity liabilities ceded under coinsurance agreements) increased 14% to \$29.5 billion in 2013 and 16% to \$26.0 billion in 2012 from \$22.4 billion in 2011. The increases in benefits recognized for lifetime income benefit riders were due to increases in the number of policies with lifetime income benefit riders and correlates to the increase in fees discussed in Annuity product charges.

Amortization of deferred sales inducements increased 190% to \$253.1 million in 2013 and 21% to \$87.2 million in 2012 from \$71.8 million in 2011. In general, amortization of deferred sales inducements has been increasing each year due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 97%, 97% and 95% of our total net annuity deposits during 2013, 2012 and 2011, respectively. The increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, amortization associated with the net realized gains (losses) on investments and net OTTI losses recognized in operations and, in 2013 and 2012, amortization associated with litigation reserves. Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options), because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected lives of the contracts which typically exceed ten years. Amortization of deferred sales inducements is summarized as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Amortization of deferred sales inducements before gross profit adjustments	\$143,415	\$136,254	\$116,938
Gross profit adjustments:			
Fair value accounting for derivatives and embedded derivatives	103,172	(45,010)	(35,498)
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation reserves	6,526	(4,087)	(9,659)
Amortization of deferred sales inducements after gross profit adjustments	\$253,113	\$87,157	\$71,781

See Net income and Operating income (a non-GAAP financial measure) above for discussion of the impact of unlocking on amortization of deferred sales inducements for the years ended December 31, 2013, 2012 and 2011. See Critical Accounting Policies—Deferred Policy Acquisition Costs and Deferred Sales Inducements.

Change in fair value of embedded derivatives includes changes in the fair value of the embedded derivative related to the conversion option of our 2015 notes (see Notes 5 and 9 to our audited consolidated financial statements) and changes in the fair value of our fixed index annuity embedded derivatives. The components of change in fair value of embedded derivatives are as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
2015 notes embedded conversion derivative	141,974	(2,488)	(21,002)
Fixed index annuities—embedded derivatives	(8,006)	289,387	(84,192)
	\$133,968	\$286,899	\$(105,194)

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

The change in fair value of the fixed index annuity embedded derivatives resulted from (i) changes in the expected index credits on the next policy anniversary dates, which are related to the change in fair value of the call options

acquired to fund those index credits discussed above in Change in fair value of derivatives; (ii) changes in discount rates used in estimating our embedded derivative liabilities; and (iii) the growth in the host component of the policy liability. See Critical Accounting Policies—Policy Liabilities for Fixed Index Annuities. The primary reason for the decrease in the change in fair value of the fixed index annuity embedded derivatives during 2013 was an increase in the discount rates used in estimating our embedded derivative liabilities. The discount rates used in estimating our embedded derivative liabilities increased as a result of the increase in the general level of interest rates during 2013. The primary reasons for the increase in the change in fair value of the fixed index annuity embedded derivatives during 2012 were increases in the expected index credits that resulted from increases in the fair value of the call options acquired to fund these index credits and decreases in the discount rates used in estimating our embedded derivative liabilities.

Interest expense on notes payable increased 36% to \$38.9 million in 2013 and decreased 10% to \$28.5 million in 2012 from \$31.6 million in 2011. The increase in 2013 was primarily due to interest expense on the \$400 million of 6.625% senior unsecured notes we issued on July 17, 2013. This increase was offset by lower interest expense on our convertible senior notes as we extinguished \$155.5 million principal amount of these notes during the fourth quarter of 2013 and \$28.3 million principal amount of these notes during the second quarter of 2013. The decrease in 2012 was primarily due to the extinguishment of \$46.3 million principal amount of our 2024 notes on December 15, 2011. See Note 9 to our audited consolidated financial statements.

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Interest expense on subordinated debentures decreased 10% to \$12.1 million in 2013 and 4% to \$13.5 million in 2012 from \$14.0 million in 2011. These decreases were primarily due to the redemption of \$22 million principal amount of our 8% Convertible Junior Subordinated Debentures in July 2012 (see Note 10 to our audited consolidated financial statements) and, to a lesser extent, a decrease in 2013 in the interest on \$169.6 million principal amount of the subordinated debentures that have interest based upon the three month London Interbank Offered Rate plus an applicable margin, which carried a weighted average interest rate of 4.07%, 4.35% and 4.12% for 2013, 2012 and 2011, respectively. See Financial Condition—Liabilities.

Amortization of deferred policy acquisition costs increased 122% to \$365.5 million in 2013 and 15% to \$164.9 million in 2012 from \$143.5 million in 2011. In general, amortization of deferred policy acquisition costs has been increasing each year due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, amortization associated with net realized gains (losses) on investments and net OTTI losses recognized in operations and, in 2013 and 2012, the amortization associated with litigation reserves. As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts.

Amortization of deferred policy acquisition costs is summarized as follows:

	Year Ended December 31,		
	2013	2012	2011
	(Dollars in thousands)		
Amortization of deferred policy acquisition costs before gross profit adjustments	\$215,560	\$224,773	\$203,296
Gross profit adjustments:			
Fair value accounting for derivatives and embedded derivatives	141,283	(53,296)	(45,360)
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation reserves	8,625	(6,558)	(14,458)
Amortization of deferred policy acquisition costs after gross profit adjustments	\$365,468	\$164,919	\$143,478

See Net income and Operating income (a non-GAAP financial measure) above for discussion of the impact of unlocking on amortization of deferred policy acquisition costs for the years ended December 31, 2013, 2012 and 2011. See Critical Accounting Policies—Deferred Policy Acquisition Costs and Deferred Sales Inducements.

Other operating costs and expenses decreased 4% to \$91.9 million in 2013 and increased 41% to \$95.5 million in 2012 from \$67.6 million in 2011. The decrease in 2013 is due to a decrease in litigation expense of \$16.5 million offset by an increase in expense for guaranty fund assessments of \$7.6 million related to the insolvency of Executive Life Insurance Company of New York and compensation costs of \$3.3 million that vary based on the Company's stock price. The increase in 2012 includes the \$17.5 million estimated litigation liability that was recorded in the third quarter of 2012. Other operating expenses also increased \$9.1 million during 2012 due to a change in accounting which we adopted prospectively effective January 1, 2012 for the types of costs that may be capitalized as acquisition costs of new and renewal insurance contracts (see Note 1 to our audited consolidated financial statements).

In 2013, other operating costs and expenses net of changes in litigation liabilities and guaranty fund assessments are primarily affected by increases in salaries and benefits, increased risk charges for our financing reinsurance agreement with Hannover (2013 Hannover Transaction) as well as the fluctuation in legal expense for the cost of defense of on-going litigation. Other operating costs and expenses excluding litigation expense and guaranty fund assessments discussed previously increased 7% to \$82.4 million in 2013 from \$77.1 million in 2012.

In 2012, other operating costs and expenses net of litigation settlements and the change in accounting were primarily affected by increases in salaries and benefits, marketing expenses and general operating expenses due to the growth of our business as well as the fluctuation in legal expense for the cost of defense of on-going litigation. Other operating

costs and expense excluding the litigations settlement and the change in accounting discussed previously increased 2% to 68.9 million in 2012 from \$67.5 million in 2011.

Income tax expense increased in 2013 and decreased in 2012 primarily because of the changes in income before income taxes. The effective income tax rates were 34.9%, 32.8% and 35.1% for 2013, 2012 and 2011, respectively. Income tax expense and the resulting effective tax rate are based upon two components of income before income taxes ("pretax income") that are taxed at different tax rates. Life insurance income is generally taxed at an effective rate of approximately 35.6% reflecting the absence of state income taxes for substantially all of the states that the life insurance subsidiaries do business in. The income (loss) for the parent company and other non-life insurance subsidiaries is generally taxed at an effective tax rate of 41.5% reflecting the combined federal / state income tax rates. The effective tax rates resulting from the combination of the income tax provisions for the life / non-life sources of income (loss) vary from year to year based primarily on the relative size of pretax income (loss) from the two sources. The effective income tax rate increased in 2013 because a portion of the parent company's loss on extinguishment of debt was not deductible resulting in an effective tax rate on the parent company's pretax loss that was less than 41.5%. The effective income tax rate decreased in 2012 due to new sources of net investment income that are exempt from federal income tax.

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## Financial Condition

## Investments

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

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

The composition of our investment portfolio is summarized as follows:

	December 31, 2013		2012		
	Carrying Amount	Percent	Carrying Amount	Percent	
	(Dollars in thousands)				
Fixed maturity securities:					
United States Government full faith and credit	\$42,925	0.2	% \$5,154	—	%
United States Government sponsored agencies	1,194,289	3.9	% 1,772,025	6.5	%
United States municipalities, states and territories	3,306,743	10.9	% 3,578,323	13.0	%
Foreign government obligations	91,557	0.3	% 105,259	0.4	%
Corporate securities	17,309,292	57.1	% 14,542,860	52.8	%
Residential mortgage backed securities	1,971,960	6.5	% 2,888,113	10.5	%
Commercial mortgage backed securities	1,735,460	5.7	% 357,982	1.3	%
Other asset backed securities	1,034,476	3.4	% 998,508	3.6	%
Total fixed maturity securities	26,686,702	88.0	% 24,248,224	88.1	%
Equity securities	7,778	—	% 53,422	0.2	%
Mortgage loans on real estate	2,581,082	8.5	% 2,623,940	9.5	%
Derivative instruments	856,050	2.8	% 415,258	1.5	%
Other investments	215,042	0.7	% 196,366	0.7	%
	\$30,346,654	100.0	% \$27,537,210	100.0	%

During 2013 and 2012, we received \$1.1 billion and \$4.6 billion, respectively, in net redemption proceeds related to calls of our callable United States Government sponsored agency securities, of which \$2.6 billion for the year ended December 31, 2012, were classified as held for investment. The proceeds from these redemptions have been reinvested primarily in United States Government sponsored agencies, corporate securities, residential and commercial mortgage backed securities and other asset backed securities classified as available for sale. We remain committed to maintaining a high quality investment portfolio with low credit risk. At December 31, 2013, 31% of our fixed income securities have call features, of which 0.5% (\$0.1 billion) were subject to call redemption and another 5% (\$1.2 billion) will become subject to call redemption during 2014.

## 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 resulted in our excess cash position during 2011, 2012 and the first nine months of 2013. 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. In addition, we have acquired a portfolio of taxable bonds issued by municipalities, states and territories of the United States that provide us with attractive yields while being consistent with our credit risk parameters. Beginning in 2012, we have increased our position in other asset backed securities as well as establishing a position in commercial mortgage backed securities ("CMBS").



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

Rating Agency Rating	December 31, 2013		2012		
	Carrying Amount	Percent of Fixed Maturity Securities	Carrying Amount	Percent of Fixed Maturity Securities	
	(Dollars in thousands)				
Aaa/Aa/A	\$16,122,487	60.4	% \$14,613,775	60.3	%
Baa	9,147,584	34.3	% 8,190,220	33.8	%
Total investment grade	25,270,071	94.7	% 22,803,995	94.1	%
Ba	477,477	1.8	% 365,102	1.5	%
B	128,488	0.5	% 79,789	0.3	%
Caa and lower	617,900	2.3	% 862,650	3.5	%
In or near default	192,766	0.7	% 136,688	0.6	%
Total below investment grade	1,416,631	5.3	% 1,444,229	5.9	%
	\$26,686,702	100.0	% \$24,248,224	100.0	%

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

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

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

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

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



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

NAIC Designation	December 31, 2013				December 31, 2012			
	Amortized Cost	Fair Value	Carrying Amount	Percentage of Total Carrying Amount	Amortized Cost	Fair Value	Carrying Amount	Percentage of Total Carrying Amount
	(Dollars in thousands)				(Dollars in thousands)			
1	\$16,394,654	\$16,531,250	\$16,531,250	62.0 %	\$13,737,381	\$15,250,560	\$15,250,560	62.9 %
2	9,630,251	9,598,399	9,598,399	36.0 %	7,838,186	8,533,121	8,533,121	35.2 %
3	502,822	474,165	489,579	1.8 %	398,294	387,222	401,789	1.7 %
4	74,493	66,078	66,078	0.2 %	53,879	56,151	56,151	0.2 %
5	—	—	—	— %	—	—	—	— %
6	1,765	1,395	1,396	— %	5,375	6,603	6,603	— %
	\$26,603,985	\$26,671,287	\$26,686,702	100.0 %	\$22,033,115	\$24,233,657	\$24,248,224	100.0 %

A summary of our RMBS by collateral type and split by NAIC designation, as well as a separate summary of securities for which we have recognized OTTI and those which we have not yet recognized any OTTI is as follows as of December 31, 2013:

Collateral Type	Principal Amount	Amortized Cost	Fair Value
(Dollars in thousands)			
OTTI has not been recognized			
Government agency	\$738,681	\$677,394	\$679,518
Prime	536,476	508,173	542,633
Alt-A	30,735	31,081	30,818
	\$1,305,892	\$1,216,648	\$1,252,969
OTTI has been recognized			
Prime	\$464,539	\$399,708	\$421,810
Alt-A	355,715	279,557	297,181
	\$820,254	\$679,265	\$718,991
Total by collateral type			
Government agency	\$738,681	\$677,394	\$679,518
Prime	1,001,015	907,881	964,443
Alt-A	386,450	310,638	327,999
	\$2,126,146	\$1,895,913	\$1,971,960
Total by NAIC designation			
1	\$1,979,769	\$1,761,462	\$1,834,105
2	104,543	97,861	101,180
3	39,274	34,825	35,299
4	—	—	—
6	2,560	1,765	1,376
	\$2,126,146	\$1,895,913	\$1,971,960

The amortized cost and fair value of fixed maturity securities at December 31, 2013, by contractual maturity are presented in Note 3 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7.

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## Unrealized Losses

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

	Number of Securities	Amortized Cost	Unrealized Losses	Fair Value
	(Dollars in thousands)			
December 31, 2013				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	4	\$35,263	\$(2,294)	) \$32,969
United States Government sponsored agencies	27	1,280,991	(121,362)	) 1,159,629
United States municipalities, states and territories	151	653,130	(39,074)	) 614,056
Foreign government obligations	3	29,760	(3,462)	) 26,298
Corporate securities:				
Finance, insurance and real estate	124	1,949,182	(105,299)	) 1,843,883
Manufacturing, construction and mining	249	3,671,716	(207,333)	) 3,464,383
Utilities and related sectors	167	2,027,723	(114,305)	) 1,913,418
Wholesale/retail trade	38	473,275	(27,181)	) 446,094
Services, media and other	74	1,003,852	(61,911)	) 941,941
Residential mortgage backed securities	52	384,521	(43,183)	) 341,338
Commercial mortgage backed securities	123	1,591,057	(89,815)	) 1,501,242
Other asset backed securities	34	479,153	(30,763)	) 448,390
	1,046	13,579,623	(845,982)	) \$12,733,641
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	\$76,255	\$(15,415)	) \$60,840
December 31, 2012				
Fixed maturity securities, available for sale:				
United States Government sponsored agencies	6	\$977,196	\$(3,468)	) \$973,728
United States municipalities, states and territories	8	\$24,518	\$(125)	) \$24,393
Corporate securities:				
Finance, insurance and real estate	19	276,235	(12,564)	) 263,671
Manufacturing, construction and mining	34	453,679	(5,584)	) 448,095
Utilities and related sectors	20	269,667	(9,399)	) 260,268
Wholesale/retail trade	11	113,032	(992)	) 112,040
Services, media and other	19	267,506	(3,085)	) 264,421
Residential mortgage backed securities	56	508,576	(27,728)	) 480,848
Commercial mortgage backed securities	12	163,565	(1,983)	) 161,582
Other asset backed securities	11	174,342	(2,973)	) 171,369
	196	\$3,228,316	\$(67,901)	) \$3,160,415
Fixed maturity securities, held for investment:				
Corporate security:				