AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
May 09, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2007

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number : 001-31911

American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

Iowa (State of Incorporation)	**42-1447959** (I.R.S. Employer Identification No.)
5000 Westown Parkway, Suite 440 **West Des Moines, Iowa** (Address of principal executive offices)	**50266** (Zip Code)
Registrant s telephone number, including area code	**(515) 221-0002** (Telephone)

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

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

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

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

(2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

APPLICABLE TO CORPORATE ISSUERS:

Shares of common stock outstanding at April 30, 2007: 56,842,517

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	March 31, 2007 (Unaudited)	December 31, 2006
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2007 - $4,310,450; 2006- $4,297,182)	$ 4,187,089	$ 4,177,029
Held for investment, at amortized cost (fair value: 2007 - $4,923,404; 2006 - $4,871,237)	5,190,953	5,128,146
Equity securities, available for sale, at fair value (cost: 2007 - $64,782; 2006 - $46,000)	64,047	45,512
Mortgage loans on real estate	1,696,169	1,652,757
Derivative instruments	354,793	381,601
Policy loans	432	419
Total investments	11,493,483	11,385,464
Cash and cash equivalents	28,479	29,949
Coinsurance deposits - related party	1,803,879	1,841,720
Accrued investment income	79,158	68,323
Deferred policy acquisition costs	1,122,217	1,088,890
Deferred sales inducements	458,416	427,554
Deferred income taxes	70,227	73,831
Income taxes recoverable	7,781	4,526
Other assets	34,564	69,866
Total assets	$ 15,098,204	$ 14,990,123

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

	March 31, 2007 (Unaudited)	December 31, 2006
Liabilities and Stockholders Equity		
Liabilities:		
Policy benefit reserves:		
Traditional life and accident and health insurance products	$ 97,242	$ 93,632
Annuity and single premium universal life products	13,394,026	13,114,299
Other policy funds and contract claims	124,748	128,579
Other amounts due to related parties	37,458	45,504
Notes payable	265,613	266,383
Subordinated debentures	268,268	268,489
Amounts due under repurchase agreements	231,834	385,973
Other liabilities	72,442	92,198
Total liabilities	14,491,631	14,395,057
Stockholders equity:		
Common Stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding: 2007 - 53,538,772 shares (excluding 2,664,466 treasury shares); 2006 - 53,500,926 shares (excluding 2,664,448 treasury shares)	53,539	53,501
Additional paid-in capital	391,266	389,644
Accumulated other comprehensive loss	(38,849)	(38,769)
Retained earnings	200,617	190,690
Total stockholders equity	606,573	595,066
Total liabilities and stockholders equity	$ 15,098,204	$ 14,990,123

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2007	2006
Revenues:		
Traditional life and accident and health insurance premiums	$ 3,057	$ 3,524
Annuity and single premium universal life product charges	8,994	7,600
Net investment income	169,358	162,385
Realized gains (losses) on investments	579	(42)
Change in fair value of derivatives	(8,522)	49,328
Total revenues	173,466	222,795
Benefits and expenses:		
Insurance policy benefits and change in future policy benefits	1,933	2,398
Interest credited to account balances	115,953	83,608
Amortization of deferred sales inducements	4,361	8,938
Change in fair value of embedded derivatives	(6,631)	62,764
Interest expense on notes payable	4,082	7,286
Interest expense on subordinated debentures	5,589	4,918
Interest expense on amounts due under repurchase agreements	4,018	5,799
Amortization of deferred policy acquisition costs	17,569	30,755
Other operating costs and expenses	11,411	10,180
Total benefits and expenses	158,285	216,646
Income before income taxes	15,181	6,149
Income tax expense	5,254	2,176
Net income	$ 9,927	$ 3,973
Earnings per common share	$ 0.18	$ 0.07
Earnings per common share - assuming dilution	$ 0.17	$ 0.07

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands, except per share data)

(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders Equity
Balance at December 31, 2005	$ 53,936	$ 380,698	$ (27,306)	$ 112,030	$ 519,358
Comprehensive loss:					
Net income for period				3,973	3,973
Change in net unrealized investment gains/losses			(34,900)		(34,900)
Total comprehensive loss					(30,927)
Share-based compensation		29			29
Issuance of 55,550 shares of common stock under compensation plans, including excess income tax benefits	56	458			514
Conversion of $210 of subordinated debentures	26	184			210
Balance at March 31, 2006	$ 54,018	$ 381,369	$ (62,206)	$ 116,003	$ 489,184
Balance at December 31, 2006	$ 53,501	$ 389,644	$ (38,769)	$ 190,690	$ 595,066
Comprehensive income:					
Net income for period				9,927	9,927
Change in net unrealized investment gains/losses			(80)		(80)
Total comprehensive income					9,847
Share-based compensation		1,338			1,338
Issuance of 7,000 shares of common stock under compensation plans, including excess income tax benefits	7	65			72
Conversion of $250 of subordinated debentures	31	219			250
Balance at March 31, 2007	$ 53,539	$ 391,266	$ (38,849)	$ 200,617	$ 606,573

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Three Months Ended March 31, 2007	2006
Operating activities		
Net income	$ 9,927	$ 3,973
Adjustments to reconcile net income to net cash used in operating activities:		
Adjustments related to interest sensitive products:		
Interest credited to account balances	115,953	83,608
Amortization of deferred sales inducements	4,361	8,938
Annuity and single premium universal life product charges	(8,994)	(7,600)
Change in fair value of embedded derivatives	(6,631)	62,764
Increase in traditional life and accident and health insurance reserves	1,795	2,824
Policy acquisition costs deferred	(49,007)	(61,631)
Amortization of discount on contingent convertible notes	262	3,351
Amortization of deferred policy acquisition costs	17,569	30,755
Provision for depreciation and other amortization	49	537
Amortization of discount and premiums on fixed maturity securities	(63,565)	(58,955)
Realized losses (gains) on investments	(579)	42
Change in fair value of derivatives	8,522	(49,328)
Deferred income taxes	3,648	(11,074)
Share-based compensation	1,338	29
Changes in other operating assets and liabilities:		
Accrued investment income	(10,835)	(19,067)
Income taxes recoverable	(3,255)	12,186
Other assets	604	(2,287)
Other policy funds and contract claims	(3,831)	1,321
Other amounts due to related parties	(6,216)	(7,152)
Other liabilities	(48,546)	(21,993)
Net cash used in operating activities	(37,431)	(28,759)
Investing Activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	71,776	52,528
Equity securities, available for sale	15,021	17,878
Mortgage loans on real estate	30,135	32,156
Derivative instruments	79,685	37,735
Acquisition of investments:		
Fixed maturity securities - available for sale	(48,679)	(372,391)
Fixed maturity securities - held for investment		(176,169)
Equity securities, available for sale	(33,659)	(3,980)
Mortgage loans on real estate	(73,547)	(129,810)
Derivative instruments	(63,320)	(45,528)
Policy loans	(13)	(17)
Purchases of property, furniture and equipment	(502)	(41)
Net cash used in investing activities	(23,103)	(587,639)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Three Months Ended March 31, 2007	2006
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	$ 444,479	$ 564,667
Coinsurance deposits-related party	45,605	42,413
Return of annuity and single premium universal life policyholder account balances	(304,801)	(305,606)
Financing fees incurred and deferred		(1,036)
Repayments of notes payable	(1,032)	(1,024)
Increase (decrease) in amounts due under repurchase agreements	(154,139)	217,349
Proceeds from issuance of subordinated debentures		30,000
Excess tax benefits realized from exercise of stock options	11	137
Proceeds from issuance of common stock	61	377
Checks in excess of cash balance	28,880	
Net cash provided by financing activities	59,064	547,277
Decrease in cash and cash equivalents	(1,470)	(69,121)
Cash and cash equivalents at beginning of period	29,949	112,395
Cash and cash equivalents at end of period	$ 28,479	$ 43,274
Supplemental disclosures of cash flow information:		
Cash paid during period for:		
Interest expense	$ 9,941	$ 10,652
Income taxes	4,200	3,667
Non-cash financing and investing activities:		
Premium and interest bonuses deferred as sales inducements	33,780	37,890
Conversion of subordinated debentures	250	210
Subordinated debentures issued to subsidiary trusts for common equity securities of the subsidiary trust		928

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

(Unaudited)

1. Organization and Significant Accounting Policies

Consolidation and Basis of Presentation

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

Reclassifications

Certain amounts in the unaudited consolidated financial statements for the period ended March 31, 2006 have been reclassified to conform to the financial statement presentation for the period ended March 31, 2007.

Adopted Accounting Pronouncements

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

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

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

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

(Unaudited)

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

New Accounting Pronouncements

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

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

2. Contingencies

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits alleging improper product design, improper sales practices and similar claims. The Company is currently a defendant in several purported class action lawsuits alleging improper sales practices. In these lawsuits, the plaintiffs are seeking returns of premiums and other compensatory and punitive damages. No class has been certified in any of the pending cases at this time. Although the Company has denied all allegations in these lawsuits and intends to vigorously defend against them, the lawsuits are in the early stages of litigation and neither their outcomes nor a range of possible outcomes can be determined at this time. However, the Company does not believe that these lawsuits will have a material adverse effect on its business, financial condition or results of operations.

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

3. Share-based Compensation Plans

During the first quarter of 2007, the Company established the 2007 Independent Sales Agent Stock Option Plan (the Plan). Under this Plan, agents of American Equity Investment Life Insurance Company may receive grants of options to acquire shares of the Company s common stock based upon their individual sales during 2007. The Plan authorizes grants of options to agents for up to 2,500,000 shares of the Company s common stock. As of March 31, 2007, there are no grants of options under the Plan.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

(Unaudited)

4. Earnings Per Share

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

	Three Months Ended March 31, 2007 (Dollars in thousands, except per share data)	2006
Numerator:		
Net income - numerator for earnings per common share	$ 9,927	$ 3,973
Interest on convertible subordinated debentures (net of income tax benefit)	265	270
Numerator for earnings per common share - assuming dilution	$ 10,192	$ 4,243
Denominator:		
Weighted average common shares outstanding (1)	56,693,206	55,553,981
Effect of dilutive securities:		
Convertible subordinated debentures	2,799,271	2,847,485
Stock options	666,603	1,115,520
Deferred compensation agreements		1,282,196
Denominator for earnings per common share - assuming dilution	60,159,080	60,799,182
Earnings per common share	$ 0.18	$ 0.07
Earnings per common share - assuming dilution	$ 0.17	$ 0.07

(1) Weighted average common shares outstanding include shares vested under the NMO Deferred Compensation Plan.

During the first quarter of 2007, 403 shares of potentially dilutive common shares were not included in the computation of diluted earnings per share because the exercise prices were greater than the average market price of the common shares. During the first quarter of 2006, all potentially dilutive common shares were included in the computation of diluted earnings per share because the exercise prices were less than the average market price of the common shares.

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

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

All statements, trend analyses and other information contained in this report and elsewhere (such as in filings by us with the Securities and Exchange Commission (SEC), press releases, presentations by us or our management or oral statements) relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as anticipate, believe, plan, estimate, expect, intend, and other similar expressions, constitute forward-looking statements under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors which may cause actual results to be materially different from those contemplated by the forward-looking statements. Such factors include, among other things:

- general economic conditions and other factors, including prevailing interest rate levels and stock and credit market performance which may affect (among other things) our ability to sell our products, our ability to access capital resources and the costs associated therewith, the fair value of our investments and the lapse rate and profitability of policies;

- customer response to new products and marketing initiatives;

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

- increasing competition in the sale of annuities;

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

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

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 charges deducted from the account balances of policyholders in connection with withdrawals, realized gains and losses on investments and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest credited to account balances, changes in fair value of embedded derivatives, amortization of deferred policy acquisition costs and deferred sales inducements, other operating costs and expenses and income taxes.

Annuity deposits by product type collected during the three months ended March 31, 2007 and 2006, were as follows:

Product Type	Three Months Ended March 31, 2007 (Dollars in thousands)	2006
Index annuities:		
Index strategies	$ 301,791	$ 362,438
Fixed strategy	128,970	177,306
	430,761	539,744
Fixed rate annuities:		
Single-year rate guaranteed	11,786	23,568
Multi-year rate guaranteed	1,932	1,355
	13,718	24,923
Total before coinsurance ceded	444,479	564,667
Coinsurance ceded	591	950
Net after coinsurance ceded	$ 443,888	$ 563,717

Net annuity deposits after coinsurance ceded decreased 21% during the first quarter of 2007 compared to the same period in 2006. We attribute this decrease to the flat to inverted yield curve interest rate environment which has made fixed income alternatives such as certificates of deposit more attractive, the impact of the NASD s notice to members on the sale of index annuities which has created confusion and impediments to sales of index annuities by annuity sales agents who are dual licensed to sell both insurance and securities products and highly competitive pricing from certain competitors.

A key element of our competitive position in the index and fixed annuity market throughout the past several years has been the financial strength rating we received from A.M. Best Company. On August 3, 2006, A.M. Best Company upgraded our financial strength rating to A- (Excellent) from B++ (Very Good). The rating outlook is stable. We believe this rating upgrade will enhance our competitive position and improve our prospects for sales increases in future periods. However, the degree to which this rating upgrade will affect future sales and persistency is unknown.

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

Our investment spread is summarized as follows:

	Three Months Ended March 31, 2007	2006
Average yield on invested assets	6.06%	6.13%
Cost of money:		
Aggregate	3.43%	3.42%
Average net cost of money for index annuities	3.41%	3.13%
Average crediting rate for fixed rate annuities:		
Annually adjustable	3.25%	3.28%
Multi-year rate guaranteed	4.28%	5.49%
Investment spread:		
Aggregate	2.63%	2.71%
Index annuities	2.65%	3.00%
Fixed rate annuities:		
Annually adjustable	2.81%	2.85%
Multi-year rate guaranteed	1.78%	0.64%

The cost of money and average crediting rates are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management s Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006. With respect to our index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration or early termination of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Derivatives Instruments - Index Products included in Management s Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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

Results of Operations

Three Months Ended March 31, 2007 and 2006

Net income increased 150% to $9.9 million in the first quarter of 2007 compared to $4.0 million for the same period in 2006. The comparability of the amounts is impacted by (i) the application of SFAS 133 to our index annuity business which we estimate decreased net income by $5.2 million and increased net income by $4.8 million for the three months ended March 31, 2007 and 2006, respectively, and (ii) the application of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133) to our contingent convertible senior notes which we estimate decreased net income by $0.2 million and $18.5 million for the three months ended March 31, 2007 and 2006, respectively. Excluding these amounts, net income for the three months ended March 31, 2007 would have been $15.3 million compared to $17.7 million for the same period in 2006. This decrease was principally due to higher amortization of deferred policy acquisition costs and deferred sales inducements as discussed below.

Annuity and single premium universal life product charges (surrender charges assessed against policy withdrawals and mortality and expense charges assessed against single premium universal life policyholder account balances) increased 18% to $9.0 million for the first quarter of 2007, compared to $7.6 million for the same period in 2006. The increase was principally due to increases in policy withdrawals subject to surrender charges due to growth in the volume and aging of the business in force. Withdrawals from annuity and single premium universal life policies subject to surrender charges were $62.0 million and $50.9 million for the three months ended March 31, 2007 and 2006, respectively. The average surrender charge collected on withdrawals subject to a surrender charge was 14.4% and 14.8% for the three months ended March 31, 2007 and 2006, respectively.

Net investment income increased 4% to $169.4 million in the first quarter of 2007, compared to $162.4 million for the same period in 2006. The increase was principally attributable to the growth in our annuity business and a corresponding increase in our invested assets, offset by a decrease in the average yield earned on investments. Average invested assets (on an amortized cost basis) increased to $11.2 billion at March 31, 2007 compared to $10.6 billion at March 31, 2006, while the average yield earned on average invested assets was 6.06% and 6.13% for the three months ended March 31, 2007 and 2006, respectively. The decline in the yield earned on average invested assets is attributable to an overall decline in yield on the mix of assets owned in the respective periods and a decline in mortgage prepayment fee income.

Realized gains (losses) on investments fluctuate from period to period due to changes in the interest rate and economic environment and the timing of the sale of investments. Realized gains and losses on investments include gains and losses on the sale of securities as well as losses recognized when the fair value of a security is written down in recognition of an other than temporary impairment. The components of realized gains (losses) on investments for the three months ended March 31, 2007 and 2006 are set forth as follows:

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	Three Months Ended March 31, 2007 (Dollars in thousands)	2006
Available for sale fixed maturity securities:		
Gross realized gains	$ 407	$ 2,022
Gross realized losses		(2,507)
	407	(485)
Equity securities:		
Gross realized gains	172	443
Gross realized losses		
	172	443
	$ 579	$ (42)

Change in fair value of derivatives (principally call options purchased to fund annual index credits on index annuities) is affected by the performance of the indices upon which our options are based and the aggregate cost of options purchased. The components of change in fair value of derivatives for the three months ended March 31, 2007 and 2006 are set forth as follows:

	Three Months Ended March 31, 2007 (Dollars in thousands)	2006
Call options:		
Change in unrealized gain (loss)	$ (39,512)	$ 43,751
Gain on option expiration or early termination	31,236	5,577
Interest rate swaps	(246)	
	$ (8,522)	$ 49,328

A substantial portion of our call options are based upon the S&P 500 Index with the remainder based upon other equity and bond market indices. The range of index appreciation for options expiring during the three months ended March 31, 2007 and 2006 is as follows:

	Three Months Ended March 31, 2007	2006
S&P 500 Index		
Point-to-point strategy	6.9% - 14.4 %	5.1% - 10.8 %
Monthly average strategy	1.2% - 4.9 %	1.1% - 4.9 %
Monthly point-to-point strategy	4.4% - 12.7 %	3.2% - 8.7 %
Lehman Brothers U.S. Aggregate and U.S. Treasury indices	2.6% - 6.4 %	1.1% - 3.8 %

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the index annuity policies (participation rates and caps) which allow us to manage the cost of the options purchased to fund the annual index credits. The change in fair value of derivatives is also influenced by the aggregate costs of options purchased. The aggregate cost of options has increased due to market volatility causing variations in our weekly hedging results and an increased amount of index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices, market volatility which affects option pricing and the policy terms and historical experience which affects the strikes and caps of the options we purchase. See Critical Accounting Policies - Derivatives Instruments - Index Products included in Management s Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Interest credited to account balances increased 39% to $116.0 million in the first quarter of 2007, compared to $83.6 million for the same period in 2006. The components of interest credited to account balances are summarized as follows:

	Three Months Ended March 31, 2007 (Dollars in thousands)	2006
Index credits on index policies	$ 77,121	$ 31,162
Interest credited including changes in minimum guaranteed interest for index annuities	38,832	52,446
	$ 115,953	$ 83,608

The changes in index credits were attributable to changes in the appreciation of the underlying indices (see discussion above under change in fair value of derivatives) and the amount of funds allocated by policyholders to the respective index options. Total proceeds received upon expiration or gains recognized upon early termination of the call options purchased to fund the annual index credits were $72.9 million and $33.3 million for the three months ended March 31, 2007 and 2006, respectively. The decrease in interest credited including changes in minimum guaranteed interest for index annuities was due to reductions in interest credited on fixed rate annuities as a result of declines in the account balances of such annuities and decreases in interest crediting rates on several products, offset in part by increases in interest credited on amounts allocated to the fixed rate strategy for index annuities as a result of the growth in amounts allocated to the fixed rate strategy in the index annuity liabilities. A significant factor in the reductions in interest credited on fixed rate annuities is the reduced interest on multi-year rate guarantee annuities. A significant amount of these annuities were sold in 2001 with an initial rate guaranteed for the first five policy years. We experienced surrenders of these policies upon expiration of this initial guaranteed interest during 2006 and reduced the crediting rates on those policies that remained in force. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 10% during the three months ended March 31, 2007 to $11.2 billion from $10.3 billion during the same period in 2006.

Amortization of deferred sales inducements decreased 51% to $4.4 million in the first quarter of 2007, compared to $8.9 million for the same period in 2006. In general, amortization of deferred sales inducements has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium and interest bonus annuity products. Bonus products represented 83% and 73% of our total annuity deposits during the three months ended March 31, 2007 and 2006, respectively. The anticipated increase in amortization from these factors has been affected by amortization associated with the application of SFAS 133 to our index annuity business. The application of SFAS 133 to our index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the purchased options because the purchased options are one-year options while the options valued in the fair value of embedded derivatives cover the expected life of the contracts which typically exceed 10 years. The gross profit adjustments resulting from the application of SFAS 133 to our index annuity business decreased amortization by $3.4 million in the first quarter of 2007 and increased amortization by $3.1 million for the same period in 2006. Excluding these amounts, amortization for the three months ended March 31, 2007 would have been $7.8 million compared to $5.8 million for the same period in 2006. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management s Discussion and Analysis included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Change in fair value of embedded derivatives was a decrease of $6.6 million in the first quarter of 2007 compared to an increase of $62.8 million in the first quarter of 2006. The components of change in fair value of derivatives are summarized as follows:

Three Months Ended March 31,	
2007	2006
(Dollars in thousands)	