

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO

Form 10-Q

August 07, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

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

Commission File Number : 001-31911

American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

Iowa

42-1447959

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

6000 Westown Parkway

West Des Moines, Iowa 50266

(Address of principal executive offices, including zip code)

(515) 221-0002

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

APPLICABLE TO CORPORATE ISSUERS:

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

As of August 2, 2017, there were 88,917,403 shares of the registrant's common stock, \$1 par value, outstanding.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

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

	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2017 - \$41,907,744; 2016 - \$39,953,955)	\$43,893,785	\$41,060,494
Held for investment, at amortized cost (fair value: 2017 - \$76,702; 2016 - \$68,766)	76,931	76,825
Mortgage loans on real estate	2,553,391	2,480,956
Derivative instruments	1,086,624	830,519
Other investments	314,421	308,774
Total investments	47,925,152	44,757,568
Cash and cash equivalents	1,574,913	791,266
Coinsurance deposits	4,710,650	4,639,492
Accrued investment income	416,482	397,773
Deferred policy acquisition costs	2,721,596	2,905,377
Deferred sales inducements	2,042,889	2,208,218
Deferred income taxes	64,074	168,578
Income taxes recoverable	952	11,474
Other assets	178,882	173,726
Total assets	\$59,635,590	\$56,053,472
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	\$53,903,497	\$51,637,026
Other policy funds and contract claims	287,381	298,347
Notes and loan payable	888,660	493,755
Subordinated debentures	242,045	241,853
Amounts due under repurchase agreements	61,673	—
Other liabilities	1,600,926	1,090,896
Total liabilities	56,984,182	53,761,877
Stockholders' equity:		
Preferred stock, par value \$1 per share, 2,000,000 shares authorized, 2017 and 2016 - no shares issued and outstanding	—	—
Common stock, par value \$1 per share, 200,000,000 shares authorized; issued and outstanding:		
2017 - 88,741,014 shares (excluding 2,573,000 treasury shares);	88,741	88,001
2016 - 88,001,130 shares (excluding 2,887,082 treasury shares)		
Additional paid-in capital	778,376	770,344
Accumulated other comprehensive income	610,122	339,966

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Retained earnings	1,174,169	1,093,284
Total stockholders' equity	2,651,408	2,291,595
Total liabilities and stockholders' equity	\$59,635,590	\$56,053,472

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<b>Revenues:</b>				
Premiums and other considerations	\$7,720	\$11,458	\$17,122	\$18,803
Annuity product charges	48,603	41,124	92,175	77,629
Net investment income	493,489	459,830	979,086	910,656
Change in fair value of derivatives	266,820	39,099	653,353	(34,966 )
Net realized gains on investments, excluding other than temporary impairment ("OTTI") losses	3,873	2,737	6,211	5,424
<b>OTTI losses on investments:</b>				
Total OTTI losses	—	(762 )	—	(6,780 )
Portion of OTTI losses recognized from other comprehensive income	(949 )	(3,684 )	(1,090 )	(3,360 )
Net OTTI losses recognized in operations	(949 )	(4,446 )	(1,090 )	(10,140 )
Loss on extinguishment of debt	(428 )	—	(428 )	—
Total revenues	819,128	549,802	1,746,429	967,406
<b>Benefits and expenses:</b>				
Insurance policy benefits and change in future policy benefits	9,986	13,393	21,861	22,502
Interest sensitive and index product benefits	472,596	111,121	891,735	208,792
Amortization of deferred sales inducements	33,695	30,672	96,020	58,151
Change in fair value of embedded derivatives	174,973	284,303	399,143	550,160
Interest expense on notes and loan payable	8,678	6,882	16,400	13,762
Interest expense on subordinated debentures	3,422	3,206	6,758	6,374
Amortization of deferred policy acquisition costs	49,547	50,665	139,225	100,378
Other operating costs and expenses	25,964	26,823	53,543	53,653
Total benefits and expenses	778,861	527,065	1,624,685	1,013,772
Income (loss) before income taxes	40,267	22,737	121,744	(46,366 )
Income tax expense (benefit)	13,321	8,029	40,859	(16,233 )
Net income (loss)	\$26,946	\$14,708	\$80,885	\$(30,133)
<b>Earnings (loss) per common share</b>				
Earnings (loss) per common share	\$0.30	\$0.18	\$0.91	\$(0.37 )
Earnings (loss) per common share - assuming dilution	\$0.30	\$0.18	\$0.90	\$(0.37 )
<b>Weighted average common shares outstanding (in thousands):</b>				
Earnings (loss) per common share	88,897	82,517	88,773	82,323
Earnings (loss) per common share - assuming dilution	90,112	83,184	90,045	83,073
See accompanying notes to unaudited consolidated financial statements.				

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income (loss)	\$26,946	\$14,708	\$80,885	\$(30,133)
Other comprehensive income:				
Change in net unrealized investment gains/losses (1)	283,345	555,412	412,469	1,060,760
Noncredit component of OTTI losses (1)	450	1,713	515	1,566
Reclassification of unrealized investment gains/losses to net income (loss) (1)	1,711	1,511	2,641	1,627
Other comprehensive income before income tax	285,506	558,636	415,625	1,063,953
Income tax effect related to other comprehensive income	(99,927)	(195,523)	(145,469)	(372,384)
Other comprehensive income	185,579	363,113	270,156	691,569
Comprehensive income	\$212,525	\$377,821	\$351,041	\$661,436

(1) Net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs.

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except share data)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2015	\$ 81,354	\$ 630,367	\$ 201,663	\$ 1,031,151	\$ 1,944,535
Net loss for period	—	—	—	(30,133 )	(30,133 )
Other comprehensive income	—	—	691,569	—	691,569
Share-based compensation, including excess income tax benefits	—	3,889	—	—	3,889
Issuance of 831,694 shares of common stock under compensation plans, including excess income tax benefits	832	2,699	—	—	3,531
Issuance of 92,998 shares of common stock to settle warrants that have reached their expiration	93	(94 )	—	—	(1 )
Balance at June 30, 2016	\$ 82,279	\$ 636,861	\$ 893,232	\$ 1,001,018	\$ 2,613,390
Balance at December 31, 2016	\$ 88,001	\$ 770,344	\$ 339,966	\$ 1,093,284	\$ 2,291,595
Net income for period	—	—	—	80,885	80,885
Other comprehensive income	—	—	270,156	—	270,156
Share-based compensation	—	4,154	—	—	4,154
Issuance of 739,884 shares of common stock under compensation plans	740	3,878	—	—	4,618
Balance at June 30, 2017	\$ 88,741	\$ 778,376	\$ 610,122	\$ 1,174,169	\$ 2,651,408

See accompanying notes to unaudited consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Operating activities		
Net income (loss)	\$80,885	\$(30,133)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Interest sensitive and index product benefits	891,735	208,792
Amortization of deferred sales inducements	96,020	58,151
Annuity product charges	(92,175)	(77,629)
Change in fair value of embedded derivatives	399,143	550,160
Change in traditional life and accident and health insurance reserves	122	2,261
Policy acquisition costs deferred	(221,909)	(304,877)
Amortization of deferred policy acquisition costs	139,225	100,378
Provision for depreciation and other amortization	1,961	1,745
Amortization of discounts and premiums on investments	8,644	(5,342)
Realized gains (losses) on investments and net OTTI losses recognized in operations	(5,121)	4,716
Change in fair value of derivatives	(653,939)	34,172
Deferred income taxes	(40,965)	(40,257)
Loss on extinguishment of debt	428	—
Share-based compensation	4,154	3,448
Change in accrued investment income	(18,709)	(15,289)
Change in income taxes recoverable/payable	10,522	(6,078)
Change in other assets	433	706
Change in other policy funds and contract claims	(14,824)	(23,793)
Change in collateral held for derivatives	289,258	10,615
Change in other liabilities	(36,848)	(41,573)
Other	(6,960)	(7,793)
Net cash provided by operating activities	831,080	422,380
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	970,752	1,421,976
Mortgage loans on real estate	185,406	215,904
Derivative instruments	750,345	15,859
Other investments	7,511	11,597
Acquisitions of investments:		
Fixed maturity securities - available for sale	(2,680,972)	(2,542,281)
Mortgage loans on real estate	(257,050)	(229,328)
Derivative instruments	(320,583)	(289,412)
Other investments	(6,950)	(6,945)
Purchases of property, furniture and equipment	(2,494)	(506)
Net cash used in investing activities	(1,354,035)	(1,403,136)





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CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Six Months Ended	
	June 30,	
	2017	2016
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	\$2,243,180	\$4,181,709
Coinsurance deposits	30,938	(884,741 )
Return of annuity policyholder account balances	(1,401,086 )	(1,168,302 )
Financing fees incurred and deferred	(5,823 )	—
Proceeds from issuance of notes payable	499,650	—
Repayment of debt	(100,000 )	—
Net proceeds from amounts due under repurchase agreements	61,673	—
Excess tax benefits realized from share-based compensation plans	—	441
Proceeds from issuance of common stock	4,618	3,779
Change in checks in excess of cash balance	(26,548 )	(2,838 )
Net cash provided by financing activities	1,306,602	2,130,048
Increase in cash and cash equivalents	783,647	1,149,292
Cash and cash equivalents at beginning of period	791,266	397,749
Cash and cash equivalents at end of period	\$1,574,913	\$1,547,041
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	\$22,739	\$19,390
Income taxes	71,526	29,961
Non-cash operating activity:		
Deferral of sales inducements	128,092	196,207
Non-cash financing activity:		
Common stock issued to settle warrants that have expired	—	93
See accompanying notes to unaudited consolidated financial statements.		

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(Unaudited)

1. Significant Accounting Policies

Consolidation and Basis of Presentation

The accompanying consolidated financial statements of American Equity Investment Life Holding Company (“we”, “us” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ended December 31, 2017. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2016.

Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued an accounting standards update (“ASU”) related to the accounting for share-based payment transactions. The aspects of accounting guidance affected by this ASU are income taxes, classification of awards as either equity or liabilities, and classification on the statement of cash flows. We adopted this ASU on January 1, 2017. The adoption of this ASU resulted in an income tax benefit of \$0.3 million and \$1.6 million being recognized in operations during the three and six month periods ended June 30, 2017 due to the requirement under this standard to recognize excess tax benefits related to share-based payment awards in income tax expense.

New Accounting Pronouncements

In January 2016, the FASB issued an ASU that, among other aspects of recognition, measurement, presentation and disclosure of financial instruments, primarily requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Additionally, it changes the accounting for financial liabilities measured at fair value under the fair value option and eliminates some disclosures regarding fair value of financial assets and liabilities measured at amortized cost. This ASU will be effective for us on January 1, 2018, and we have not determined the effect it will have on our consolidated financial statements.

In February 2016, the FASB issued an ASU that will require recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU affects accounting and disclosure more dramatically for lessees as accounting for lessors is mainly unchanged. This ASU will be effective for us on January 1, 2019, with early adoption permitted, and we have not determined the effect it will have on our consolidated financial statements.

In June 2016, the FASB issued an ASU that significantly changes the impairment model for most financial assets that are measured at amortized cost and certain other instruments from an incurred loss model to an expected loss model that requires these assets be presented at the net amount expected to be collected. In addition, credit losses on available for sale debt securities should be recorded through an allowance account. This ASU will be effective for us on January 1, 2020, with early adoption permitted, and we have not yet determined the impact this updated guidance

will have on our consolidated financial statements.

In August 2016, the FASB issued an ASU that clarifies how certain cash receipts and cash payments are to be presented and classified in the statement of cash flows. This ASU will be effective for us on January 1, 2018, with early adoption permitted, and we have not yet determined the impact this updated guidance will have on our consolidated financial statements.

In March 2017, the FASB issued an ASU that applies to certain callable debt securities where the amortized cost basis is at a premium to the price repayable by the issuer at the earliest call date. Under this guidance, the premium will be amortized to the first call date. This ASU will be effective for us on January 1, 2019, with early adoption permitted, and we have not yet determined the impact this updated guidance will have on our consolidated financial statements.

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## 2. Fair Values of Financial Instruments

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

	June 30, 2017		December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(Dollars in thousands)				
<b>Assets</b>				
Fixed maturity securities:				
Available for sale	\$43,893,785	\$43,893,785	\$41,060,494	\$41,060,494
Held for investment	76,931	76,702	76,825	68,766
Mortgage loans on real estate	2,553,391	2,554,995	2,480,956	2,522,035
Derivative instruments	1,086,624	1,086,624	830,519	830,519
Other investments	314,421	305,551	308,774	300,918
Cash and cash equivalents	1,574,913	1,574,913	791,266	791,266
Coinsurance deposits	4,710,650	4,213,996	4,639,492	4,150,792
Interest rate caps	468	468	1,082	1,082
Counterparty collateral	144,283	144,283	145,693	145,693
<b>Liabilities</b>				
Policy benefit reserves	53,546,680	44,785,605	51,280,331	43,104,183
Single premium immediate annuity (SPIA) benefit reserves	286,856	296,948	297,724	308,028
Notes and loan payable	888,660	929,437	493,755	519,440
Subordinated debentures	242,045	245,190	241,853	225,106
Amounts due under repurchase agreements	61,673	61,673	—	—
Interest rate swap	2,001	2,001	2,113	2,113

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

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

- Level 1— Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.
- Level 2— Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.
- Level 3— Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant

would use in determining fair value.

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

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Our assets and liabilities which are measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)				
June 30, 2017				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$12,174	\$5,807	\$6,367	\$ —
United States Government sponsored agencies	1,340,839	—	1,340,839	—
United States municipalities, states and territories	4,137,714	—	4,137,714	—
Foreign government obligations	238,869	—	238,869	—
Corporate securities	29,287,071	6	29,287,065	—
Residential mortgage backed securities	1,181,850	—	1,181,850	—
Commercial mortgage backed securities	5,540,383	—	5,540,383	—
Other asset backed securities	2,154,885	—	2,154,885	—
Other investments: equity securities, available for sale	7,982	—	7,982	—
Derivative instruments	1,086,624	—	1,086,624	—
Cash and cash equivalents	1,574,913	1,574,913	—	—
Interest rate caps	468	—	468	—
Counterparty collateral	144,283	—	144,283	—
	\$46,708,055	\$1,580,726	\$45,127,329	\$ —
Liabilities				
Interest rate swap	\$2,001	\$ —	\$2,001	\$ —
Fixed index annuities - embedded derivatives	7,552,365	—	—	7,552,365
	\$7,554,366	\$ —	\$2,001	\$7,552,365
December 31, 2016				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	\$11,805	\$5,381	\$6,424	\$ —
United States Government sponsored agencies	1,344,787	—	1,344,787	—
United States municipalities, states and territories	3,926,950	—	3,926,950	—
Foreign government obligations	236,341	—	236,341	—
Corporate securities	27,114,418	6	27,114,412	—
Residential mortgage backed securities	1,254,835	—	1,254,835	—
Commercial mortgage backed securities	5,365,235			