MORGAN STANLEY
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Morgan Stanley Finance LLC

Structured Investments

Opportunities in U.S. Equities

Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Fully and Unconditionally Guaranteed by Morgan Stanley

Principal at Risk Securities

The Buffered PLUS offered are unsecured obligations of Morgan Stanley Finance LLC ("MSFL") and are fully and unconditionally guaranteed by Morgan Stanley. The Buffered PLUS will pay no interest, provide a minimum payment at maturity of only 15% of the stated principal amount and have the terms described in the accompanying product supplement for PLUS, index supplement and prospectus, as supplemented or modified by this document. At maturity, if the underlying index has **appreciated** in value, investors will receive the stated principal amount of their investment plus leveraged upside performance of the underlying index, subject to the maximum payment at maturity. If the underlying index has **depreciated** in value, but the underlying index has not declined by more than the specified buffer amount, the Buffered PLUS will redeem for par. However, if the underlying index has declined by more than the buffer amount, investors will lose 1% for every 1% decline beyond the specified buffer amount, subject to the minimum payment at maturity of 15% of the stated principal amount. Investors may lose up to 85% of the stated principal amount of the Buffered PLUS. The Buffered PLUS are for investors who seek an equity index-based return and who are willing to risk their principal and forgo current income and upside above the maximum payment at maturity in exchange for the leverage and buffer features that in each case apply to a limited range of performance of the underlying index. The Buffered PLUS are notes issued as part of MSFL's Series A Global Medium-Term Notes program.

All payments are subject to our credit risk. If we default on our obligations, you could lose some or all of your investment. These Buffered PLUS are not secured obligations and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.

Summary Terms

Issuer:	Morgan Stanley Finance LLC
Guarantor:	Morgan Stanley
Maturity date:	April 29, 2021
Underlying index:	S&P 500® Index
Aggregate principal amount:	$
Payment at maturity per Buffered PLUS:	If the final index value is greater than the initial index value: $1,000 + leveraged upside payment *In no event will the payment at maturity exceed the maximum payment at maturity* If the final index value is less than or equal to the initial index value but has decreased from the initial index value by an amount less than or equal to the buffer amount of 15%: $1,000 If the final index value is less than the initial index value and has decreased from the initial index value by an amount greater than the buffer amount of 15%: ($1,000 x the index performance factor) + $150 *Under these circumstances, the payment at maturity will be less than the stated principal amount of $1,000. However, under no circumstances will the Buffered PLUS pay less than $150 per Buffered PLUS at maturity.*
Leveraged upside payment:	$1,000 × leverage factor × index percent increase
Index percent increase:	(final index value – initial index value) / initial index value
Initial index value:	, which is the index closing value on the pricing date
Final index value:	The index closing value on the valuation date
Valuation date:	April 26, 2021, subject to postponement for non-index business days and certain market disruption events
Leverage factor:	200%
Buffer amount:	15%. As a result of the buffer amount of 15%, the value at or above which the underlying index must close on the valuation date so that investors do not suffer a loss on their initial investment in the Buffered PLUS is , which is 85% of the initial index value.
Minimum payment at maturity:	$150 per Buffered PLUS (15% of the stated principal amount)
Index performance factor:	Final index value *divided* by the initial index value
Maximum payment at maturity:	$1,130 to $1,140 per Buffered PLUS (113% to 114% of the stated principal amount). The actual maximum payment at maturity will be determined on the pricing date.

Stated principal amount:	$1,000 per Buffered PLUS
Issue price:	$1,000 per Buffered PLUS (see "Commissions and issue price" below)
Pricing date:	April 25, 2019
Original issue date:	April 30, 2019 (3 business days after the pricing date)
CUSIP:	61768D3U7
ISIN:	US61768D3U79
Listing:	The Buffered PLUS will not be listed on any securities exchange.
Agent:	Morgan Stanley & Co. LLC ("MS & Co."), an affiliate of MSFL and a wholly owned subsidiary of Morgan Stanley. See "Supplemental information regarding plan of distribution; conflicts of interest."
Estimated value on the pricing date:	Approximately $965.80 per Buffered PLUS, or within $15.00 of that estimate. See "Investment Summary" beginning on page 2.

Commissions and issue price:	Price to public	Agent's commissions(1)	Proceeds to us(2)
Per Buffered PLUS	$1,000	$20	$980
Total	$	$	$

(1) Selected dealers and their financial advisors will collectively receive from the agent, MS & Co., a fixed sales commission of $20 for each Buffered PLUS they sell. See "Supplemental information regarding plan of distribution; conflicts of interest." For additional information, see "Plan of Distribution (Conflicts of Interest)" in the accompanying product supplement for PLUS.

(2) See "Use of proceeds and hedging" on page 12.

The Buffered PLUS involve risks not associated with an investment in ordinary debt securities. See "Risk Factors" beginning on page 5.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this document or the accompanying product supplement, index supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The Buffered PLUS are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.

You should read this document together with the related product supplement, index supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see "Additional Terms of the Buffered PLUS" and "Additional Information About the Buffered PLUS" at the end of this document.

As used in this document, "we," "us" and "our" refer to Morgan Stanley or MSFL, or Morgan Stanley and MSFL collectively, as the context requires.

<u>**Product Supplement for PLUS dated November 16, 2017**</u>   <u>**Index Supplement dated November 16, 2017**</u>

Prospectus dated November 16, 2017

Morgan Stanley Finance LLC

Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Principal at Risk Securities

Investment Summary

Buffered Performance Leveraged Upside Securities

Principal at Risk Securities

The Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021 (the "Buffered PLUS") can be used:

§ As an alternative to direct exposure to the underlying index that enhances returns for a certain range of positive performance of the underlying index, subject to the maximum payment at maturity

§ To enhance returns and potentially outperform the underlying index in a moderately bullish scenario

§ To achieve similar levels of upside exposure to the underlying index as a direct investment, subject to the maximum payment at maturity, while using fewer dollars by taking advantage of the leverage factor

§ To obtain a buffer against a specified level of negative performance in the underlying index

Maturity:	Approximately 2 years
Leverage factor:	200%
Maximum payment at maturity:	$1,130 to $1,140 per Buffered PLUS (113% to 114% of the stated principal amount). The actual maximum payment at maturity will be determined on the pricing date.
Buffer amount:	15%, with 1-to-1 downside exposure below the buffer
Minimum payment at maturity:	$150 per Buffered PLUS (15% of the stated principal amount). Investors may lose up to 85% of the stated principal amount of the Buffered PLUS.
Coupon:	None

The original issue price of each Buffered PLUS is $1,000. This price includes costs associated with issuing, selling, structuring and hedging the Buffered PLUS, which are borne by you, and, consequently, the estimated value of the Buffered PLUS on the pricing date will be less than $1,000. We estimate that the value of each Buffered PLUS on the pricing date will be approximately $965.80, or within $15.00 of that estimate. Our estimate of the value of the Buffered PLUS as determined on the pricing date will be set forth in the final pricing supplement.

What goes into the estimated value on the pricing date?

In valuing the Buffered PLUS on the pricing date, we take into account that the Buffered PLUS comprise both a debt component and a performance-based component linked to the underlying index. The estimated value of the Buffered PLUS is determined using our own pricing and valuation models, market inputs and assumptions relating to the underlying index, instruments based on the underlying index, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

What determines the economic terms of the Buffered PLUS?

In determining the economic terms of the Buffered PLUS, including the leverage factor, the maximum payment at maturity, the buffer amount and the minimum payment at maturity, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the Buffered PLUS would be more favorable to you.

What is the relationship between the estimated value on the pricing date and the secondary market price of the Buffered PLUS?

The price at which MS & Co. purchases the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the underlying index, may vary from, and be lower than, the estimated value on the pricing date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the Buffered PLUS are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the underlying index, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the Buffered PLUS, and, if it once chooses to make a market, may cease doing so at any time.

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Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Principal at Risk Securities

Key Investment Rationale

The Buffered PLUS offer leveraged upside exposure to the underlying index, subject to the maximum payment at maturity, while providing limited protection against negative performance of the underlying index. Once the underlying index has decreased in value by more than the specified buffer amount, investors are exposed to the negative performance of the underlying index, subject to the minimum payment at maturity. At maturity, if the underlying index has appreciated, investors will receive the stated principal amount of their investment plus leveraged upside performance of the underlying index, subject to the maximum payment at maturity. At maturity, if the underlying index has depreciated and (i) if the final index value of the underlying index has not declined from the initial index value by more than the specified buffer amount, the Buffered PLUS will redeem for par, or (ii) if the final index value of the underlying index has declined by more than the buffer amount, the investor will lose 1% for every 1% decline beyond the specified buffer amount, subject to the minimum payment at maturity. **Investors may lose up to 85% of the stated principal amount of the Buffered PLUS.**

Leveraged Performance	The Buffered PLUS offer investors an opportunity to capture enhanced returns for a certain range of positive performance relative to a direct investment in the underlying index.
Upside Scenario	The underlying index increases in value, and, at maturity, the Buffered PLUS redeem for the stated principal amount of $1,000 plus 200% of the index percent increase, subject to the maximum payment at maturity of $1,130 to $1,140 per Buffered PLUS (113% to 114% of the stated principal amount). The actual maximum payment at maturity will be determined on the pricing date.
Par Scenario	The underlying index declines in value by no more than 15%, and, at maturity, the Buffered PLUS redeem for the stated principal amount of $1,000.
Downside Scenario	The underlying index declines in value by more than 15%, and, at maturity, the Buffered PLUS redeem for less than the stated principal amount by an amount that is proportionate to the percentage decrease of the underlying index from the initial index value, plus the buffer amount of 15%. (Example: if the underlying index decreases in value by 35%, the Buffered PLUS will redeem for $800.00, or 80.00% of the stated principal amount.) The minimum payment at maturity is $150 per Buffered PLUS.

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How the Buffered PLUS Work

Payoff Diagram

The payoff diagram below illustrates the payment at maturity on the Buffered PLUS based on the following terms:

Stated principal amount:	$1,000 per Buffered PLUS
Leverage factor:	200%
Buffer amount:	15%
Hypothetical maximum payment at maturity:	$1,135 per Buffered PLUS (113.50% of the stated principal amount, the midpoint of the specified range)
Minimum payment at maturity:	$150 per Buffered PLUS

Buffered PLUS Payoff Diagram

How it works

§ **Upside Scenario.** If the final index value is greater than the initial index value, investors will receive the $1,000 stated principal amount *plus* 200% of the appreciation of the underlying index over the term of the Buffered PLUS, subject to the maximum payment at maturity. Under the terms of the Buffered PLUS, an investor will realize the hypothetical maximum payment at maturity of $1,135 per Buffered PLUS (113.50% of the stated principal amount) at a final index value of 106.75% of the initial index value.

§ If the underlying index appreciates 2%, the investor would receive a 4% return, or $1,040.00 per Buffered PLUS.

§ If the underlying index appreciates 40%, the investor would receive only the hypothetical maximum payment at maturity of $1,135 per Buffered PLUS, or 113.50% of the stated principal amount.

§ **Par Scenario.** If the final index value is less than or equal to the initial index value but has decreased from the initial index value by an amount less than or equal to the buffer amount of 15%, investors will receive the stated principal amount of $1,000 per Buffered PLUS.

§ If the underlying index depreciates 5%, investors will receive the $1,000 stated principal amount.

§ **Downside Scenario.** If the final index value is less than the initial index value and has decreased from the initial index value by an amount greater than the buffer amount of 15%, investors will receive an amount that is less than the stated principal amount by an amount that is proportionate to the percentage decrease of the value of the underlying index from the initial index value, plus the buffer amount of 15%. The minimum payment at maturity is $150 per Buffered PLUS.

§ For example, if the underlying index depreciates 45%, investors would lose 30.00% of their principal and receive only $700 per Buffered PLUS at maturity, or 70.00% of the stated principal amount.

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Risk Factors

The following is a non-exhaustive list of certain key risk factors for investors in the Buffered PLUS. For further discussion of these and other risks, you should read the section entitled "Risk Factors" in the accompanying product supplement for PLUS, index supplement and prospectus. We also urge you to consult your investment, legal, tax, accounting and other advisers in connection with your investment in the Buffered PLUS.

§ **Buffered PLUS do not pay interest and provide a minimum payment at maturity of only 15% of your principal.** The terms of the Buffered PLUS differ from those of ordinary debt securities in that the Buffered PLUS do not pay interest, and provide a minimum payment at maturity of only 15% of the stated principal amount of the Buffered PLUS, subject to our credit risk. If the final index value is less than 85% of the initial index value, you will receive for each Buffered PLUS that you hold a payment at maturity that is less than the stated principal amount of each Buffered PLUS by an amount proportionate to the decline in the closing value of the underlying index from the initial index value, plus $150 per Buffered PLUS. **Accordingly, investors may lose up to 85% of the stated principal amount of the Buffered PLUS.**

§ **The appreciation potential of the Buffered PLUS is limited by the maximum payment at maturity.** The appreciation potential of the Buffered PLUS is limited by the maximum payment at maturity of $1,130 to $1,140 per Buffered PLUS, or 113% to 114% of the stated principal amount. The actual maximum payment at maturity will be determined on the pricing date. Although the leverage factor provides 200% exposure to any increase in the final index value over the initial index value, because the payment at maturity will be limited to 113% to 114% of the stated principal amount for the Buffered PLUS, any increase in the final index value over the initial index value by more than 6.50% to 7.00% of the initial index value will not further increase the return on the Buffered PLUS.

§ **The market price of the Buffered PLUS will be influenced by many unpredictable factors.** Several factors, many of which are beyond our control, will influence the value of the Buffered PLUS in the secondary market and the price at which MS & Co. may be willing to purchase or sell the Buffered PLUS in the secondary market, including the value, volatility (frequency and magnitude of changes in value) and dividend yield of the underlying index, interest and yield rates in the market, time remaining until the Buffered PLUS mature, geopolitical conditions and economic, financial, political, regulatory or judicial events that affect the underlying index or equities markets generally and which may affect the final index value of the underlying index and any actual or anticipated changes in our credit ratings or credit spreads. The value of the underlying index may be, and has recently been, volatile, and we can give you no assurance that the volatility will lessen. See "S&P 500® Index Overview" below. You may receive less, and possibly significantly less, than the stated principal amount per Buffered PLUS if you try to sell your

Buffered PLUS prior to maturity.

§ **The Buffered PLUS are subject to our credit risk, and any actual or anticipated changes to our credit ratings or credit spreads may adversely affect the market value of the Buffered PLUS.** You are dependent on our ability to pay all amounts due on the Buffered PLUS at maturity and therefore you are subject to our credit risk. If we default on our obligations under the Buffered PLUS, your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the Buffered PLUS prior to maturity will be affected by changes in the market's view of our creditworthiness. Any actual or anticipated decline in our credit ratings or increase in the credit spreads charged by the market for taking our credit risk is likely to adversely affect the market value of the Buffered PLUS.

§ **As a finance subsidiary, MSFL has no independent operations and will have no independent assets.** As a finance subsidiary, MSFL has no independent operations beyond the issuance and administration of its securities and will have no independent assets available for distributions to holders of MSFL securities if they make claims in respect of such securities in a bankruptcy, resolution or similar proceeding. Accordingly, any recoveries by such holders will be limited to those available under the related guarantee by Morgan Stanley and that guarantee will rank *pari passu* with all other unsecured, unsubordinated obligations of Morgan Stanley. Holders will have recourse only to a single claim against Morgan Stanley and its assets under the guarantee. Holders of securities issued by MSFL should accordingly assume that in any such proceedings they would not have any priority over and should be treated *pari passu* with the claims of other unsecured, unsubordinated creditors of Morgan Stanley, including holders of Morgan Stanley-issued securities.

§ **The amount payable on the Buffered PLUS is not linked to the value of the underlying index at any time other than the valuation date.** The final index value will be based on the index closing value on the valuation date, subject to postponement for non-index business days and certain market disruption events. Even if the value of the underlying index appreciates prior to the valuation date but then drops by the valuation date by more than 15% of the initial index value, the payment at maturity will be less, and may be significantly less, than it would have been had the payment at maturity been linked to the value of the underlying index prior to such drop. Although the actual value of the underlying index on the stated maturity date or at other times during the term of the Buffered PLUS may be higher than the index closing value on the valuation date, the payment at maturity will be based solely on the index closing value on the valuation date.

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§ **Investing in the Buffered PLUS is not equivalent to investing in the underlying index.** Investing in the Buffered PLUS is not equivalent to investing in the underlying index or its component stocks. As an investor in the Buffered PLUS, you will not have voting rights or rights to receive dividends or other distributions or any other rights with respect to stocks that constitute the underlying index.

§ **The rate we are willing to pay for securities of this type, maturity and issuance size is likely to be lower than the rate implied by our secondary market credit spreads and advantageous to us. Both the lower rate and the inclusion of costs associated with issuing, selling, structuring and hedging the Buffered PLUS in the original issue price reduce the economic terms of the Buffered PLUS, cause the estimated value of the Buffered PLUS to be less than the original issue price and will adversely affect secondary market prices.** Assuming no change in market conditions or any other relevant factors, the prices, if any, at which dealers, including MS & Co., may be willing to purchase the Buffered PLUS in secondary market transactions will likely be significantly lower than the original issue price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the original issue price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the Buffered PLUS in the original issue price and the lower rate we are willing to pay as issuer make the economic terms of the Buffered PLUS less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the Buffered PLUS are not fully deducted upon issuance, for a period of up to 6 months following the issue date, to the extent that MS & Co. may buy or sell the Buffered PLUS in the secondary market, absent changes in market conditions, including those related to the underlying index, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect that those higher values will also be reflected in your brokerage account statements.

§ **Adjustments to the underlying index could adversely affect the value of the Buffered PLUS.** The underlying index publisher may add, delete or substitute the stocks constituting the underlying index or make other methodological changes that could change the value of the underlying index. The underlying index publisher may discontinue or suspend calculation or publication of the underlying index at any time. In these circumstances, the calculation agent will have the sole discretion to substitute a successor index that is comparable to the discontinued underlying index and is not precluded from considering indices that are calculated and published by the calculation agent or any of its affiliates. If the calculation agent determines that there is no appropriate successor index, the payment at maturity on the Buffered PLUS will be an amount based on the closing prices at maturity of the securities composing the underlying index at the time of such discontinuance, without rebalancing or substitution, computed by the calculation agent in accordance with the formula for calculating the underlying index last in effect prior to discontinuance of the underlying index.

§ **The estimated value of the Buffered PLUS is determined by reference to our pricing and valuation models, which may differ from those of other dealers and is not a maximum or minimum secondary market price.** These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the Buffered PLUS than those generated by others, including other dealers in the market, if they attempted to value the Buffered PLUS. In addition, the estimated value on the pricing date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your Buffered PLUS in the secondary market (if any exists) at any time. The value of your Buffered PLUS at any time after the date of this document will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also “The market price of the Buffered PLUS will be influenced by many unpredictable factors” above.

§ **The Buffered PLUS will not be listed on any securities exchange and secondary trading may be limited.** The Buffered PLUS will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the Buffered PLUS. MS & Co. may, but is not obligated to, make a market in the Buffered PLUS and, if it once chooses to make a market, may cease doing so at any time. When it does make a market, it will generally do so for transactions of routine secondary market size at prices based on its estimate of the current value of the Buffered PLUS, taking into account its bid/offer spread, our credit spreads, market volatility, the notional size of the proposed sale, the cost of unwinding any related hedging positions, the time remaining to maturity and the likelihood that it will be able to resell the Buffered PLUS. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the Buffered PLUS easily. Since other broker-dealers may not participate significantly in the secondary market for the Buffered PLUS, the price at which you may be able to trade your Buffered PLUS is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were to cease making a market in the Buffered PLUS, it is likely that there would be no secondary market for the Buffered PLUS. Accordingly, you should be willing to hold your Buffered PLUS to maturity.

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Principal at Risk Securities

§ **The calculation agent, which is a subsidiary of Morgan Stanley and an affiliate of MSFL, will make determinations with respect to the Buffered PLUS.** As calculation agent, MS & Co. will determine the initial index value and the final index value, and will calculate the amount of cash you receive at maturity. Moreover, certain determinations made by MS & Co., in its capacity as calculation agent, may require it to exercise discretion and make subjective judgments, such as with respect to the occurrence or non-occurrence of market disruption events and the selection of a successor index or calculation of the final index value in the event of a market disruption event or discontinuance of the underlying index. These potentially subjective determinations may adversely affect the payout to you at maturity. For further information regarding these types of determinations, see "Description of PLUS—Postponement of Valuation Date(s)" and "—Calculation Agent and Calculations" and related definitions in the accompanying product supplement. In addition, MS & Co. has determined the estimated value of the Buffered PLUS on the pricing date.

§ **Hedging and trading activity by our affiliates could potentially adversely affect the value of the Buffered PLUS.** One or more of our affiliates and/or third-party dealers expect to carry out hedging activities related to the Buffered PLUS (and possibly to other instruments linked to the underlying index or its component stocks), including trading in the stocks that constitute the underlying index as well as in other instruments related to the underlying index. As a result, these entities may be unwinding or adjusting hedge positions during the term of the Buffered PLUS, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the valuation date approaches. Some of our affiliates also trade the stocks that constitute the underlying index and other financial instruments related to the underlying index on a regular basis as part of their general broker-dealer and other businesses. Any of these hedging or trading activities on or prior to the pricing date could potentially increase the initial index value, and, therefore, could increase the value at or above which the underlying index must close on the valuation date so that investors do not suffer a loss on their initial investment in the Buffered PLUS. Additionally, such hedging or trading activities during the term of the Buffered PLUS, including on the valuation date, could adversely affect the closing value of the underlying index on the valuation date, and, accordingly, the amount of cash an investor will receive at maturity.

§ **The U.S. federal income tax consequences of an investment in the Buffered PLUS are uncertain.** Please read the discussion under "Additional Information—Tax considerations" in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement for PLUS (together, the "Tax Disclosure Sections") concerning the U.S. federal income tax consequences of an investment in the Buffered PLUS. If the Internal Revenue Service (the "IRS") were successful in asserting an alternative treatment, the timing and character of income on the Buffered PLUS might differ significantly from the tax treatment described in the Tax Disclosure Sections. For example, under one possible treatment, the IRS could seek to recharacterize the Buffered PLUS as debt instruments. In that event, U.S. Holders would be required to accrue into income original issue discount on the Buffered PLUS every year at a "comparable yield" determined at the time of issuance and recognize all income and gain in respect of the Buffered PLUS as ordinary income. Additionally, as discussed under "United States Federal Taxation—FATCA" in the accompanying product supplement for PLUS, the withholding rules commonly referred to as "FATCA" would apply to the Buffered PLUS if they were recharacterized as debt instruments. However, recently proposed regulations (the preamble to which specifies that taxpayers are permitted to rely on them pending finalization) eliminate the withholding requirement on payments of gross proceeds of a taxable disposition. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the Buffered PLUS, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features. We do not plan to request a ruling from the IRS regarding the tax treatment of the Buffered PLUS, and the IRS or a court may not agree with the tax treatment described in the Tax Disclosure Sections.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the “constructive ownership” rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the Buffered PLUS, possibly with retroactive effect. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the Buffered PLUS, including possible alternative treatments, the issues presented by this notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Morgan Stanley Finance LLC

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Principal at Risk Securities

S&P 500® Index Overview

The S&P 500® Index, which is calculated, maintained and published by S&P Dow Jones Indices LLC ("S&P"), consists of stocks of 500 component companies selected to provide a performance benchmark for the U.S. equity markets. The calculation of the S&P 500® Index is based on the relative value of the float adjusted aggregate market capitalization of the 500 component companies as of a particular time as compared to the aggregate average market capitalization of 500 similar companies during the base period of the years 1941 through 1943. For additional information about the S&P 500® Index, see the information set forth under "S&P 500® Index" in the accompanying index supplement.

Information as of market close on March 20, 2019:

Bloomberg Ticker Symbol:	SPX
Current Index Value:	2,824.23
52 Weeks Ago:	2,716.94
52 Week High (on 9/20/2018):	2,930.75
52 Week Low (on 12/24/2018):	2,351.10

The following graph sets forth the daily index closing values of the underlying index for each quarter in the period from January 1, 2014 through March 20, 2019. The related table sets forth the published high and low closing values, as well as end-of-quarter closing values, of the underlying index for each quarter in the same period. The index closing value of the underlying index on March 20, 2019 was 2,824.23. We obtained the information in the table and graph below from Bloomberg Financial Markets, without independent verification. The underlying index has at times experienced periods of high volatility. You should not take the historical values of the underlying index as an indication of its future performance, and no assurance can be given as to the index closing value of the underlying index on the valuation date.

S&P 500® Index Daily Index Closing Values

January 1, 2014 to March 20, 2019

April 2019 Page 8

Morgan Stanley Finance LLC

Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Principal at Risk Securities

S&P 500® Index	High	Low	Period End
2014			
First Quarter	1,878.04	1,741.89	1,872.34
Second Quarter	1,962.87	1,815.69	1,960.23
Third Quarter	2,011.36	1,909.57	1,972.29
Fourth Quarter	2,090.57	1,862.49	2,058.90
2015			
First Quarter	2,117.39	1,992.67	2,067.89
Second Quarter	2,130.82	2,057.64	2,063.11
Third Quarter	2,128.28	1,867.61	1,920.03
Fourth Quarter	2,109.79	1,923.82	2,043.94
2016			
First Quarter	2,063.95	1,829.08	2,059.74
Second Quarter	2,119.12	2,000.54	2,098.86
Third Quarter	2,190.15	2,088.55	2,168.27
Fourth Quarter	2,271.72	2,085.18	2,238.83
2017			
First Quarter	2,395.96	2,257.83	2,362.72
Second Quarter	2,453.46	2,328.95	2,423.41
Third Quarter	2,519.36	2,409.75	2,519.36
Fourth Quarter	2,690.16	2,529.12	2,673.61
2018			
First Quarter	2,872.87	2,581.00	2,640.87
Second Quarter	2,786.85	2,581.88	2,718.37
Third Quarter	2,930.75	2,713.22	2,913.98
Fourth Quarter	2,925.51	2,351.10	2,506.85
2019			

First Quarter (through March 20, 2019)	2,832.94	2,447.89	2,824.23

"Standard & Poor's®," "S&P®," "S&P 500®," "Standard & Poor's 500" and "500" are trademarks of Standard and Poor's Financial Services LLC. See "S&P 500® Index" in the accompanying index supplement.

Morgan Stanley Finance LLC

Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Principal at Risk Securities

Additional Terms of the Buffered PLUS

Please read this information in conjunction with the summary terms on the front cover of this document.

Additional Terms:

If the terms described herein are inconsistent with those described in the accompanying product supplement, index supplement or prospectus, the terms described herein shall control.

Underlying index publisher:	S&P Dow Jones Indices LLC or any successor thereof
Interest:	None
Bull market or bear market PLUS:	Bull market PLUS
Postponement of maturity date:	If the scheduled valuation date is not an index business day or if a market disruption event occurs on that day so that the valuation date as postponed falls less than two business days prior to the scheduled maturity date, the maturity date of the Buffered PLUS will be postponed to the second business day following that valuation date as postponed.
Denominations:	$1,000 per Buffered PLUS and integral multiples thereof
Trustee:	The Bank of New York Mellon
Calculation agent:	MS & Co.
Issuer notice to registered security holders, the trustee and the depositary:	In the event that the maturity date is postponed due to postponement of the valuation date, the issuer shall give notice of such postponement and, once it has been determined, of the date to which the maturity date has been rescheduled (i) to each registered holder of the Buffered PLUS by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder's last address as it shall appear upon the registry books, (ii) to the trustee by facsimile confirmed by mailing such notice to the trustee by first class mail, postage prepaid, at its New York office and (iii) to The Depository Trust Company (the "depositary") by telephone or facsimile, confirmed by mailing such notice to the depositary by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the Buffered PLUS in the manner herein provided shall be conclusively presumed to have been duly given to such registered

holder, whether or not such registered holder receives the notice. The issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the maturity date, the business day immediately preceding the scheduled maturity date and (ii) with respect to notice of the date to which the maturity date has been rescheduled, the business day immediately following the actual valuation date for determining the final index value.

The issuer shall, or shall cause the calculation agent to, (i) provide written notice to the trustee and to the depositary of the amount of cash to be delivered with respect to each stated principal amount of the Buffered PLUS, on or prior to 10:30 a.m. (New York City time) on the business day preceding the maturity date, and (ii) deliver the aggregate cash amount due with respect to the Buffered PLUS to the trustee for delivery to the depositary, as holder of the Buffered PLUS, on the maturity date.

Morgan Stanley Finance LLC

Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

Buffered Performance Leveraged Upside Securities℠

Principal at Risk Securities

Additional Information About the Buffered PLUS

Additional Information:	
Minimum ticketing size:	$1,000 / 1 Buffered PLUS
Tax considerations:	Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the Buffered PLUS due to the lack of governing authority, in the opinion of our counsel, Davis Polk & Wardwell LLP, under current law, and based on current market conditions, a Buffered PLUS should be treated as a single financial contract that is an "open transaction" for U.S. federal income tax purposes. However, because our counsel's opinion is based in part on market conditions as of the date of this document, it is subject to confirmation on the pricing date.

Assuming this treatment of the Buffered PLUS is respected and subject to the discussion in "United States Federal Taxation" in the accompanying product supplement for PLUS, the following U.S. federal income tax consequences should result based on current law:

§ A U.S. Holder should not be required to recognize taxable income over the term of the Buffered PLUS prior to settlement, other than pursuant to a sale or exchange.

§ Upon sale, exchange or settlement of the Buffered PLUS, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder's tax basis in the Buffered PLUS. Such gain or loss should be long-term capital gain or loss if the investor has held the Buffered PLUS for more than one year, and short-term capital gain or loss otherwise.

In 2007, the U.S. Treasury Department and the Internal Revenue Service (the "IRS") released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the Buffered PLUS, possibly with retroactive effect.

As discussed in the accompanying product supplement for PLUS, Section 871(m) of the Internal Revenue Code of 1986, as amended, and Treasury regulations promulgated thereunder ("Section 871(m)") generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an "Underlying Security"). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a "Specified Security"). However, pursuant to an IRS notice, Section 871(m) will not apply to securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on the terms of the Buffered PLUS and current market conditions, we expect that the Buffered PLUS will not have a delta of one with respect to any Underlying Security on the pricing date. However, we will provide an updated determination in the final pricing supplement. Assuming that the Buffered PLUS do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the Buffered PLUS should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the Buffered PLUS.

Both U.S. and non-U.S. investors considering an investment in the Buffered PLUS should read the discussion under "Risk Factors" in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement for PLUS and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the Buffered PLUS, including possible alternative treatments, the issues presented by the aforementioned notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

The discussion in the preceding paragraphs under "Tax considerations" and the discussion contained in the section entitled "United States Federal Taxation" in the accompanying product supplement for PLUS, insofar as they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the Buffered PLUS.

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Buffered Performance Leveraged Upside Securities℠

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	The proceeds from the sale of the Buffered PLUS will be used by us for general corporate purposes. We will receive, in aggregate, $1,000 per Buffered PLUS issued, because, when we enter into hedging transactions in order to meet our obligations under the Buffered PLUS, our hedging counterparty will reimburse the cost of the agent's commissions. The costs of the Buffered PLUS borne by you and described beginning on page 2 above comprise the agent's commissions and the cost of issuing, structuring and hedging the Buffered PLUS.
Use of proceeds and hedging:	On or prior to the pricing date, we will hedge our anticipated exposure in connection with the Buffered PLUS by entering into hedging transactions with our affiliates and/or third-party dealers. We expect our hedging counterparties to take positions in stocks of the underlying index, futures and options contracts on the underlying index and any component stocks of the underlying index listed on major securities markets or positions in any other available securities or instruments that they may wish to use in connection with such hedging. Such purchase activity could potentially increase the value of the underlying index on the pricing date, and, therefore, could increase the value at or above which the underlying index must close on the valuation date so that investors do not suffer a loss on their initial investment in the Buffered PLUS. In addition, through our affiliates, we are likely to modify our hedge position throughout the term of the Buffered PLUS, including on the valuation date, by purchasing and selling the stocks constituting the underlying index, futures or options contracts on the underlying index or its component stocks listed on major securities markets or positions in any other available securities or instruments that we may wish to use in connection with such hedging activities. As a result, these entities may be unwinding or adjusting hedge positions during the term of the Buffered PLUS, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the valuation date approaches. We cannot give any assurance that our hedging activities will not affect the value of the underlying index, and, therefore, adversely affect the value of the Buffered PLUS or the payment you will receive at maturity. For further information on our use of proceeds and hedging, see "Use of Proceeds and Hedging" in the accompanying product supplement for PLUS.
Benefit plan investor considerations:	Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (a "Plan"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the Buffered PLUS. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a "party in interest" within the meaning of ERISA, or a "disqualified person" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also "Plans"). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the Buffered PLUS are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the Buffered PLUS are acquired pursuant to an exemption from the "prohibited transaction" rules. A violation of these "prohibited transaction" rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions ("PTCEs") that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the Buffered PLUS. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the issuer of the securities nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than "adequate consideration" in connection with the transaction (the so-called "service provider" exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the Buffered PLUS.

Because we may be considered a party in interest with respect to many Plans, the Buffered PLUS may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include "plan assets" by reason of any Plan's investment in the entity (a "Plan Asset Entity") or any person investing "plan assets" of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibited. Any purchaser, including any fiduciary purchasing on behalf of a Plan, transferee or holder of the Buffered PLUS will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the Buffered PLUS that either (a) it is not a Plan or a Plan Asset Entity and is not purchasing such Buffered PLUS on behalf of or with "plan assets" of any Plan or with any assets of a

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Buffered PLUS Based on the Value of the S&P 500® Index due April 29, 2021

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governmental, non-U.S. or church plan that is subject to any federal, state, local or non-U.S. law that is substantially similar to the provisions of Section 406 of ERISA or Section 4975 of the Code ("Similar Law") or (b) its purchase, holding and disposition of these Buffered PLUS will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or violate any Similar Law.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the Buffered PLUS on behalf of or with "plan assets" of any Plan consult with their counsel regarding the availability of exemptive relief.

The Buffered PLUS are contractual financial instruments. The financial exposure provided by the Buffered PLUS is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the Buffered PLUS. The Buffered PLUS have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the Buffered PLUS. 1,746,99

Each purchaser or holder of any Buffered PLUS acknowledges and agrees that:

(i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the puertical-align:bottom;padding-left:2px;padding-top:2px;padding-bottom:2px;padding-right:2px;">

Benefits and expenses:

1,647

Insurance policy benefits and change in future policy benefits		
Interest sensitive and index product benefits	327,976	
Amortization of deferred sales inducements	34,625	
Change in fair value of embedded derivatives	36,224	
Interest expense on notes payable	12,957	
Interest expense on subordinated debentures	3,034	
Amortization of deferred policy acquisition costs	50,034	
Other operating costs and expenses	20,658	
Total benefits and expenses	487,155	
Income (loss) before income taxes	85,727	
Income tax expense (benefit)	29,546	
	$	56,181

Net income (loss)		
Earnings (loss) per common share	$	0.86
Earnings (loss) per common share - assuming dilution	$	0.75
Weighted average common shares outstanding (in thousands):		
Earnings (loss) per common share	65,129	
Earnings (loss) per common share - assuming dilution	74,560	

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Dollars in thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income (loss)	$56,181	$(7,829)	$202,325	$21,401
Other comprehensive income (loss):				
Change in net unrealized investment gains/losses (1)	(123,269)	202,184	(793,140)	390,575
Noncredit component of OTTI losses (1)	239	1,377	586	1,667
Reclassification of unrealized investment gains/losses to net income (loss) (1)	(903)	—	(12,189)	—
Other comprehensive income (loss) before income tax	(123,933)	203,561	(804,743)	392,242
Income tax effect related to other comprehensive income (loss)	43,378	(71,247)	281,661	(137,285)
Other comprehensive income (loss)	(80,555)	132,314	(523,082)	254,957
Comprehensive income (loss)	$(24,374)	$124,485	$(320,757)	$276,358

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

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2012	$61,751	$496,715	$(2,583)	$ 686,807	$477,547	$ 1,720,237
Net income for period	—	—	—	—	202,325	202,325
Other comprehensive loss	—	—	—	(523,082)	—	(523,082)
Allocation of 89,150 shares of common stock by ESOP, including excess income tax benefits	—	432	960	—	—	1,392
Share-based compensation, including excess income tax benefits	—	7,492	—	—	—	7,492
Issuance of 2,755,270 shares of common stock under compensation plans, including excess income tax benefits	2,755	23,663	—	—	—	26,418
Extinguishment of convertible senior notes, net of tax, including 216,729 shares of common stock issued upon conversion	217	1,547	—	—	—	1,764
Warrants to be settled in cash	—	(41,878)	—	—	—	(41,878)
Balance at September 30, 2013	$64,723	$487,971	$(1,623)	$ 163,725	$679,872	$ 1,394,668
Balance at December 31, 2011	$57,837	$468,281	$(3,620)	$ 457,229	$428,952	$ 1,408,679
Net income for period	—	—	—	—	21,401	21,401
Other comprehensive income	—	—	—	254,957	—	254,957
Conversion of $20,770 of subordinated debentures	2,564	17,027	—	—	—	19,591
Allocation of 63,946 shares of common stock by ESOP, including excess income tax benefits	—	32	689	—	—	721
Share-based compensation, including excess income tax benefits	—	5,495	—	—	—	5,495
Issuance of 1,147,440 shares of common stock under compensation plans, including excess income tax benefits	1,147	2,962	—	—	—	4,109
Balance at September 30, 2012	$61,548	$493,797	$(2,931)	$ 712,186	$450,353	$ 1,714,953

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30,	
	2013	2012
Operating activities		
Net income	$202,325	$21,401
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	889,810	527,961
Amortization of deferred sales inducements	183,992	50,359
Annuity product charges	(71,443)	(65,176)
Change in fair value of embedded derivatives	(8,913)	466,278
Change in traditional life and accident and health insurance reserves	(3,925)	27,850
Policy acquisition costs deferred	(313,560)	(287,285)
Amortization of deferred policy acquisition costs	265,534	105,086
Provision for depreciation and other amortization	14,285	13,969
Amortization of discounts and premiums on investments	7,920	(75,596)
Realized gains/losses on investments and net OTTI losses recognized in operations	(17,963)	13,470
Change in fair value of derivatives	(631,030)	(269,404)
Deferred income taxes	9,965	(41,469)
Share-based compensation	5,942	4,907
Change in accrued investment income	(45,721)	(47,938)
Change in income taxes payable	23,040	9,856
Change in other assets	(36)	(5,354)
Change in other policy funds and contract claims	(24,327)	56,568
Change in collateral held for derivatives	115,666	324,596
Change in other liabilities	5,474	3,442
Other	(2,611)	(3,873)
Net cash provided by operating activities	604,424	829,648
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	2,955,734	1,942,533
Fixed maturity securities - held for investment	—	2,618,207
Equity securities - available for sale	44,829	7,604
Mortgage loans on real estate	402,233	341,771
Derivative instruments	662,336	276,227
Other investments	18,244	25,901
Acquisition of investments:		
Fixed maturity securities - available for sale	(6,691,800)	(4,987,848)
Mortgage loans on real estate	(383,074)	(280,749)
Derivative instruments	(302,135)	(280,407)
Other investments	(24,302)	(83,779)
Purchases of property, furniture and equipment	(621)	(378)
Net cash used in investing activities	(3,318,556)	(420,918)

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

	Nine Months Ended September 30,	
	2013	2012
Financing activities		
Receipts credited to annuity policyholder account balances	$3,073,490	$2,738,553
Coinsurance deposits	20,355	(16,364)
Return of annuity policyholder account balances	(1,226,967)	(1,134,943)
Financing fees incurred and deferred	(9,045)	—
Proceeds from notes payable	415,000	—
Repayment of notes payable	(43,243)	—
Repayment of subordinated debentures	—	(270)
Proceeds from amounts due under repurchase agreements	148,180	—
Excess tax benefits realized from share-based compensation plans	1,993	624
Proceeds from issuance of common stock	25,900	4,055
Change in checks in excess of cash balance	(25,145)	(7,903)
Net cash provided by financing activities	2,380,518	1,583,752
Increase (decrease) in cash and cash equivalents	(333,614)	1,992,482
Cash and cash equivalents at beginning of period	1,268,545	404,952
Cash and cash equivalents at end of period	$934,931	$2,397,434
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$19,136	$20,858
Income taxes	72,900	41,938
Non-cash operating activity:		
Deferral of sales inducements	(250,322)	220,784
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	6,285	14,932
Non-cash financing activities:		
Conversion of subordinated debentures	—	20,770
Common stock issued in extinguishment of debt	3,367	—
Warrants to be settled in cash	41,878	—

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2013
(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 nine month periods ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. 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, 2012.

As previously reported in the notes to consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012, we identified certain classification errors related to amounts reported in the financing activities section of our consolidated statements of cash flows. Consistent with that presentation, we have revised the consolidated statement of cash flows for the nine months ended September 30, 2012 resulting in decreases of $140.3 million to receipts credited to annuity policyholder account balances and return of annuity policyholder account balances. These revisions had no net impact on net cash provided by financing activities, and no impact on our consolidated balance sheets, statements of operations, statements of comprehensive income or statements of changes in stockholders' equity.

Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") that expands the disclosure requirements related to other comprehensive income (loss). A reporting entity is now required to provide information about the amounts reclassified out of accumulated other comprehensive income (loss) by component. In addition, a reporting entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. This ASU became effective for interim and annual periods beginning after December 15, 2012. We adopted this ASU on January 1, 2013.

New Accounting Pronouncements

There are currently no accounting standards updates with effective dates after September 30, 2013 that will significantly affect our consolidated financial statements.

2. Fair Values of Financial Instruments

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

	September 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$26,262,878	$26,262,878	$24,172,136	$24,172,136
Held for investment	76,212	60,843	76,088	61,521
Equity securities, available for sale	9,708	9,708	53,422	53,422
Mortgage loans on real estate	2,593,851	2,711,170	2,623,940	2,848,235
Derivative instruments	625,236	625,236	415,258	415,258
Other investments	187,437	187,655	163,193	163,517
Cash and cash equivalents	934,931	934,931	1,268,545	1,268,545
Coinsurance deposits	2,970,601	2,642,309	2,910,701	2,678,232
Interest rate caps	5,356	5,356	3,247	3,247
2015 notes hedges	144,904	144,904	43,105	43,105
Counterparty collateral	240,713	240,713	—	—
Liabilities				
Policy benefit reserves	34,319,660	28,802,302	31,452,496	26,264,831
Single premium immediate annuity (SPIA) benefit reserves	430,908	444,512	455,167	469,768
Notes payable	691,452	1,023,962	309,869	422,175
Subordinated debentures	246,003	233,125	245,869	218,283
2015 notes embedded derivatives	147,150	147,150	43,105	43,105
2015 warrants	51,077	51,077	—	—
Interest rate swap	222	222	4,261	4,261

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 the nine months ended September 30, 2013.

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Our assets and liabilities which are measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012 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)			
September 30, 2013				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,907	$4,907	$—	$—
United States Government sponsored agencies	1,239,603	—	1,239,603	—
United States municipalities, states and territories	3,461,131	—	3,461,131	—
Foreign government obligations	92,682	—	92,682	—
Corporate securities	16,741,581	8,794	16,732,787	—
Residential mortgage backed securities	2,118,827	—	2,117,513	1,314
Commercial mortgage backed securities	1,590,310	—	1,590,310	—
Other asset backed securities	1,013,837	362	1,013,475	—
Equity securities, available for sale: finance, insurance and real estate	9,708	1,908	7,800	—
Derivative instruments	625,236	—	625,236	—
Cash and cash equivalents	934,931	934,931	—	—
Interest rate caps	5,356	—	5,356	—
2015 notes hedges	144,904	—	144,904	—
Counterparty collateral	240,713	—	240,713	—
	$28,223,726	$950,902	$27,271,510	$1,314
Liabilities				
2015 notes embedded derivatives	$147,150	$—	$147,150	$—
Interest rate swap	222	—	222	—
2015 warrants	51,077	—	51,077	—
Fixed index annuities - embedded derivatives	3,975,862	—	—	3,975,862
	$4,174,311	$—	$198,449	$3,975,862
December 31, 2012				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$5,154	$5,154	$—	$—
United States Government sponsored agencies	1,772,025	—	1,772,025	—
United States municipalities, states and territories	3,578,323	—	3,578,323	—
Foreign government obligations	105,259	—	105,259	—
Corporate securities	14,466,772	33,131	14,433,641	—
Residential mortgage backed securities	2,888,113	—	2,886,301	1,812
Commercial mortgage backed securities	357,982	—	357,982	—
Other asset backed securities	998,508	378	998,130	—
Equity securities, available for sale: finance, insurance and real estate	53,422	36,928	16,494	—

Derivative instruments	415,258	—	415,258	—
Cash and cash equivalents	1,268,545	1,268,545	—	—
Interest rate caps	3,247	—	3,247	—
2015 notes hedges	43,105	—	43,105	—
	$25,955,713	$1,344,136	$24,609,765	$1,812
Liabilities				
2015 notes embedded derivatives	$43,105	$—	$43,105	$—
Interest rate swap	4,261	—	4,261	—
Fixed index annuities - embedded derivatives	3,337,556	—	—	3,337,556
	$3,384,922	$—	$47,366	$3,337,556

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

Fixed maturity securities and equity securities

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

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

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

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

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of September 30, 2013 and December 31, 2012.

Mortgage loans on real estate

Mortgage loans on real estate are not measured at fair value on a recurring basis. The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using current competitive market interest rates currently being offered for similar loans. The fair values of impaired mortgage loans on real estate that we have considered to be collateral dependent are based on the fair value of the real estate collateral (based on appraised values) less estimated costs to sell. The inputs utilized to determine fair value of all mortgage loans are unobservable market data (competitive market interest rates and appraised property values); therefore, fair value of mortgage loans falls into Level 3 in the fair value hierarchy.

Derivative instruments

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

Other investments

None of the financial instruments included in other investments are measured at fair value on a recurring basis. Financial instruments included in other investments are policy loans, equity method investments and company owned life insurance (COLI). We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived. The fair values of our equity method investments qualify as Level 3 fair values and were determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread and a liquidity discount. The risk spread and liquidity discount are rates determined by our investment professionals and are unobservable market inputs. The fair value of our COLI approximates the cash surrender value of the policies and falls within Level 2 of the fair value hierarchy.

Cash and cash equivalents

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

Interest rate swap and caps

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

2015 notes hedges and warrants

The fair value of these call options has been determined by a third party who applies market observable data such as our common stock price, its dividend yield and its volatility, as well as the time to expiration of the call options to determine a fair value of the buy side of these options. Since August 26, 2013, when 50% of these call options were committed to partial unwind agreements, fair value has been determined in accordance with the terms of the unwind agreement that relies on market data. Fair value of the warrants that were committed to the partial unwind agreements has been determined in a similar manner in accordance with terms of the unwind agreements.

Counterparty collateral

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

Policy benefit reserves, coinsurance deposits and SPIA benefit reserves

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. For period-certain annuity benefit contracts, the fair value is determined by discounting the benefits at the interest rates currently in effect for newly purchased immediate annuity contracts. We are not required to and have not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value. Policy benefit reserves, coinsurance deposits and SPIA benefit reserves are not measured at fair value on a recurring basis. All of the fair values presented within these categories fall within Level 3 of the fair value hierarchy as most of the inputs are unobservable market data.

Notes payable

The fair values of our senior unsecured notes and convertible senior notes are based upon pricing matrices developed by a third party pricing service when quoted market prices are not available and are categorized as Level 2 within the fair value hierarchy. Notes payable are not remeasured at fair value on a recurring basis.

Subordinated debentures

Fair values for subordinated debentures are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued. These fair values are categorized as Level 2 within the fair value hierarchy. Subordinated debentures are not measured at fair value on a recurring basis.

2015 notes embedded derivatives

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

Fixed index annuities - embedded derivatives

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

The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$1,541	$2,005	$1,812	$2,098
Principal returned	(148)	(101)	(709)	(194)
Accretion of discount	(18)	13	116	60
Total gains (losses) (realized/unrealized):				
Included in other comprehensive income (loss)	(61)	28	95	211
Included in operations	—	(73)	—	(303)
Ending balance	$1,314	$1,872	$1,314	$1,872

The Level 3 assets included in the table above are not material to our financial position, results of operations or cash flows, and it is management's opinion that the sensitivity of the inputs used in determining the fair value of these assets is not material as well.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives				
Beginning balance	$3,747,052	$2,914,948	$3,337,556	$2,530,496
Premiums less benefits	372,363	229,340	1,044,756	418,845
Change in unrealized gains, net	(143,553)	122,494	(406,450)	317,441
Ending balance	$3,975,862	$3,266,782	$3,975,862	$3,266,782

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

Certain derivatives embedded in our fixed index annuity contracts are our most significant financial instrument measured at fair value that are categorized as Level 3 in the fair value hierarchy. The contractual obligations for future annual index credits within our fixed index annuity contracts are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We estimate the fair value of these embedded derivatives at each valuation date by the method described above under fixed index annuities - embedded derivatives. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at September 30, 2013, were to increase by 100 basis points, the fair value of the embedded derivatives would decrease by $255.4 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of $155.2 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as an increase in amortization of deferred policy acquisition costs and deferred sales inducements. A decrease by 100 basis points in the discount rate used to discount the excess projected contract values would increase the fair value of the embedded derivatives by $283.6 million recorded through operations as an increase in the change in fair value of embedded derivatives and there would be a corresponding increase of $168.8 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.

3. Investments

At September 30, 2013 and December 31, 2012, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
September 30, 2013				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,608	$342	$(43)	$4,907
United States Government sponsored agencies	1,314,449	4,069	(78,915)	1,239,603
United States municipalities, states and territories	3,278,749	212,975	(30,593)	3,461,131
Foreign government obligations	86,109	9,365	(2,792)	92,682
Corporate securities	16,420,869	720,010	(399,298)	16,741,581
Residential mortgage backed securities	1,999,201	145,605	(25,979)	2,118,827
Commercial mortgage backed securities	1,664,541	5,194	(79,425)	1,590,310
Other asset backed securities	1,014,590	23,544	(24,297)	1,013,837
	$25,783,116	$1,121,104	$(641,342)	$26,262,878
Held for investment:				
Corporate security	$76,212	$—	$(15,369)	$60,843
Equity securities, available for sale:				
Finance, insurance, and real estate	$8,917	$791	$—	$9,708
December 31, 2012				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,590	$564	$—	$5,154
United States Government sponsored agencies	1,763,789	11,704	(3,468)	1,772,025
United States municipalities, states and territories	3,116,678	461,770	(125)	3,578,323
Foreign government obligations	86,099	19,160	—	105,259
Corporate securities	12,930,173	1,568,223	(31,624)	14,466,772
Residential mortgage backed securities	2,743,537	172,304	(27,728)	2,888,113
Commercial mortgage backed securities	354,870	5,095	(1,983)	357,982
Other asset backed securities	957,291	44,190	(2,973)	998,508
	$21,957,027	$2,283,010	$(67,901)	$24,172,136
Held for investment:				
Corporate security	$76,088	$—	$(14,567)	$61,521
Equity securities, available for sale:				
Finance, insurance, and real estate	$44,598	$10,227	$(1,403)	$53,422

During the nine months ended September 30, 2013 and 2012, we received $1.1 billion and $3.8 billion, respectively, in redemption proceeds related to calls of our callable United States Government sponsored agency securities and public and private corporate bonds, of which $2.6 billion for the nine months ended September 30, 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. At September 30, 2013, 31% of our fixed income securities have call features of which 5% ($1.3 billion) will become subject to call redemption during the next twelve months, of which $500.0

million are U.S. Government agency securities maturing in January 2028 with 3.75% coupons. These securities are callable quarterly and a modest decline in interest rates from current levels could result in the calls being exercised on their next call date in January of 2014.

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The amortized cost and fair value of fixed maturity securities at September 30, 2013, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives and are shown below as separate lines.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$123,756	$126,880	$—	$—
Due after one year through five years	853,588	958,053	—	—
Due after five years through ten years	7,379,238	7,364,750	—	—
Due after ten years through twenty years	6,226,753	6,341,286	—	—
Due after twenty years	6,521,449	6,748,935	76,212	60,843
	21,104,784	21,539,904	76,212	60,843
Residential mortgage backed securities	1,999,201	2,118,827	—	—
Commercial mortgage backed securities	1,664,541	1,590,310	—	—
Other asset backed securities	1,014,590	1,013,837	—	—
	$25,783,116	$26,262,878	$76,212	$60,843

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

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	$480,553	$2,223,933
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(263,337)	(1,201,974)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax benefit	(76,025)	(357,686)
Net unrealized gains reported as accumulated other comprehensive income	$163,725	$686,807

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade.” Based on the NAIC designations, we had 98% of our fixed maturity portfolio rated investment grade at September 30, 2013 and December 31, 2012.

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

	September 30, 2013		December 31, 2012	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$15,945,089	$16,367,238	$13,737,381	$15,250,560
2	9,277,558	9,352,577	7,838,186	8,533,121
3	533,890	509,433	398,294	387,222
4	100,907	93,126	53,879	56,151
5	—	—	—	—
6	1,884	1,347	5,375	6,603

$25,859,328	$26,323,721	$22,033,115	$24,233,657

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The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 885 and 198 securities, respectively) have been in a continuous unrealized loss position, at September 30, 2013 and December 31, 2012:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
September 30, 2013						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$977	$(43)	$—	$—	$977	$(43)
United States Government sponsored agencies	1,130,979	(78,915)	—	—	1,130,979	(78,915)
United States municipalities, states and territories	488,260	(30,593)	—	—	488,260	(30,593)
Foreign government obligations	26,985	(2,792)	—	—	26,985	(2,792)
Corporate securities:						
Finance, insurance and real estate	1,291,001	(71,692)	119,734	(11,273)	1,410,735	(82,965)
Manufacturing, construction and mining	2,925,074	(161,188)	16,494	(2,608)	2,941,568	(163,796)
Utilities and related sectors	1,568,088	(83,013)	30,766	(2,673)	1,598,854	(85,686)
Wholesale/retail trade	336,683	(20,153)	—	—	336,683	(20,153)
Services, media and other	843,825	(44,173)	30,939	(2,525)	874,764	(46,698)
Residential mortgage backed securities	296,361	(23,605)	34,068	(2,374)	330,429	(25,979)
Commercial mortgage backed securities	1,268,293	(79,425)	—	—	1,268,293	(79,425)
Other asset backed securities	402,461	(17,914)	44,726	(6,383)	447,187	(24,297)
	$10,578,987	$(613,506)	$276,727	$(27,836)	$10,855,714	$(641,342)
Held for investment:						
Corporate security:						
Insurance	$—	$—	$60,843	$(15,369)	$60,843	$(15,369)
December 31, 2012						
Fixed maturity securities:						
Available for sale:						
United States Government sponsored agencies	$973,728	$(3,468)	$—	$—	$973,728	$(3,468)
United States municipalities, states and territories	24,393	(125)	—	—	24,393	(125)
Corporate securities:						
Finance, insurance and real estate	177,962	(4,126)	85,709	(8,438)	263,671	(12,564)
Manufacturing, construction and mining	426,120	(4,303)	21,975	(1,281)	448,095	(5,584)
Utilities and related sectors	221,044	(5,187)	39,224	(4,212)	260,268	(9,399)
Wholesale/retail trade	101,790	(784)	10,250	(208)	112,040	(992)
Services, media and other	264,421	(3,085)	—	—	264,421	(3,085)
	220,622	(8,679)	260,226	(19,049)	480,848	(27,728)

Residential mortgage backed securities						
Commercial mortgage backed securities	161,582	(1,983)	—	—	161,582	(1,983)
Other asset backed securities	145,238	(2,242)	26,131	(731)	171,369	(2,973)
	$2,716,900	$(33,982)	$443,515	$(33,919)	$3,160,415	$(67,901)
Held for investment:						
Corporate security:						
Insurance	$—	$—	$61,521	$(14,567)	$61,521	$(14,567)
Equity security, available for sale:						
Services	$—	$—	$8,722	$(1,403)	$8,722	$(1,403)

The following is a description of the factors causing the temporary unrealized losses by investment category as of September 30, 2013:

United States Government sponsored agencies: These securities are relatively long in duration; however, they are callable in less than 12 months making the value of such securities sensitive to changes in market interest rates. The timing of when some of these securities were purchased gave rise to unrealized losses at September 30, 2013.

United States municipalities, states and territories: These securities are relatively long in duration and their fair values are sensitive to changes in market interest rates. The timing of the purchase of these securities have resulted in unrealized losses at this point in time.

Foreign government obligations: The unrealized losses on these securities are due to wider spreads on the announcement of increased capital expenditures with resulting higher leverage and greater supply.
Corporate securities: The unrealized losses in these securities are due partially to the timing of purchases in 2012 and 2013. These securities carry yields less than those available at September 30, 2013 as the result of rising interest rates in the first nine months of 2013. In addition, a small number of securities have seen their credit spreads remain wide due to issuer or industry specific news while some financial and industrial sector credit spreads remain wide due to continued economic uncertainty and concerns of economic instability.
Residential mortgage backed securities: At September 30, 2013, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $323.4 million and a fair value of $340.7 million. Despite recent improvements in the capital markets, the fair values of RMBS with weaker borrower characteristics continue at prices below amortized cost. These RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.
Commercial mortgage backed securities: The unrealized losses in these securities are due partially to the timing of purchases in 2012 and 2013. A number of purchases made in the middle of the fourth quarter 2012 were at yields lower than what could be executed at the end of this quarter due to the increase in the treasury yield since the time of purchase. Yield spreads for commercial mortgage backed securities have narrowed but remain attractive.
Other asset backed securities: The unrealized losses in these securities are predominantly assigned to financial sector capital trust securities which have longer maturity dates and have declined in price due to prolonged stress in the financial sector. No securities in an unrealized loss position are rated below investment grade.
Approximately 94% and 75% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2013 and December 31, 2012, respectively, are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the securities with unrealized losses are current with respect to the payment of principal and interest.
Changes in net unrealized gains on investments for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Fixed maturity securities held for investment carried at amortized cost	$(449)	$(626)	$(802)	$(12,505)
Investments carried at fair value:				
Fixed maturity securities, available for sale	$(276,793)	$402,274	$(1,735,347)	$790,648
Equity securities, available for sale	(84)	2,963	(8,033)	6,600
	(276,877)	405,237	(1,743,380)	797,248
Adjustment for effect on other balance sheet accounts:				
Deferred policy acquisition costs and deferred sales inducements	152,944	(201,676)	938,637	(405,006)
Deferred income tax asset/liability	43,378	(71,247)	281,661	(137,285)
	196,322	(272,923)	1,220,298	(542,291)
Change in net unrealized gains on investments carried at fair value	$(80,555)	$132,314	$(523,082)	$254,957

Proceeds from sales of available for sale securities for the nine months ended September 30, 2013 and 2012 were $1.2 billion and $276.1 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the nine months ended September 30, 2013 and 2012 were $1.9 billion and $1.6 billion, respectively.

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Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Net realized gains (losses) on investments, excluding net OTTI losses for the three and nine months ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$3,965	$3,028	$24,608	$8,076
Gross realized losses	(2,096)	(180)	(5,106)	(535)
	1,869	2,848	19,502	7,541
Equity securities:				
Gross realized gains	—	—	9,571	562
Other investments:				
Gain on sale of real estate	201	53	1,505	2,948
Loss on sale of real estate	(278)	—	(744)	—
Impairment losses on real estate	(678)	(830)	(823)	(3,473)
	(755)	(777)	(62)	(525)
Mortgage loans on real estate:				
Increase in allowance for credit losses	(3,191)	(3,309)	(4,814)	(15,503)
	$(2,077)	$(1,238)	$24,197	$(7,925)

Losses in 2013 were realized primarily due to strategies in place to reposition the fixed maturity security portfolio that result in improved net investment income, risk or duration profiles as they pertain to our asset liability management. One corporate issue was sold at a loss in 2013 due to the our fundamental, long-term concern with the issuer's ability to meet its future financial obligations.

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

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

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

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

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

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

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

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

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

The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the nine months ended September 30, 2013 and 2012, which are all senior level tranches within the structure of the securities:

		Discount Rate		Default Rate		Loss Severity	
Sector	Vintage	Min	Max	Min	Max	Min	Max
Nine months ended September 30, 2013							
Prime	2003	5.1 %	5.1 %	2 %	2 %	30 %	30 %
	2005	6.5 %	7.7 %	8 %	18 %	50 %	65 %
	2006	6.0 %	6.9 %	9 %	16 %	50 %	50 %
	2007	6.2 %	6.7 %	11 %	25 %	40 %	60 %
	2008	6.6 %	6.6 %	16 %	16 %	45 %	45 %
	2009	6.8 %	6.8 %	17 %	17 %	60 %	60 %
Alt-A	2005	5.6 %	8.7 %	15 %	81 %	2 %	65 %
	2007	6.2 %	6.9 %	38 %	52 %	60 %	65 %

Nine months ended September 30, 2012							
Prime	2005	6.5 %	7.7 %	9 %	18 %	50 %	50 %
	2006	5.8 %	7.4 %	9 %	19 %	40 %	55 %
	2007	6.2 %	7.3 %	11 %	38 %	40 %	60 %
Alt-A	2005	5.6 %	8.7 %	12 %	27 %	5 %	55 %
	2006	6.0 %	6.0 %	32 %	46 %	55 %	60 %
	2007	6.2 %	7.0 %	31 %	55 %	55 %	60 %

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

In addition, for debt securities which we do not intend to sell and it is not more likely than not we will be required to sell, but our intent changes due to changes or events that could not have been reasonably anticipated, an other than temporary impairment charge is recognized. Once an impairment charge has been recorded, we then continue to review the other than temporarily impaired securities for appropriate valuation on an ongoing basis. Unrealized losses may be recognized in future periods through a charge to earnings, should we later conclude that the decline in fair value below amortized cost is other than temporary pursuant to our accounting policy described above. The use of different methodologies and assumptions to determine the fair value of investments and the timing and amount of impairments may have a material effect on the amounts presented in our consolidated financial statements.

The following table summarizes other than temporary impairments for the three and nine months ended September 30, 2013 and 2012, by asset type:

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized from Other Comprehensive Income	Net OTTI Losses Recognized in Operations
		(Dollars in thousands)		
Three months ended September 30, 2013				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	2	$—	$ (222)	$ (222)
Three months ended September 30, 2012				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	4	$—	$ (1,686)	$ (1,686)
Nine months ended September 30, 2013				
Fixed maturity securities, available for sale:				
United States Government sponsored agencies	2	$ (2,775)	$ —	$ (2,775)
Corporate securities:				
Industrial	1	(1,761)	—	(1,761)
Residential mortgage backed securities	6	—	(1,270)	(1,270)
Equity security, available for sale:				
Industrial	1	(428)	—	(428)
	10	$ (4,964)	$ (1,270)	$ (6,234)
Nine months ended September 30, 2012				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	24	$ (2,156)	$ (3,389)	$ (5,545)

Other than temporary impairments during the nine months ended September 30, 2013 on United States Government sponsored agencies were recognized as we had the intent to sell these securities as of June 30, 2013. These securities were sold during the quarter ended September 30, 2013. The other than temporary impairments were determined based on the market values of the underlying securities at June 30, 2013.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Cumulative credit loss at beginning of period	$(128,513)	$(122,954)	$(134,027)	$(119,095)
Credit losses on securities for which OTTI has not previously been recognized	—	—	(4,536)	(47)
Additional credit losses on securities for which OTTI has previously been recognized	(222)	(1,686)	(1,270)	(5,498)
Accumulated losses on securities that were disposed of during the period	2,775	—	13,873	—
Cumulative credit loss at end of period	$(125,960)	$(124,640)	$(125,960)	$(124,640)

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security, for securities that are part of our investment portfolio at September 30, 2013 and December 31, 2012:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
September 30, 2013				
Fixed maturity securities, available for sale:				
Corporate securities	$—	$—	$32	$32
Residential mortgage backed securities	715,871	(176,334)	222,943	762,480
Equity securities, available for sale:				
Finance, insurance and real estate and services	1,416	—	493	1,909
	$717,287	$(176,334)	$223,468	$764,421
December 31, 2012				
Fixed maturity securities, available for sale:				
Corporate securities	$10,599	$(2,151)	$5,676	$14,124
Residential mortgage backed securities	855,915	(177,604)	171,514	849,825
Equity securities, available for sale:				
Finance, insurance and real estate	9,976	—	9,668	19,644
	$876,490	$(179,755)	$186,858	$883,593

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio, summarized in the following table, totaled $2.6 billion at September 30, 2013 and December 31, 2012, with commitments outstanding of $81.2 million at September 30, 2013.

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Principal outstanding	$2,625,563	$2,658,883
Loan loss allowance	(31,118)	(34,234)
Deferred prepayment fees	(594)	(709)
Carrying value	$2,593,851	$2,623,940

The portfolio consists of commercial mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	September 30, 2013			December 31, 2012		
	Principal Outstanding	Percent		Principal Outstanding	Percent	
	(Dollars in thousands)					
Geographic distribution						
East	$772,366	29.4	%	$732,762	27.5	%
Middle Atlantic	149,951	5.7	%	155,094	5.8	%
Mountain	353,820	13.5	%	387,599	14.6	%
New England	22,790	0.9	%	26,385	1.0	%
Pacific	316,822	12.1	%	320,982	12.1	%
South Atlantic	491,221	18.7	%	458,802	17.3	%
West North Central	358,115	13.6	%	370,168	13.9	%
West South Central	160,478	6.1	%	207,091	7.8	%
	$2,625,563	100.0	%	$2,658,883	100.0	%
Property type distribution						
Office	$613,050	23.4	%	$666,467	25.1	%
Medical Office	131,304	5.0	%	136,764	5.1	%
Retail	698,189	26.6	%	677,951	25.5	%
Industrial/Warehouse	664,703	25.3	%	692,637	26.1	%
Hotel	79,385	3.0	%	94,045	3.5	%
Apartment	269,817	10.3	%	219,335	8.2	%
Mixed use/other	169,115	6.4	%	171,684	6.5	%
	$2,625,563	100.0	%	$2,658,883	100.0	%

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. A mortgage loan is impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. If we determine that the value of any specific mortgage loan is impaired, the carrying amount of the mortgage loan will be reduced to its fair value, based upon the present value of expected future cash flows from the loan discounted at the loan's effective interest rate, or the fair value of the underlying collateral less estimated costs to sell. In addition, we analyze the mortgage loan portfolio for the need of a general loan allowance for probable losses on all other loans. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions.

Our financing receivables currently consist of one portfolio segment which is our commercial mortgage loan portfolio. These are mortgage loans with collateral consisting of commercial real estate and borrowers consisting mostly of limited liability partnerships or limited liability corporations.

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

We rate the mortgage loans in our portfolio based on factors such as historical operating performance, loan to value ratio and economic outlook, among others. We calculate a loss factor to apply to each rating based on historical losses we have recognized in our mortgage loan portfolio. We apply the loss factors to the total principal outstanding within each rating category to determine an appropriate estimate of general loan loss allowance at September 30, 2013 and December 31, 2012.

The following tables present a rollforward of our specific and general valuation allowances for mortgage loans on real estate:

	Three Months Ended September 30, 2013		Three Months Ended September 30, 2012	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	$(21,176)	$(10,500)	$(25,445)	$(11,200)
Charge-offs	3,749	—	1,932	—
Recoveries	—	—	—	—
Provision for credit losses	(2,691)	(500)	(2,909)	(400)
Ending allowance balance	$(20,118)	$(11,000)	$(26,422)	$(11,600)

	Nine Months Ended September 30, 2013		Nine Months Ended September 30, 2012	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	$(23,134)	$(11,100)	$(23,664)	$(9,300)
Charge-offs	7,930	—	10,445	—
Recoveries	—	—	—	—
Provision for credit losses	(4,914)	100	(13,203)	(2,300)
Ending allowance balance	$(20,118)	$(11,000)	$(26,422)	$(11,600)

The specific allowance represents the total credit loss allowances on loans which are individually evaluated for impairment. The general allowance is the group of loans discussed above which are collectively evaluated for impairment. The following table presents the total outstanding principal of loans evaluated for impairment by basis of impairment method:

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Individually evaluated for impairment	$50,055	$53,110
Collectively evaluated for impairment	2,575,508	2,605,773
Total loans evaluated for impairment	$2,625,563	$2,658,883

Charge-offs include allowances that have been established on loans that were satisfied by taking ownership of the collateral. When the property is taken it is recorded at its fair value as a component of other investments and the mortgage loan is recorded as fully paid, with any allowance for credit loss that has been established charged off. Fair value of the real estate is determined by third party appraisal. There could be other situations that develop where we have established a larger specific loan loss allowance than is needed based on increases in the fair value of collateral supporting collateral dependent loans, or improvements in the financial position of a borrower so that a loan would become reliant on cash flows from debt service instead of dependent upon sale of the collateral. Charge-offs of the allowance would be recognized in those situations as well. We define collateral dependent loans as those mortgage loans for which we will depend on the value of the collateral real estate to satisfy the outstanding principal of the loan. During the three and nine months ended September 30, 2013, three and four mortgage loans, respectively, were satisfied by taking ownership of any real estate serving as collateral compared to two and eight mortgage loans for the same periods in 2012. The following table summarizes the activity in the real estate owned which was obtained in satisfaction of mortgage loans on real estate:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Real estate owned at beginning of period	$26,609	$38,390	$33,172	$36,821

Real estate acquired in satisfaction of mortgage loans	5,441	2,916	6,285	14,902
Additions	52	—	532	117
Sales	(5,832)	(5,727)	(13,245)	(13,093)
Impairments	(678)	(830)	(823)	(3,473)
Depreciation	(159)	(185)	(488)	(710)
Real estate owned at end of period	$25,433	$34,564	$25,433	$34,564

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

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Credit Exposure--By Payment Activity		
Performing	$2,588,791	$2,597,440
In workout	30,724	26,723
Collateral dependent	6,048	34,720
	$2,625,563	$2,658,883

Mortgage loans are considered delinquent when they become 60 days past due. When loans become 90 days past due, become collateral dependent or enter a period with no debt service payments required we place them on non-accrual status and discontinue recognizing interest income. If payments are received on a delinquent loan, interest income is recognized to the extent it would have been recognized if normal principal and interest would have been received timely. If payments are received to bring a delinquent loan back to current we will resume accruing interest income on that loan. Outstanding principal of loans in a non-accrual status at September 30, 2013 and December 31, 2012 totaled $6.0 million and $34.7 million, respectively.

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

Aging of financing receivables is summarized in the following table, with loans in a "workout" period as of the reporting date considered current if payments are current in accordance with agreed upon terms:

	30 - 59 Days	60 - 89 Days	90 Days and Over	Total Past Due	Current	Collateral Dependent Receivables	Total Financing Receivables
	(Dollars in thousands)						
Commercial Mortgage Loans							
September 30, 2013	$—	$—	$—	$—	$2,619,515	$6,048	$2,625,563
December 31, 2012	$—	$—	$—	$—	$2,624,163	$34,720	$2,658,883

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
September 30, 2013					
Mortgage loans with an allowance	$29,937	$50,055	$(20,118)	$32,897	$2,082
Mortgage loans with no related allowance	18,782	18,782	—	18,976	799

	$48,719	$68,837	$(20,118)	$51,873	$2,881
December 31, 2012					
Mortgage loans with an allowance	$29,976	$53,110	$(23,134)	$37,480	$1,946
Mortgage loans with no related allowance	27,765	27,765	—	27,696	1,664
	$57,741	$80,875	$(23,134)	$65,176	$3,610

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The loans that are categorized as "in workout" consist of loans that we have agreed to lower or no mortgage payments for a period of time while the borrowers address cash flow and/or operational issues. The key features of these workouts have been determined on a loan-by-loan basis. Most of these loans are in a period of low cash flow due to tenants vacating their space or tenants requesting rent relief during difficult economic periods. Generally, we have allowed the borrower a six month interest only period and in some cases a twelve month period of interest only. Interest only workout loans are expected to return to their regular debt service payments after the interest only period. Interest only loans that are not fully amortizing will have a larger balance at their balloon date than originally contracted. Fully amortizing loans that are in interest only periods will have larger debt service payments for their remaining term due to lost principal payments during the interest only period. In limited circumstances we have allowed borrowers to pay the principal portion of their loan payment into an escrow account that can be used for capital and tenant improvements for a period of not more than twelve months. In these situations new loan amortization schedules are calculated based on the principal not collected during this twelve month workout period and larger payments are collected for the remaining term of each loan. In all cases, original interest rate and maturity date have not been modified and we have not forgiven any principal amounts.

A Troubled Debt Restructuring ("TDR") is a situation where we have granted a concession to a borrower for economic or legal reasons related to the borrower's financial difficulties that we would not otherwise consider. A mortgage loan that has been granted new terms, including workout terms as described previously, would be considered a TDR if it meets conditions that would indicate a borrower is experiencing financial difficulty and the new terms constitute a concession on our part. We analyze all loans where we have agreed to workout terms and all loans that we have refinanced to determine if they meet the definition of a TDR. We consider the following factors in determining whether or not a borrower is experiencing financial difficulty:

- borrower is in default,
- borrower has declared bankruptcy,
- there is growing concern about the borrower's ability to continue as a going concern,
- borrower has insufficient cash flows to service debt,
- borrower's inability to obtain funds from other sources, and
- there is a breach of financial covenants by the borrower.

If the borrower is determined to be in financial difficulty, we consider the following conditions to determine if the borrower was granted a concession:

- assets used to satisfy debt are less than our recorded investment,
- interest rate is modified,
- maturity date extension at an interest rate less than market rate,
- capitalization of interest,
- delaying principal and/or interest for a period of three months or more, and
- partial forgiveness of the balance or charge-off.

Mortgage loan workouts, refinances or restructures that are classified as TDRs are individually evaluated and measured for impairment. A summary of mortgage loans on commercial real estate with outstanding principal at September 30, 2013 and December 31, 2012 that we determined to be TDRs are as follows:

Geographic Region	Number of TDRs	Principal Balance Outstanding	Specific Loan Loss Allowance	Net Carrying Amount
		(Dollars in thousands)		
September 30, 2013				
East	1	$3,712	$(949)	$2,763
Mountain	7	21,514	(631)	20,883
South Atlantic	6	10,792	(3,314)	7,478
East North Central	1	2,219	(467)	1,752
West North Central	1	1,938	—	1,938

West South Central	1	1,714	(256	) 1,458
	17	$41,889	$(5,617	) $36,272
December 31, 2012				
East	1	$4,208	$(1,425	) $2,783
Mountain	10	28,786	(1,702	) 27,084
South Atlantic	9	23,358	(5,047	) 18,311
East North Central	1	2,232	(467	) 1,765
West North Central	3	9,466	(2,328	) 7,138
	24	$68,050	$(10,969	) $57,081

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5. Derivative Instruments

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

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Assets		
Derivative instruments		
Call options	$625,236	$415,258
Other assets		
2015 notes hedges	144,904	43,105
Interest rate caps	5,356	3,247
	$775,496	$461,610
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$3,975,862	$3,337,556
Other liabilities		
2015 notes embedded derivatives	147,150	43,105
2015 warrants	51,077	—
Interest rate swap	222	4,261
	$4,174,311	$3,384,922

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

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(Dollars in thousands)			
Change in fair value of derivatives:				
Call options	$129,428	$160,735	$532,282	$280,014
2015 notes hedges	73,504	1,839	101,799	(5,573)
2015 warrants	(9,199)	—	(9,199)	—
Interest rate swap	(496)	(1,171)	4,039	(4,319)
Interest rate caps	(209)	(313)	2,109	(718)
	$193,028	$161,090	$631,030	$269,404
Change in fair value of embedded derivatives:				
2015 notes embedded derivatives	$75,750	$1,839	$104,045	$(5,573)
Fixed index annuities	(39,526)	186,362	(112,958)	471,851
	$36,224	$188,201	$(8,913)	$466,278

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

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

The notional amount and fair value of our call options by counterparty and each counterparty's current credit rating are as follows:

			September 30, 2013		December 31, 2012	
Counterparty	Credit Rating (S&P)	Credit Rating (Moody's)	Notional Amount	Fair Value	Notional Amount	Fair Value
			(Dollars in thousands)			
Bank of America	A	A3	$1,273,995	$47,681	$568,786	$16,533
Barclays	A	A2	2,936,023	108,872	3,463,777	103,929
BNP Paribas	A+	A2	1,481,037	45,958	2,207,097	60,301
Citibank, N.A.	A	A3	1,368,136	47,915	2,878,588	67,592
Credit Suisse	A	A1	3,886,014	116,310	936,625	21,518
Deutsche Bank	A	A2	909,823	37,627	886,688	20,787
HSBC	AA-	A1	235,430	12,415	295,520	6,539
J.P. Morgan	A+	Aa3	778,891	21,204	735,016	21,940
Morgan Stanley	A-	Baa1	2,713,249	89,525	1,590,505	40,113
Royal Bank of Canada	AA-	Aa3	298,349	5,862	—	—
Wells Fargo	AA-	Aa3	2,284,217	91,867	2,060,903	56,006
			$18,165,164	$625,236	$15,623,505	$415,258

As of September 30, 2013 and December 31, 2012, we held $622.0 million and $328.7 million, respectively, of cash and cash equivalents and other securities from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of economic loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $48.0 million and $93.7 million at September 30, 2013 and December 31, 2012, respectively.

The future annual index credits on our fixed index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. We do not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. We must value both the call options and the related forward embedded options in the policies at fair value.

We entered into an interest rate swap and interest rate caps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures. See Note 10 in our Annual Report on Form 10-K for the year ended December 31, 2012 for more information on our subordinated debentures. The terms of the interest rate swap provide that we pay a fixed rate of interest and receive a floating rate of interest. The terms of the interest rate caps limit the three month London Interbank Offered Rate ("LIBOR") to 2.50%. The interest rate swap and caps are not effective hedges under accounting guidance for derivative instruments and hedging activities. Therefore, we record the interest rate swap and caps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swap are as follows:

	Notional	Pay		September 30, 2013	December 31, 2012

Maturity Date	Amount	Receive Rate	Rate		Counterparty	Fair Value		Fair Value	
						(Dollars in thousands)			
March 15, 2021	$85,500	LIBOR	2.415	%	SunTrust	$(222	)	$(4,261	)

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Details regarding the interest rate caps are as follows:

Maturity Date	Notional Amount	Floating Rate	Cap Rate		Counterparty	September 30, 2013 Fair Value	December 31, 2012 Fair Value
						(Dollars in thousands)	
July 7, 2021	$40,000	LIBOR	2.50	%	SunTrust	$2,697	$1,634
July 8, 2021	12,000	LIBOR	2.50	%	SunTrust	809	490
July 29, 2021	27,000	LIBOR	2.50	%	SunTrust	1,850	1,123
	$79,000					$5,356	$3,247

The interest rate swap has a forward starting date beginning in March 2014 and converts floating rates to fixed rates for seven years. The interest rate caps have a forward starting date beginning in July 2014 and cap our interest rates for seven years. As of September 30, 2013, we held $5.2 million of cash and cash equivalents from the counterparty for derivative collateral related to the swap and caps, which is included in other liabilities on our consolidated balance sheets.

In September 2010, concurrently with the issuance of $200.0 million principal amount of 3.5% Convertible Senior Notes Due 2015 (the "2015 notes"), we entered into hedge transactions (the "2015 notes hedges") with two counterparties whereby we have the option to receive the cash equivalent of the conversion spread on 16.0 million shares of our common stock based upon a strike price of $12.50 per share, subject to certain conversion rate adjustments in the 2015 notes. These options expire on September 15, 2015, and must be settled in cash. The 2015 notes hedges are accounted for as derivative assets, and are included in Other assets in our Consolidated Balance Sheets.

The 2015 notes embedded conversion derivative and the 2015 notes hedges are adjusted to fair value each reporting period and unrealized gains and losses are reflected in our Consolidated Statements of Operations.

In separate transactions, we also sold warrants (the "2015 warrants") to two counterparties for the purchase of up to 16.0 million shares of our common stock at a price of $16.00 per share. The number of shares and strike price of the warrants are subject to adjustment based on dividends we pay subsequent to selling the warrants. As of September 30, 2013, such adjustments have resulted in warrants outstanding for the purchase of up to 16.2 million shares of our common stock at a strike price of $15.81 per share. The warrants expire on various dates from December 2015 through March 2016 and are intended to be settled in net shares. The total number of shares of common stock deliverable under the 2015 warrants is, however, currently limited to 11.6 million shares. We received $15.6 million in cash proceeds from the sale of the 2015 warrants, which has been recorded as an increase in additional paid-in capital. Changes in the fair value of these warrants will not be recognized in our Consolidated Financial Statements as long as the instruments remain classified as equity.

On August 26, 2013, we entered into partial unwind agreements with the two counterparties to the 2015 notes hedges and the 2015 warrants. We agreed to settle 50% of both the outstanding call options (2015 notes hedges) and warrants on October 22, 2013, in net cash to be received from each counterparty. This coincides with the expiration of the exchange offer for the outstanding 2015 Notes discussed below. The agreements to settle the warrants in net cash required us to reclassify $41.9 million from equity to a derivative liability which represents the fair value of 50% of the outstanding warrants on the day that we entered into the unwind agreements. Subsequent to the reclassification, we are required to recognize the change in fair value of these warrants committed to the unwind agreements through net income.

6. Notes Payable

On July 17, 2013, we issued $400 million aggregate principal amount of senior unsecured notes due 2021 which bear interest at 6.625% per year and will mature on July 15, 2021. We used $15 million of the net proceeds from the issuance to repay the entire amount outstanding under our revolving credit facility and, in October 2013, used $127.6 million to pay the cash consideration portion of the convertible note exchange offers discussed below. We intend to use the remaining net proceeds from the notes issuance to tender for, redeem or repurchase the $213.9 million aggregate principal amount of convertible notes that did not accept the exchange offers discussed below and are currently outstanding. The form and timing of any such activity will be dependent upon market conditions and other factors and there can be no assurance that any such transactions can be completed prior to the December 2014 call date for the 5.25% contingent convertible senior notes due December 15, 2029 (the "2029 notes") or the September 2015 maturity date for the 2015 notes.

The convertible senior notes included in notes payable are accounted for separately as a liability component and an equity component in the consolidated balance sheets. The liability component and equity component are as follows:

	September 30, 2013		December 31, 2012		
	September 2015 Notes	December 2029 Notes	September 2015 Notes	December 2029 Notes	December 2024 Notes
	(Dollars in thousands)				
Notes payable:					
Principal amount of liability component	$200,000	$115,839	$200,000	$115,839	$28,243
Unamortized discount	(16,420)	(7,967)	(21,944)	(12,269)	—
Net carrying amount of liability component	$183,580	$107,872	$178,056	$103,570	$28,243
Additional paid-in capital:					
Carrying amount of equity component		$15,586		$15,586	$22,637
Amount by which the if-converted value exceeds principal	$54,179	$138,958	$—	$30,382	$—

The discount is being amortized over the expected lives of the notes, which is December 15, 2014 for the 2029 notes and September 15, 2015 for the 2015 notes. The effective interest rates during the discount amortization periods are 8.9% and 11.9% on the 2015 notes and the 2029 notes, respectively. The interest cost recognized in operations for the convertible notes, inclusive of the coupon and amortization of the discount and debt issue costs, was $7.1 million and $21.1 million for the three and nine months ended September 30, 2013, respectively, and $7.1 million and $21.2 million for the same periods in 2012.

We are required to include the dilutive effect of the 2029 notes in our diluted earnings per share calculation. Because these notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the fair value of our common stock at the end of the reporting period exceeds the conversion price per share of $9.57. At September 30, 2013 and 2012, the conversion premium of the 2029 notes was dilutive and the effect has been included in diluted earnings per share for the three and nine months ended September 30, 2013 and 2012. The 2015 notes and the 2015 notes hedges are excluded from the dilutive effect in our diluted earnings per share calculation as they are currently to be settled only in cash. At September 30, 2013, the 2015 warrants that were not assigned to the partial unwind agreement were dilutive as the average price of our commons stock exceeded the $15.81 strike price of the 2015 warrants and the effect has been included in diluted earnings per share for the three and nine months ended September 30, 2013.

On March 25, 2013, notice of mandatory redemption was issued for our 2024 notes. $25.8 million principal amount of the convertible notes exercised their conversion rights prior to the April 30, 2013 mandatory redemption date. The holders of these notes received the principal amount of their notes in cash and the conversion premium in shares of our common stock, for which 216,729 shares were issued. The balance of the convertible notes ($2.5 million principal amount) was redeemed for cash.

On August 23, 2013, we offered to exchange cash and, in certain circumstances, newly issued shares of our common stock, for any and all of our outstanding 2015 notes and 2029 notes. The exchange offers expired on October 21, 2013, and the results are discussed in Note 9.

In 2011, we entered into a three year $160 million revolving line of credit agreement with seven banks. The interest rate is floating at a rate based on our election that will be equal to the alternate base rate (as defined in the credit agreement) plus the applicable margin or the adjusted LIBOR rate (as defined in the credit agreement) plus the applicable margin. We also pay a commitment fee on the available unused portion of the credit facility. The applicable margin and commitment fee rate are based on our credit rating and can change throughout the period of the credit facility. Based upon our current credit rating, the applicable margin is 2.00% for alternate base rate borrowings and 3.00% for adjusted LIBOR rate borrowings and the commitment fee is 0.50%. Under this agreement, we are required to maintain a minimum risk-based capital ratio at American Equity Life, a maximum ratio of debt to total capital, a minimum cash coverage ratio, and a minimum level of statutory surplus at American Equity Life. No amounts were outstanding at September 30, 2013 and December 31, 2012.

As part of our investment strategy, we enter into securities repurchase agreements (short-term collateralized borrowings). The maximum amount borrowed during the nine months ended September 30, 2013 was $258.6 million. We had no borrowings under repurchase agreements during the nine months ended September 30, 2012. When we do borrow cash on these repurchase agreements, we pledge collateral in the form of debt securities with fair values approximately equal to the amount due and we use the cash to purchase debt securities ahead of the time we collect the cash from selling annuity policies to avoid a lag between the investment of funds and the obligation to credit interest to policyholders. We earn investment income on the securities purchased with these borrowings at a rate in excess of the cost of these borrowings. Such borrowings averaged $131.5 million and $47.5 million for the three and nine months ended September 30, 2013, respectively. The weighted average interest rate on amounts due under repurchase agreements was 0.17% and 0.18% for the three and nine months ended September 30, 2013, respectively.

7. Commitments and Contingencies

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

In accordance with applicable accounting guidelines, we establish an accrued liability for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. As a litigation or regulatory matter is developing we, in conjunction with outside counsel, evaluate on an ongoing basis whether the matter presents a loss contingency that meets conditions indicating the need for accrual and/or disclosure, and if not the matter will continue to be monitored for further developments. If and when the loss contingency related to litigation or regulatory matters is deemed to be both probable and estimable, we will establish an accrued liability with respect to that matter and will continue to monitor the matter for further developments that may affect the amount of the accrued liability. We recorded an estimated litigation liability of $17.5 million during the third quarter of 2012 based on developments in the mediation of the matter discussed below.

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in a purported class action, McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation (complaint filed September 7, 2005) (the "Los Angeles Case"), involving allegations of improper sales practices and similar claims as described below.

The Los Angeles Case is a consolidated action involving several lawsuits filed by putative class members seeking class action status for a national class of purchasers of annuities issued by us. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek rescission and injunctive relief including restitution and disgorgement of profits on behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. On July 30, 2013, the parties entered into a settlement agreement and stipulated to certification of the case as a class action for settlement purposes only. On September 16, 2013, the Court granted preliminary approval of the settlement, conditionally approved the class for settlement purposes, approved the issuance of notice to the class and set the fairness hearing relating to the settlement for January 27, 2014. Notice of the terms of the settlement was mailed to the members of the class on October 7, 2013. Based upon the terms of the settlement agreement, the $17.5 million litigation liability referred to above represents our best estimate of probable loss with respect to this litigation; however, the settlement is contingent upon final court approval which has not yet been granted. Additionally, other factors could potentially result in a change in this estimate as further developments take place. In particular, part of the settlement involves a claims process for individual class members, and it is difficult to predict the amount of the liabilities that will ultimately result from that process. In light of the inherent uncertainties involved in the pending purported class action lawsuit, there can be no assurance that such litigation, or any other pending or future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

In addition to our commitments to fund mortgage loans, we have unfunded commitments at September 30, 2013 to limited partnerships of $30.1 million and to secured bank loans of $19.7 million.

8. Earnings (Loss) Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands, except per share data)			
Numerator:				
Net income (loss) - numerator for earnings (loss) per common share	$56,181	$(7,829)	$202,325	$21,401
Interest on convertible subordinated debentures (net of income tax benefit)	—	2	—	517
Numerator for earnings (loss) per common share - assuming dilution	$56,181	$(7,827)	$202,325	$21,918
Denominator:				
Weighted average common shares outstanding (1)	65,129,442	62,504,421	64,239,117	60,722,625
Effect of dilutive securities:				
Convertible subordinated debentures	—	65,688	—	1,801,211
Convertible senior notes	6,601,347	2,145,940	6,601,347	2,145,940
2015 warrants	1,388,826	—	462,942	—
Stock options and deferred compensation agreements	1,440,101	545,877	1,155,670	562,309
Denominator for earnings (loss) per common share - assuming dilution	74,559,716	65,261,926	72,459,076	65,232,085
Earnings (loss) per common share	$0.86	$(0.13)	$3.15	$0.35
Earnings (loss) per common share - assuming dilution	$0.75	$(0.13)	$2.79	$0.34

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

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

Period	Number of Shares	Range of Exercise Prices	
		Minimum	Maximum
Three months ended September 30, 2013	—	$—	$—
Nine months ended September 30, 2013	—	$—	$—
Three months ended September 30, 2012	1,498,100	$11.88	$14.34
Nine months ended September 30, 2012	1,502,100	$11.35	$14.34

9. Subsequent Event

On October 22, 2013, we settled the partial unwind agreements with counterparties (see Note 5). The agreement was to settle 50% of the outstanding call options (2015 notes hedges) and warrants in net cash on the day following the expiration of our exchange offer for our outstanding 2015 notes which resulted in our receipt of $20.3 million in total cash from the counterparties. After the settlement, 8.1 million warrants remain outstanding with a strike price of $15.81 and continue to be accounted for as equity. The 2015 notes hedges with two counterparties remain outstanding whereby we have the option to receive the cash equivalent of the conversion spread on approximately 8.1 million shares of our common stock based upon a strike price of $12.35 per share, subject to certain conversion rate adjustments in the 2015 notes.

On October 24, 2013, we extinguished $72.3 million principal amount of our 2015 notes and $29.6 million principal amount of our 2029 notes pursuant to our exchange offers that expired on October 21, 2013. Total consideration paid to the holders of the 2015 notes consisted of $83.2 million in cash and $44.5 million in shares of our common stock (2,079,295 shares). Total consideration paid to holders of the 2029 notes consisted of $44.4 million in cash and $22.3 million in shares of our common stock (1,039,485 shares). Total consideration paid to the holders of the 2015 notes and 2029 notes excludes the accrued interest through the settlement date that was paid. The carrying value of the convertible notes at extinguishment was $66.6 million and $27.7 million for the 2015 notes and 2029 notes, respectively, and losses net of tax of $8.1 million for the 2015 notes and $3.3 million for the 2029 notes were recognized.

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

Management's discussion and analysis reviews our unaudited consolidated financial position at September 30, 2013, and the unaudited consolidated results of operations for the three and nine month periods ended September 30, 2013 and 2012, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2012.

Cautionary Statement Regarding Forward-Looking Information

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

- general economic conditions and other factors, including prevailing interest rate levels and stock and credit market performance which may affect (among other things) our ability to sell our products, our ability to access capital resources and the costs associated therewith, the fair value of our investments, which could result in 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 our Annual Report on Form 10-K for the year ended December 31, 2012.

Overview

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a lesser extent, we also sell life insurance policies. Under U.S. generally accepted accounting principles ("GAAP"), premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liabilities for policyholder account balances and not as expenses. Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender and other charges deducted from 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 four 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.

Annuity deposits by product type collected during the three and nine months ended September 30, 2013 and 2012, were as follows:

Product Type	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
	(Dollars in thousands)			
Fixed index annuities:				
Index strategies	$722,088	$547,230	$2,091,166	$1,568,989
Fixed strategy	254,399	315,029	782,944	885,589
	976,487	862,259	2,874,110	2,454,578
Fixed rate annuities:				
Single-year rate guaranteed	16,238	22,413	56,552	78,041
Multi-year rate guaranteed	47,281	45,037	142,828	205,934
Single premium immediate annuities	13,618	52,315	45,422	140,265
	77,137	119,765	244,802	424,240
Total before coinsurance ceded	1,053,624	982,024	3,118,912	2,878,818
Coinsurance ceded	42,004	36,539	129,183	167,986
Net after coinsurance ceded	$1,011,620	$945,485	$2,989,729	$2,710,832

Annuity deposits before coinsurance ceded increased 7% during the third quarter of 2013 and 8% during the nine months ended September 30, 2013 compared to the same periods in 2012. We attribute the continuing significant sales of our products to factors including the highly competitive rates of our products, our continued strong relationships with our national marketing organizations and field force of licensed, independent insurance agents, the increased attractiveness of safe money products in volatile markets, lower interest rates on competing products such as bank certificates of deposit and product enhancements including a new generation of guaranteed income withdrawal benefit riders. The extent to which this trend will be sustained in future periods is uncertain.

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

	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
Average yield on invested assets	5.02%	5.17%	4.99%	5.36%
Aggregate cost of money	2.22%	2.55%	2.26%	2.60%
Aggregate investment spread	2.80%	2.62%	2.73%	2.76%
Impact of:				
Investment yield - additional prepayment income	0.05%	0.04%	0.06%	0.04%
Cost of money benefit of over (under) hedging	0.03%	0.01%	0.04%	0.01%

Our investment spread for the nine months ended September 30, 2013 and three and nine months ended September 30, 2012 were 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. We eliminated the excess liquidity during the third quarter of 2013 and returned to a fully invested position. The callable government agency securities have been a cornerstone of our investment portfolio since our formation. Through the years they have provided very acceptable yields that met our spread requirements without any risk-based capital charges. We have been 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. However, in the current interest rate environment, we have been reluctant to reinvest the call redemption proceeds in government agency securities and only purchased $948.9 million in 2012 compared to $4.3 billion in calls. Consequently, we have been managing excess cash and other short-term investments throughout 2012 and into the third quarter of 2013. We ended the second quarter of 2013 with $815.9 million in excess cash and other short-term investments compared to $1.3 billion at the end of the first quarter of 2013 and $2.2 billion at the end of 2012. See Results of Operations - Net investment income for additional information regarding our excess liquidity.

The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration or early termination of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

As reported in previous filings, in response to the continuing 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 the 2013 and 2012 periods reflect the benefit from these reductions; however, the reductions in cost of money were offset by lower yields available on investments including those purchased with reinvestment of proceeds from bonds called for redemption. We expect to continue to manage policyholder crediting rates with the objective of restoring our investment spread to our 3.00% target. We have approximately 0.60% of room to reduce rates before we would reach minimum guaranteed rates on our entire book of business.

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

Results of Operations for the Three and Nine Months Ended September 30, 2013 and 2012

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 $30.0 billion during third quarter of 2013 and increased 13% to $29.0 billion for the nine months ended September 30, 2013 compared to $26.3 billion and $25.7 billion for the same periods in 2012. Our investment spread measured in dollars was $182.5 million during the third quarter of 2013 and $511.5 million for the nine months ended September 30, 2013 compared to $146.0 million and $447.5 million during the same periods in 2012. As previously mentioned, our investment spread 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 three and nine months ended September 30, 2013 has been positively impacted by decreases in the change in fair value of embedded derivatives due to an increase in the discount rate used to estimate our liability for policy growth (see Change in fair value of embedded derivatives).

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 during the three and nine months ended September 30, 2013 was a $11.1 million decrease in amortization of deferred sales inducements and a $18.5 million decrease in amortization of deferred policy acquisition costs and included the impact of account balance true ups as of September 30, 2013 and adjustment to future period assumptions for surrenders and certain expenses. The unlocking process increased net income for the three and nine months ended September 30, 2013 by $19.1 million. The impact of unlocking during the three and nine months ended September 30, 2012 was a $0.2 million decrease in amortization of deferred sales inducements and a $3.7 million increase in amortization of deferred policy acquisition costs, which increased net loss for the three months ended September 30, 2012 and decreased net income for the nine months ended September 30, 2012 by $2.2 million.

Net income for the 2013 periods was positively impacted by a revision of assumptions used in determining reserves held 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 for the three and nine months ended September 30, 2013 by $1.8 million and increased net income for the three and nine months ended September 30, 2013 by $1.1 million. For the three and nine months ended September 30, 2012, the impact from the revision of these assumptions decreased interest sensitive and index product benefits by $2.2 million, reduced the net loss for the three months ended September 30, 2012 by $1.4 million and increased net income for the nine months ended September 30, 2012 by $1.4 million.

Net income for the 2013 periods was negatively impacted due to the partial unwind agreements we entered into related to the 2015 notes hedges and 2015 warrants. The impact decreased the change in fair value of derivatives for the three and nine months ended September 30, 2013 by $11.4 million and decreased net income for the three and nine months ended September 30, 2013 by $6.7 million.

Operating income (a non-GAAP financial measure) increased 170% to $59.8 million in the third quarter of 2013 and increased 56% to $123.6 million for the nine months ended September 30, 2013 compared to $22.2 million and $79.3 million for the same periods in 2012.

In addition to net income, we have consistently utilized operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains (losses) on investments including net other than temporary impairment ("OTTI") losses recognized in operations, fair value changes in derivatives and embedded derivatives, losses 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.

The adjustments made to net income (loss) to arrive at operating income for the three and nine months ended September 30, 2013 and 2012 are set forth in the table that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Reconciliation of net income (loss) to operating income:				
Net income (loss)	$56,181	$(7,829)	$202,325	$21,401
Net realized (gains) losses and net OTTI losses on investments, net of offsets	890	1,415	(5,488)	5,823
Net effect of derivatives and embedded derivatives, net of offsets	2,229	19,000	(72,187)	42,478
Extinguishment of debt, net of income taxes	548	—	893	—
Litigation reserve, net of offsets	—	9,580	(1,969)	9,580
Operating income	$59,848	$22,166	$123,574	$79,282

Operating income for the 2013 periods includes benefit from unlocking which decreased amortization of deferred sales inducements by $12.6 million and amortization of deferred acquisition costs by $20.4 million and increased operating income by $21.3 million for the three and nine months ended September 30, 2013. The three and nine months ended September 30, 2012 includes expense from unlocking which increased amortization of deferred sales inducements by $2.4 million and amortization of deferred acquisition costs by $7.3 million and decreased operating income by $6.3 million.

Operating income for the 2013 periods also includes benefit from a revision of assumptions used in determining reserves held for living income benefit riders which decreased interest sensitive and index product benefits for the three and nine months ended September 30, 2013 by $1.8 million and increased operating income for the three and nine months ended September 30, 2013 by $1.1 million. For the three and nine months ended September 30, 2012, the impact decreased interest sensitive and index product benefits by $2.2 million and increased operating income by $1.4 million.

Net realized gains/losses on investments and net impairment losses recognized in operations fluctuate from period to period based upon changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. The amounts disclosed in the reconciliation above are net of related adjustments in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

Amounts attributable to the fair value accounting for fixed index annuity derivatives and embedded derivatives fluctuate from 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 above 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 the item disclosed in the reconciliation above relate primarily to a change in the discount rate used to estimate our embedded derivative liabilities which increased during the three and nine months ended September 30, 2013 as compared to the three and nine months ended September 30, 2012 as a result of an increase in the general level of interest rates during 2013.

Fair value accounting for the 2015 notes hedges and 2015 warrants fluctuates from year to year based upon changes in the fair value of our common stock, its dividend yield and its volatility. The net effect of derivatives and embedded derivatives, net of offsets adjustment to arrive at operating income for the three and nine months ended September 30, 2013 in the above reconciliation includes a positive $6.7 million related to the change in fair value of the 2015 notes hedges and 2015 warrants.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 11% to $26.5 million in the third quarter of 2013 and increased 10% to $71.4 million for the nine months ended September 30, 2013 compared to $23.9 million and $65.2 million for the same periods in 2012. The components of annuity product charges are set forth in the table that follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2013		2012		2013		2012	
	(Dollars in thousands)							
Surrender charges	$11,160		$11,240		$33,954		$35,037	
Lifetime income benefit riders (LIBR) fees	15,291		12,635		37,489		30,139	
	$26,451		$23,875		$71,443		$65,176	
Withdrawals from annuity policies subject to surrender charges	$79,693		$83,447		$239,003		$261,237	
Average surrender charge collected on withdrawals subject to surrender charges	14.0	%	13.4	%	14.2	%	13.3	%
Fund values on policies subject to LIBR fees	$2,681,460		$2,232,426		$6,996,570		$5,746,587	
Weighted average per policy LIBR fee	0.57	%	0.57	%	0.54	%	0.52	%

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. Decreases in surrender charges were primarily attributable to reductions in withdrawals subject to a surrender charge. The lower amount of withdrawals was influenced by the continuing low interest rate environment.

Net investment income increased 11% to $354.1 million in the third quarter of 2013 and 6% to $1.0 billion for the nine months ended September 30, 2013 compared to $318.6 million and $965.8 million for the same periods in 2012. This increase was principally attributable to the growth in our annuity business and a corresponding increase in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 15% to $28.4 billion for the third quarter of 2013 and 14% to $27.3 billion for the nine months ended September 30, 2013 compared to $24.7 billion and $24.0 billion for the same periods in 2012. The average yield earned on average invested assets was 5.02% for the third quarter of 2013 and 4.99% for the nine months ended September 30, 2013 compared to 5.17% and 5.36% for the same periods in 2012.

The decrease in yield earned on average invested assets was attributable to yields on investments purchased in 2012 and the nine months ended September 30, 2013 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 the periods 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 $0.3 billion and $1.3 billion for the three and nine months ended September 30, 2013 compared to $2.0 billion and $1.4 billion for the same periods in 2012, respectively. However, we did eliminate our excess liquidity during the third quarter of 2013 and returned to a fully invested position. The average yield on our cash and short-term investments for the three and nine months ended September 30, 2013 was 0.64% and 0.48% compared to 0.26% and 0.17% for the same periods in 2012, respectively. Additionally, net investment income and average yield was positively impacted by prepayment and fee income received resulting in additional net investment income of $3.8 million and $11.8 million for the three and nine months ended September 30, 2013 compared to $2.2 million and $7.8 million for the same periods in 2012, respectively.

Change in fair value of derivatives consists primarily of call options purchased to fund annual index credits on fixed index annuities and the 2015 notes hedges and 2015 warrants related to our 2015 notes. The components of change in fair value of derivatives are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Call options:				

Gain (loss) on option expiration	$144,830	$57,637	$354,530	$(17,663)
Change in unrealized gain/loss	(15,402)	103,098	177,752	297,677
2015 notes hedges	73,504	1,839	101,799	(5,573)
2015 warrants	(9,199)	—	(9,199)	—
Interest rate swap	(496)	(1,171)	4,039	(4,319)
Interest rate caps	(209)	(313)	2,109	(718)
	$193,028	$161,090	$631,030	$269,404

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The differences between the change in fair value of derivatives between periods 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 the three and nine months ended September 30, 2013 and 2012 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
S&P 500 Index				
Point-to-point strategy	2.3 - 11.5%	0.0 - 11.7%	1.5 - 11.5%	0.0 - 11.7%
Monthly average strategy	0.0 - 18.2%	0.0 - 19.3%	0.0 - 19.0%	0.0 - 19.3%
Monthly point-to-point strategy	0.0 - 18.2%	0.0 - 18.0%	0.0 - 19.0%	0.0 - 18.0%
Fixed income (bond index) strategies	0.0 - 0.0%	1.6 - 10.0%	0.0 - 8.0%	1.6 - 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 included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

The fair value of the 2015 warrants primarily changes based upon changes in the price of our common stock. 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 liabilities 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 and the amount of the change in the related embedded derivative liability are not equal for the three and nine months ended September 30, 2013 by $2.2 million. See Note 5 to our consolidated financial statements for a discussion of the unwind agreements, the 2015 notes hedges and the 2015 warrants. See Note 9 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012 for a further discussion of the 2015 notes hedges and 2015 warrants.

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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$3,965	$3,028	$24,608	$8,076
Gross realized losses	(2,096)	(180)	(5,106)	(535)
	1,869	2,848	19,502	7,541
Equity securities:				
Gross realized gains	—	—	9,571	562
Other investments:				

Gain on sale of real estate	201	53	1,505	2,948
Loss on sale of real estate	(278)	—	(744)	—
Impairment losses on real estate	(678)	(830)	(823)	(3,473)
	(755)	(777)	(62)	(525)
Mortgage loans on real estate:				
Increase in allowance for credit losses	(3,191)	(3,309)	(4,814)	(15,503)
	$(2,077)	$(1,238)	$24,197	$(7,925)

Losses in 2013 were realized primarily due to strategies in place to reposition the fixed maturity security portfolio that result in improved net investment income, risk or duration profiles as they pertain to our asset liability management. One corporate issue was sold at a loss in 2013 due to the our fundamental, long-term concern with the issuer's ability to meet its future financial obligations.

See Financial Condition - Investments for additional discussion of allowance for credit losses on mortgage loans on real estate.

Net OTTI losses recognized in operations decreased to $0.2 million in the third quarter of 2013 compared to $1.7 million for the same period in 2012 and increased to $6.2 million for the nine months ended September 30, 2013 compared to $5.5 million for the same period in 2012. See Financial Condition - Investments and Note 3 to our consolidated financial statements for additional discussion of write downs of securities for other than temporary impairments.

Interest sensitive and index product benefits increased 33% to $328.0 million in the third quarter of 2013 and 69% to $889.8 million for the nine months ended September 30, 2013 compared to $246.1 million and $528.0 million for the same periods in 2012. The components of interest credited to account balances are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Index credits on index policies	$233,316	$152,150	$610,458	$253,490
Interest credited (including changes in minimum guaranteed interest for fixed index annuities)	81,022	83,506	242,240	245,967
Living income benefit rider	13,638	10,449	37,112	28,504
	$327,976	$246,105	$889,810	$527,961

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 $235.4 million and $615.4 million for the three and nine months ended September 30, 2013, compared to $152.7 million and $253.6 million for the same periods in 2012. The decrease in interest credited was due to a decrease in the average rate credited to the annuity liabilities outstanding receiving a fixed rate of interest. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 14% to $30.0 billion during third quarter of 2013 and increased 13% to $29.0 billion for the nine months ended September 30, 2013 compared to $26.3 billion and $25.7 billion for the same periods in 2012. The increases in benefits recognized for living income benefit rider 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 349% to $34.6 million in the third quarter of 2013 and 265% to $184.0 million for the nine months ended September 30, 2013 compared to $7.7 million and $50.4 million for the same periods in 2012. In general, amortization of deferred sales inducements has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 97% of our net annuity deposits during the three and nine months ended September 30, 2013 and 2012. 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. 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 exceeds ten years. Amortization of deferred sales inducements is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Amortization of deferred sales inducements before gross profit adjustments	$27,860	$35,987	$102,091	$102,596

Gross profit adjustments:				
Fair value accounting for derivatives and embedded derivatives	7,138	(26,972)	77,925	(49,609)
Net realized gains (losses) on investments and net OTTI losses recognized in operations	(373)	(1,306)	3,976	(2,628)
Amortization of deferred sales inducements after gross profit adjustments	$34,625	$7,709	$183,992	$50,359

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 three and nine months ended September 31, 2013 and 2012. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012. Change in fair value of embedded derivatives primarily relates to fixed index annuity embedded derivatives and 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 liability for policy growth; and (iii) the growth in the host component of the policy liability. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012. The primary reasons for the decrease in the change in fair value of the fixed index annuity embedded derivatives during the three and nine months ended September 30, 2013 was an increase in the discount rate used in estimating our liability for policy growth.. The discount rates used in estimating our liability for policy growth increased as a result of the increase in the general level of interest rates during 2013. The changes for the three and nine months ended September 30, 2013 also include increases of $75.8 million and $104.0 million, respectively, compared to an increase of $1.8 million and decrease of $5.6 million for the same periods in 2012, respectively, in the fair value of the 2015 notes embedded conversion derivative.

Interest expense on notes payable increased 81% to $13.0 million in the third quarter of 2013 and 27% to $27.0 million for the nine months ended September 30, 2013 compared to $7.1 million and $21.2 million for the same periods in 2012. The increase is primarily attributable to interest expense on the $400 million of 6.625% senior unsecured notes we issued on July 17, 2013.

Interest expense on subordinated debentures decreased 6% to $3.0 million in the third quarter of 2013 and 13% to $9.1 million for the nine months ended September 30, 2013 compared to $3.2 million and $10.4 million for the same periods in 2012. The decrease is primarily attributable to the redemption of $22 million principal amount of our 8% Convertible Junior Subordinated Debentures in July 2012. $169.6 million principal amount of the subordinated debentures has floating rates of interest based upon the three month London Interbank Offered Rate plus an applicable margin. See Financial Condition - Liabilities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

Amortization of deferred policy acquisition costs increased 93% to $50.0 million in the third quarter of 2013 and 153% to $265.5 million for the nine months ended September 30, 2013 compared to $26.0 million and $105.1 million for the same periods in 2012. In general, amortization of deferred policy acquisition costs has been increasing each period due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The 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 losses on investments and net OTTI losses recognized in operations. As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts.

Amortization of deferred policy acquisition costs is summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Amortization of deferred policy acquisition costs before gross profit adjustments	$40,184	$61,590	$153,815	$171,686
Gross profit adjustments:				
Fair value accounting for derivatives and embedded derivatives	10,393	(33,559)	106,098	(62,144)
Net realized gains (losses) on investments and net OTTI losses recognized in operations	(543)	(2,077)	5,621	(4,456)
Amortization of deferred policy acquisition costs after gross profit adjustments	$50,034	$25,954	$265,534	$105,086

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 three and nine months ended September 31, 2013 and 2012. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

Other operating costs and expenses decreased 43% to $20.7 million in the third quarter of 2013 and 15% to $65.0 million for the nine months ended September 30, 2013 compared to $36.2 million and $76.8 million for the same periods in 2012. The decrease for the three month period ended September 30, 2013 was primarily due to an estimated litigation liability of $17.5 million which was recorded in the third quarter of 2012. This decrease was offset by an increase in compensation costs that vary based on the Company's stock price. The decrease for the nine month period ended September 30, 2013 was primarily due to the estimated litigation liability discussed above and a $3.2 million decrease in a litigation liability associated with a previous lawsuit settlement that represents undistributed settlement awards due to contractholders and beneficiaries that could not be located or did not come forward to claim such awards during the agreed upon time period, which expired during 2013. This decrease was offset by $8.5 million of guaranty fund assessments related to the insolvency of Executive Life Insurance Company of New York which was recorded during 2013 and an increase in compensation costs that vary based on the Company's stock price.

Income tax expense (benefit) increased to $29.5 million in the third quarter of 2013 and to $107.7 million for the nine months ended September 30, 2013 compared to $(4.6) million and $10.9 million for the same periods in 2012. The change in income tax expense (benefit) was primarily due to changes in income (loss) before income taxes. Income tax expense (benefit) and the resulting effective tax rate are based upon two components of income (loss) before income taxes (benefits) ("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 period to period based primarily on the relative size of pretax income (loss) from the two sources. The effective tax rate for the three and nine months ended September 30, 2013 was 34.5% and 34.7%, respectively, and 37.1% and 33.8% for the same periods in 2012, respectively. The higher effective tax rate for the three months ended September 30, 2012 was due to the overall net loss and more of that net loss being generated by the non-life insurance subsidiaries that are generally taxed at an effective rate of 41.5%.

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 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:

	September 30, 2013			December 31, 2012		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Fixed maturity securities:						
United States Government full faith and credit	$4,907	—	%	$5,154	—	%
United States Government sponsored agencies	1,239,603	4.2	%	1,772,025	6.5	%
United States municipalities, states and territories	3,461,131	11.6	%	3,578,323	13.0	%
Foreign government obligations	92,682	0.3	%	105,259	0.4	%
Corporate securities	16,817,793	56.5	%	14,542,860	52.8	%
Residential mortgage backed securities	2,118,827	7.1	%	2,888,113	10.5	%
Commercial mortgage backed securities	1,590,310	5.4	%	357,982	1.3	%
Other asset backed securities	1,013,837	3.4	%	998,508	3.6	%
Total fixed maturity securities	26,339,090	88.5	%	24,248,224	88.1	%
Equity securities	9,708	—	%	53,422	0.2	%
Mortgage loans on real estate	2,593,851	8.7	%	2,623,940	9.5	%
Derivative instruments	625,236	2.1	%	415,258	1.5	%
Other investments	212,870	0.7	%	196,366	0.7	%
	$29,780,755	100.0	%	$27,537,210	100.0	%

Fixed Maturity Securities

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

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

Rating Agency Rating	September 30, 2013 Carrying Amount	Percent of Fixed Maturity Securities		December 31, 2012 Carrying Amount	Percent of Fixed Maturity Securities	
	(Dollars in thousands)					
Aaa/Aa/A	$15,889,898	60.3	%	$14,613,775	60.3	%
Baa	8,990,901	34.2	%	8,190,220	33.8	%
Total investment grade	24,880,799	94.5	%	22,803,995	94.1	%
Ba	494,981	1.9	%	365,102	1.5	%
B	99,908	0.4	%	79,789	0.3	%
Caa and lower	695,562	2.6	%	862,650	3.5	%
In or near default	167,840	0.6	%	136,688	0.6	%
Total below investment grade	1,458,291	5.5	%	1,444,229	5.9	%
	$26,339,090	100.0	%	$24,248,224	100.0	%

The National Association of Insurance Commissioner's ("NAIC") Securities Valuation Office ("SVO") is responsible for the 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 an NAIC designation and/or unit price. Typically, if a security has been rated by a Nationally Recognized Statistical Rating Organization ("NRSRO"), the SVO utilizes that rating and assigns an NAIC designation based upon the following system:

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

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 residential mortgage-backed securities ("RMBS") and commercial mortgage-backed securities (“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:

	September 30, 2013					December 31, 2012				
NAIC Designation	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount		Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount	
	(Dollars in thousands)					(Dollars in thousands)				
1	$15,945,089	$16,367,238	$16,367,238	62.1	%	$13,737,381	$15,250,560	$15,250,560	62.9	%
2	9,277,558	9,352,577	9,352,577	35.5	%	7,838,186	8,533,121	8,533,121	35.2	%
3	533,890	509,433	524,802	2.0	%	398,294	387,222	401,789	1.7	%
4	100,907	93,126	93,126	0.4	%	53,879	56,151	56,151	0.2	%
5	—	—	—	—	%	—	—	—	—	%
6	1,884	1,347	1,347	—	%	5,375	6,603	6,603	—	%
	$25,859,328	$26,323,721	$26,339,090	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 recognized any OTTI is as follows as of September 30, 2013:

Collateral Type	Principal Amount	Amortized Cost	Fair Value
	(Dollars in thousands)		
OTTI has not been recognized			
Government agency	$736,217	$674,219	$707,533
Prime	606,642	575,629	615,401
Alt-A	33,094	33,482	33,413
	$1,375,953	$1,283,330	$1,356,347
OTTI has been recognized			
Prime	$493,889	$425,986	$455,228
Alt-A	368,256	289,885	307,252
	$862,145	$715,871	$762,480
Total by collateral type			
Government agency	$736,217	$674,219	$707,533
Prime	1,100,531	1,001,615	1,070,629
Alt-A	401,350	323,367	340,665
	$2,238,098	$1,999,201	$2,118,827
Total by NAIC designation			
1	$1,950,683	$1,739,173	$1,850,871
2	192,269	175,920	180,714
3	65,094	58,300	61,671
4	27,272	23,924	24,257
6	2,780	1,884	1,314
	$2,238,098	$1,999,201	$2,118,827

The amortized cost and fair value of fixed maturity securities at September 30, 2013, by contractual maturity, are presented in Note 3 to our consolidated financial statements in this form 10-Q, which is incorporated by reference in this Item 2.

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)		
September 30, 2013				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	2	$1,020	$(43)	$977
United States Government sponsored agencies	15	1,209,894	(78,915)	1,130,979
United States municipalities, states and territories	125	518,853	(30,593)	488,260
Foreign government obligations	3	29,777	(2,792)	26,985
Corporate securities:				
Finance, insurance and real estate	95	1,493,700	(82,965)	1,410,735
Manufacturing, construction and mining	215	3,105,364	(163,796)	2,941,568
Utilities and related sectors	139	1,684,540	(85,686)	1,598,854
Wholesale/retail trade	32	356,836	(20,153)	336,683
Services, media and other	73	921,462	(46,698)	874,764
Residential mortgage backed securities	50	356,408	(25,979)	330,429
Commercial mortgage backed securities	104	1,347,718	(79,425)	1,268,293
Other asset backed securities	31	471,484	(24,297)	447,187
	884	$11,497,056	$(641,342)	$10,855,714
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	$76,212	$(15,369)	$60,843
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:				
Insurance	1	$76,088	$(14,567)	$61,521
Equity securities, available for sale:				
Finance, insurance and real estate	1	$10,125	$(1,403)	$8,722

Unrealized losses increased $572.8 million from $83.9 million at December 31, 2012 to $656.7 million at September 30, 2013. Unrealized losses primarily increased due to a rise in ten-year treasury yields during the nine months ended September 30, 2013.

The following table sets forth the composition by credit quality (NAIC designation) of fixed maturity securities with gross unrealized losses:

NAIC Designation	Carrying Value of Securities with Gross Unrealized Losses	Percent of Total		Gross Unrealized Losses		Percent of Total	
	(Dollars in thousands)						
September 30, 2013							
1	$6,073,408	55.6	%	$(369,632	)	56.3	%
2	4,498,927	41.2	%	(244,828	)	37.3	%
3	300,146	2.7	%	(32,761	)	5.0	%
4	58,131	0.5	%	(8,920	)	1.3	%
5	—	—	%	—		—	%
6	1,314	—	%	(570	)	0.1	%
	$10,931,926	100.0	%	$(656,711	)	100.0	%
December 31, 2012							
1	$1,992,406	61.5	%	$(38,125	)	46.2	%
2	1,071,009	33.1	%	(23,969	)	29.1	%
3	157,464	4.9	%	(19,410	)	23.5	%
4	13,812	0.4	%	(299	)	0.4	%
5	—	—	%	—		—	%
6	1,812	0.1	%	(665	)	0.8	%
	$3,236,503	100.0	%	$(82,468	)	100.0	%

Our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 885 and 198 securities, respectively) have been in a continuous unrealized loss position at September 30, 2013 and December 31, 2012, along with a description of the factors causing the unrealized losses is presented in Note 3 to our consolidated financial statements in this Form 10-Q, which is incorporated by reference in the Item 2.

The amortized cost and fair value of fixed maturity securities and equity securities in an unrealized loss position and the number of months in a continuous unrealized loss position (fixed maturity securities that carry an NRSRO rating of BBB/Baa or higher considered investment grade) were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2013				
Fixed maturity securities:				
Investment grade:				
Less than six months	751	$9,458,574	$8,974,493	$(484,081)
Six months or more and less than twelve months	66	1,549,028	1,430,457	(118,571)
Twelve months or greater	13	222,456	201,879	(20,577)
Total investment grade	830	11,230,058	10,606,829	(623,229)
Below investment grade:				
Less than six months	40	164,897	160,227	(4,670)
Six months or more and less than twelve months	1	19,994	13,810	(6,184)
Twelve months or greater	14	158,319	135,691	(22,628)
Total below investment grade	55	343,210	309,728	(33,482)
	885	$11,573,268	$10,916,557	$(656,711)
December 31, 2012				
Fixed maturity securities:				
Investment grade:				
Less than six months	106	$2,464,476	$2,440,131	$(24,345)
Six months or more and less than twelve months	4	40,054	39,151	(903)
Twelve months or greater	14	165,718	155,618	(10,100)
Total investment grade	124	2,670,248	2,634,900	(35,348)
Below investment grade:				
Less than six months	23	110,435	108,531	(1,904)
Six months or more and less than twelve months	9	135,915	129,086	(6,829)
Twelve months or greater	41	387,806	349,419	(38,387)
Total below investment grade	73	634,156	587,036	(47,120)
Equity securities:				
Less then six months	—	—	—	—
Six months or more and less than twelve months	1	10,125	8,722	(1,403)
Twelve months or greater	—	—	—	—
Total equity securities	1	10,125	8,722	(1,403)
	198	$3,314,529	$3,230,658	$(83,871)

The amortized cost and fair value of fixed maturity securities (excluding United States Government and United States Government sponsored agency securities) segregated by investment grade (NRSRO rating of BBB/Baa or higher) and below investment grade and equity securities that had unrealized losses greater than 20% and the number of months in a continuous unrealized loss position were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2013				
Investment grade:				
Less than six months	5	$57,429	$43,598	$(13,831)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	1	20,000	14,981	(5,019)
Total investment grade	6	77,429	58,579	(18,850)
Below investment grade:				
Less than six months	4	101,206	78,310	(22,896)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	2	1,884	1,314	(570)
Total below investment grade	6	103,090	79,624	(23,466)
	12	$180,519	$138,203	$(42,316)
December 31, 2012				
Investment grade:				
Less than six months	—	$—	$—	$—
Six months or more and less than twelve months	1	20,000	15,379	(4,621)
Twelve months or greater	—	—	—	—
Total investment grade	1	20,000	15,379	(4,621)
Below investment grade:				
Less than six months	1	1,416	1,131	(285)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	3	9,324	7,148	(2,176)
Total below investment grade	4	10,740	8,279	(2,461)
	5	$30,740	$23,658	$(7,082)

The amortized cost and fair value of fixed maturity securities, by contractual maturity, that were in an unrealized loss position are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
September 30, 2013				
Due in one year or less	$—	$—	$—	$—
Due after one year through five years	20,005	19,961	—	—
Due after five years through ten years	4,705,261	4,494,011	—	—
Due after ten years through twenty years	2,597,951	2,435,217	—	—
Due after twenty years	1,998,229	1,860,616	76,212	60,843
	9,321,446	8,809,805	76,212	60,843
Residential mortgage backed securities	356,408	330,429	—	—
Commercial mortgage backed securities	1,347,718	1,268,293	—	—
Other asset backed securities	471,484	447,187	—	—
	$11,497,056	$10,855,714	$76,212	$60,843
December 31, 2012				
Due in one year or less	$—	$—	$—	$—
Due after one year through five years	22,160	21,059	—	—
Due after five years through ten years	623,802	617,848	—	—
Due after ten years through twenty years	1,319,250	1,302,283	—	—
Due after twenty years	416,621	405,426	76,088	61,521
	2,381,833	2,346,616	76,088	61,521
Residential mortgage backed securities	508,576	480,848	—	—
Commercial mortgage backed securities	163,565	161,582	—	—
Other asset backed securities	174,342	171,369	—	—
	$3,228,316	$3,160,415	$76,088	$61,521

International Exposure

We hold fixed maturity securities with international exposure. As of September 30, 2013, 15% of the carrying value of our fixed maturity securities was comprised of corporate debt securities of issuers based outside of the United States and debt securities of foreign governments. All of these securities are denominated in U.S. dollars and all are investment grade (NAIC designation of either 1 or 2), except for sixteen securities with a total fair value of $90.4 million which have an NAIC 3 designation and two securities with a total fair value of $21.5 million which have an NAIC 4 designation. Our investment professionals analyze each holding for credit risk by economic and other factors of each country and industry. The following table presents our international exposure in our fixed maturity portfolio by country or region:

	September 30, 2013		
	Amortized Cost	Carrying Amount/Fair Value	Percent of Total Carrying Amount
	(Dollars in thousands)		
GIIPS (1)	$234,317	$235,415	0.9%
Asia/Pacific	194,142	191,715	0.7%
Non-GIIPS Europe	1,786,022	1,795,396	6.8%

Latin America	195,147	187,546	0.7%
Non-U.S. North America	795,883	797,148	3.0%
Australia & New Zealand	382,062	379,263	1.5%
Other	371,013	389,596	1.5%
	$3,958,586	$3,976,079	15.1%

(1) Greece, Ireland, Italy, Portugal and Spain continue to cause credit risk as economic conditions in these countries continue to be volatile, especially within the financial and banking sectors. All of our exposure in GIIPS are corporate securities with issuers domiciled in these countries. None of our foreign government obligations were held in any of these countries.

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Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment, we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 25% or greater change in market price relative to its amortized cost and a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our RMBS as we monitor all of our RMBS on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At September 30, 2013, the amortized cost and fair value of securities on the watch list are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
		(Dollars in thousands)				
Investment grade						
Corporate fixed maturity securities:						
Finance	2	$40,000	$(6,036)	$33,964	25 - 34	0 - 23
Industrial	3	28,870	(7,132)	21,738	11 - 37	0 - 4
Industrial	1	9,357	75	9,432		
	6	$78,227	$(13,093)	$65,134		
Below investment grade						
Corporate fixed maturity securities:						
Industrial	1	20,604	(1,408)	19,196	28	—
	7	$98,831	(14,501)	$84,330		

A majority of the investment grade securities on the watch list have Eurozone exposure that has contributed to their depressed fair values. Our analysis of all of the securities on the watch list that we have determined are temporarily impaired and their credit performance at September 30, 2013 is as follows:

Finance: The decline in value of these securities which are rated investment grade is due to the continued wide spreads as a result of the ongoing concerns relating to capital, asset quality and earnings stability due to the financial events of the past three years and the ongoing events in the Eurozone, specifically the sovereign debt crisis. While these issuers have had their financial position and profitability weakened by the credit and liquidity crisis, we have determined that these securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of each individual issuer.

Industrial: The decline in value of these securities relates to ongoing operational issues or recent corporate actions. These issues have caused the price for these securities to decline; however, the companies have strong liquidity and ample time to strengthen their credit profile. We have determined that these securities were not other than temporarily impaired due to the issuers' very strong market positions, restructuring actions that are expected to favorably impact future profitability and a history of strong reliable operating performance, improving economic conditions and rising security prices.

Other Than Temporary Impairments

We have a policy and process in place to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.
We recognized other than temporary impairments and additional credit losses on a number of securities for which we have previously recognized OTTI. A summary of OTTI is presented in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.
Several factors led us to believe that full recovery of amortized cost will not be expected. A discussion of these factors and our policy and process in place to identify securities that could potentially have impairment that is other than temporary is in Note 3 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location, and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, adjusted for amortization of premiums and accrual of discounts net of valuation allowances. At September 30, 2013 and December 31, 2012 the largest principal amount outstanding for any single mortgage loan was $14.6 million and $15.0 million, respectively, and the average loan size was $2.5 million and $2.4 million as of September 30, 2013 and December 31, 2012. respectively. We have the contractual ability to pursue full personal recourse on 10.7% of the loans and partial personal recourse on 28.7% of the loans. In addition, the average loan to value ratio for the overall portfolio was 54.2% and 53.5% at September 30, 2013 and December 31, 2012, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value is indicative of our conservative underwriting policies and practices for making commercial mortgage loans and may not be indicative of collateral values at the current reporting date. Our current practice is to only obtain market value appraisals of the underlying collateral at the inception of the loan unless we identify indicators of impairment in our ongoing analysis of the portfolio, in which case, we either calculate a value of the collateral using a capitalization method or obtain a current appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type in Note 4 - Mortgage Loans on Real Estate in our unaudited consolidated financial statements.

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At September 30, 2013, we had commitments to fund commercial mortgage loans totaling $81.2 million, with fixed interest rates ranging from 4.49% to 5.15%. During 2012 and 2013, due to historically low interest rates, the commercial mortgage loan industry has been very competitive. This competition has resulted in a number of borrowers refinancing with other lenders. For the nine months ended September 30, 2013, we received $329.2 million in cash for loans being paid in full compared to $269.6 million for the nine months ended September 30, 2012. Some of the loans being paid off have either reached their maturity or are nearing maturity; however, some borrowers are paying the prepayment fee and refinancing at a lower rate.

See Note 4 to our unaudited consolidated financial statements for a presentation of our specific and general loan loss allowances, foreclosure activity and troubled debt restructure analysis.

We increased the specific allowance for loan losses by $2.7 million on six mortgage loans with outstanding principal due totaling $17.0 million and increased the specific allowance for loan losses by $4.9 million on nine mortgage loans with outstanding principal due totaling $23.7 million during the three and nine months ended September 30, 2013, respectively. We recorded impairment losses of $2.9 million on six mortgage loans with outstanding principal due totaling $20.3 million and impairment losses of $13.2 million on 21 mortgage loans with outstanding principal due totaling $64.0 million during the same periods in 2012.

In 2012, we initiated a process by which we evaluate the credit quality of each of our commercial mortgage loans. This process utilizes each loan's debt service coverage ratio as a primary metric. A summary of our portfolio by debt service coverage ratio follows:

	September 30, 2013			December 31, 2012		
	Principal Outstanding	Percent of Total Principal Outstanding		Principal Outstanding	Percent of Total Principal Outstanding	
	(Dollars in thousands)					
Debt Service Coverage Ratio:						
Greater than or equal to 1.5	$1,581,358	60.2	%	$1,517,840	57.1	%
Greater than or equal to 1.2 and less than 1.5	571,643	21.8	%	604,512	22.7	%
Greater than or equal to 1.0 and less than 1.2	228,639	8.7	%	262,165	9.9	%
Less than 1.0	243,923	9.3	%	274,366	10.3	%
	$2,625,563	100.0	%	$2,658,883	100.0	%

At September 30, 2013, we have two mortgages that are in the process of being satisfied by our taking ownership of the real estate serving as collateral. These loans have an outstanding principal balance of $4.7 million and we have recorded specific loan loss allowances totaling $0.9 million, all of which was recognized prior to 2013. We also have 11 commercial mortgage loans at September 30, 2013 with an outstanding principal balance of $30.7 million that have been given "workout" terms which generally allow for interest only payments or the capitalization of interest for a specified period of time and we have recorded specific loan loss allowances on six of these loans (principal balance of $12.9 million) of $3.6 million. At September 30, 2013, we had no commercial mortgage loans that were delinquent (60 days or more past due at the reporting date). The total outstanding principal balance of these 13 loans is $35.4 million, which represents less than 2% of our total mortgage loan portfolio.

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

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Mortgage loans with allowances	$50,055	$53,110
Mortgage loans with no allowance for losses	18,782	27,765
Allowance for probable loan losses	(20,118)	(23,134)
Net carrying value of impaired mortgage loans	$48,719	$57,741

Derivative Instruments

Our derivative instruments primarily consist of call options purchased to provide the income needed to fund the annual index credits on our fixed index annuity products. 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. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options.

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. A presentation of our derivative instruments along with a discussion of the business strategy involved with our derivatives is included in Note 5 to our unaudited consolidated financial statements in this Form 10-Q, which is incorporated by reference in this Item 2.

Liquidity and Capital Resources

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were $1.9 billion for the nine months ended September 30, 2013 compared to $1.6 billion for the nine months ended September 30, 2012, with the increase attributable to a $373.7 million increase in net annuity deposits after coinsurance and a $94.1 million (after coinsurance) increase in funds returned to policyholders. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed maturity securities and fixed rate commercial mortgage loans.

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. We need liquidity primarily to service our debt, including the senior notes, convertible senior notes and subordinated debentures issued to subsidiary trusts, pay operating expenses and pay dividends to stockholders. Our assets consist primarily of the capital stock and surplus notes of our subsidiaries. Accordingly, our future cash flows depend upon the availability of dividends, surplus note interest payments and other statutorily permissible payments from our subsidiaries, such as payments under our investment advisory agreements and tax allocation agreement with our subsidiaries. These sources provide adequate cash flow to us to meet our current and reasonably foreseeable future obligations and we expect they will be adequate to fund our parent company cash flow requirements for the rest of 2013.

The ability of our life insurance subsidiaries to pay dividends or distributions, including surplus note payments, will be limited by applicable laws and regulations of the states in which our life insurance subsidiaries are domiciled, which subject our life insurance subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, our insurance subsidiaries to maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay.

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 net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory capital and surplus at the preceding December 31. For 2013, up to $165.6 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 statutory earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities in the life subsidiary's state of domicile. American Equity Life had $876.3 million of statutory earned surplus at September 30, 2013.

The maximum distribution permitted by law or contract is not necessarily indicative of an insurer's actual ability to pay such distributions, which may be constrained by business and regulatory considerations, such as the impact of such distributions on surplus, which could affect the insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends or make other distributions. Further, state insurance laws and regulations require that the statutory surplus of our life subsidiaries following any dividend or distribution must be reasonable in relation to their outstanding liabilities and adequate for their financial needs. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from A.M. Best. Given recent economic events that have affected the insurance industry, both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries. As of September 30, 2013, we estimate American Equity Life has sufficient statutory capital and surplus, combined with capital available to the holding company, to meet this rating objective. However, this capital may not be sufficient if significant future losses are incurred or A.M. Best modifies its rating criteria and, given the current market conditions, access to additional capital could be limited.

The transfer of funds by American Equity Life is also restricted by a covenant in our line of credit agreement which requires American Equity Life to maintain a minimum risk-based capital ratio of 275% and a minimum level of statutory surplus equal to the sum of 1) 80% of statutory surplus at December 31, 2010, 2) 50% of the statutory net income for each fiscal quarter ending after December 31, 2010, and 3) 50% of all capital contributed to American Equity Life after September 30, 2010. American Equity Life's risk-based capital ratio was 332% at December 31, 2012. Under this agreement we are also required to maintain a maximum ratio of adjusted debt to total adjusted capital of 0.35 and a minimum cash coverage ratio of 1.0.

Cash and cash equivalents of the parent holding company at September 30, 2013, was $421.3 million, which includes approximately $376 million in remaining net proceeds from the $400 million issuance of senior unsecured notes described below. In addition, we have a $160 million line of credit, with no borrowings outstanding, available through January 2014 for general corporate purposes of the parent company and its subsidiaries. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution under a currently effective shelf registration statement on Form S-3. The terms of any offering would be established at the time of the offering, subject to market conditions.

On July 17, 2013, we issued $400 million aggregate principal amount of senior unsecured notes due 2021 which bear interest at 6.625% per year and will mature on July 15, 2021. We used $15 million of the net proceeds from the issuance to repay the entire amount outstanding under our revolving credit facility and, in October 2013, used $127.6 million to pay the cash consideration portion of the notes tendered in connection with an offer to exchange any and all of our outstanding 2029 notes and 2015 notes for cash and newly issued shares of common stock. The aggregate principal amount of 2029 notes and 2015 notes retired through the exchange offers was $29.6 million and $72.3 million, respectively. We intend to use the remaining net proceeds from the notes issuance to tender for, redeem or repurchase the $213.9 million aggregate principal amount of 2029 notes and 2015 notes that did not accept the exchange offers and are currently outstanding. The form and timing of any such activity will be dependent upon market conditions and other factors and there can be no assurance that any such transactions can be completed prior to the December 2014 call date for the 2029 notes or the September 2015 maturity date for the 2015 notes.

On March 25, 2013, notice of mandatory redemption was issued for our 2024 notes. $25.8 million principal amount of the convertible notes exercised their conversion rights prior to the April 30, 2013 mandatory redemption date. The holders of these notes received the principal amount of their notes in cash and the conversion premium in shares of our common stock, for which 216,729 shares were issued. The balance of the convertible notes ($2.5 million principal amount) was redeemed for cash.

New Accounting Pronouncements

See Note 1 - Significant Accounting Policies to the Consolidated Financial Statements, which is incorporated by reference in this Item 2, for new accounting pronouncement disclosures that supplements the disclosure in Note 1 - Significant Accounting Policies to the Consolidated Financial Statements of our 2012 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs: and (vi) other factors. An OTTI shall be considered to have occurred when we have an intention to sell available for sale securities in an unrealized loss position. If we do not intend to sell a debt security, we consider all available evidence to make an assessment of whether it is more likely than not that we will be required to sell the security before the recovery of its amortized cost basis. If it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, an OTTI will be considered to have occurred.

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate subordinated debentures. Our floating rate trust preferred securities bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was $169.6 million at September 30, 2013, of which $85.5 million has been swapped to a fixed rate and $79.0 million has been capped for a term of seven years beginning March or July 2014 (See Note 5 to our unaudited consolidated financial statements). The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (caps, participation rates or asset fee rates for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

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

If interest rates were to increase 10% (37 basis points) from levels at September 30, 2013, we estimate that the fair value of our fixed maturity securities would decrease by approximately $853.2 million. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be a decrease of $212.0 million in accumulated other comprehensive income and a decrease in stockholders' equity. The computer models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2012.

At September 30, 2013, 31% of our fixed income securities have call features of which 5% ($1.3 billion) will become subject to call redemption during the next twelve months. During the nine months ended September 30, 2013 and 2012, we received $1.1 billion and $3.8 billion, respectively, in redemption proceeds related to the exercise of such call options. We have reinvestment risk related to these redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to the redeemed bonds. Such reinvestment risk typically occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on annuity liabilities, we have the ability to reduce crediting rates (caps, participation rates or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At September 30, 2013, approximately 99% of our annuity liabilities were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies.

We purchase call options on the applicable indices to fund the annual index credits on our fixed index annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for fixed index products. For the nine months ended September 30, 2013 and 2012, the annual index credits to policyholders on their anniversaries were $610.5 million and $253.5 million, respectively. Proceeds received at expiration of these options related to such credits were $615.4 million and $253.6 million for the nine months ended September 30, 2013 and 2012, respectively.

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15 and 15d-15, our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective as of September 30, 2013 in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7 - Commitments and Contingencies to the Consolidated Financial Statements, which is incorporated by reference in this Item 1, for litigation and regulatory disclosures that supplements the disclosure in Note 13 - Commitments and Contingencies to the Consolidated Financial Statements of our 2012 Annual Report on Form 10-K.

Item 1A. Risk Factors

Our 2012 Annual Report on Form 10-K described our Risk Factors. There have been no material changes to the Risk Factors during the nine months ended September 30, 2013.

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

There were no issuer purchases of equity securities for the quarter ended September 30, 2013.

We have a Rabbi Trust, the NMO Deferred Compensation Trust, which purchases our common shares to fund the amount of shares earned by our agents under the NMO Deferred Compensation Plan. At September 30, 2013, all shares earned and vested by agents have been purchased and contributed to the Rabbi Trust.

In addition, we have a share repurchase program under which we are authorized to purchase up to 10,000,000 shares of our common stock. As of September 30, 2013, no shares of our common stock had been repurchased under this program.

Item 6. Exhibits

Number	Name	Method of Filing
4.2	First Supplemental Indenture, dated July 17, 2013, among American Equity Investment Life Holding Company, U.S. Bank National Association, and Wells Fargo Bank, National Association.	Incorporated by reference to Exhibit 4.2 to Form 8-K filed on July 17, 2013
4.3	Second Supplemental Indenture, dated July 17, 2013, between American Equity Investment Life Holding Company and Wells Fargo Bank, National Association.	Incorporated by reference to Exhibit 4.2 to Form 8-K filed on July 17, 2013
10.1	First Amendment, dated July 12, 2013, to the Credit Agreement dated January 28, 2011 among American Equity Investment Life Holding Company, JPMorgan Chase Bank, National Association, SunTrust Bank and Deutsche Bank Securities, Inc.	Incorporated by reference to Exhibit 10.1 to Form 8-K filed on July 17, 2013
12.1	Ratio of Earnings to Fixed Charges	Filed herewith
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
101.INS	XBRL Instance Document	*
101.SCH	XBRL Taxonomy Extension Schema Document	*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	*

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities and Exchange Act of 1934, as amended and otherwise are not

subject to liability under those sections.

SIGNATURES

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

Date: November 8, 2013	AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
	By: /s/ John M. Matovina John M. Matovina, Chief Executive Officer and President (Principal Executive Officer)
	By: /s/ Ted M. Johnson Ted M. Johnson, Chief Financial Officer and Treasurer (Principal Financial Officer)
	By: /s/ Scott A. Samuelson Scott A. Samuelson, Vice President - Controller (Principal Accounting Officer)

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