AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
November 08, 2011

FORM 10-Q

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

(Mark One)

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

For the quarterly period ended September 30, 2011

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

For the transition period from ________ to ________

Commission File Number : 001-31911

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

Iowa	42-1447959
(State of Incorporation)	(I.R.S. Employer Identification No.)
6000 Westown Parkway West Des Moines, Iowa	50266
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code	(515) 221-0002
	(Telephone)

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

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

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

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

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

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

APPLICABLE TO CORPORATE ISSUERS:
Shares of common stock outstanding at October 31, 2011: 59,581,489

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2011 - $15,924,537; 2010 - $15,621,894)	$17,378,812	$15,830,663
Held for investment, at amortized cost (fair value: 2011 - $2,838,736; 2010 - $781,748)	2,827,461	822,200
Equity securities, available for sale, at fair value (cost: 2011 - $59,197; 2010 - $61,185)	65,401	65,961
Mortgage loans on real estate	2,838,893	2,598,641
Derivative instruments	171,905	479,786
Other investments	112,876	19,680
Total investments	23,395,348	19,816,931
Cash and cash equivalents	572,314	597,766
Coinsurance deposits	2,759,735	2,613,191
Accrued investment income	212,792	167,645
Deferred policy acquisition costs	1,638,087	1,747,760
Deferred sales inducements	1,199,372	1,227,328
Deferred income taxes	21,386	143,253
Income taxes recoverable	18,036	6,134
Other assets	58,867	106,755
Total assets	$29,875,937	$26,426,763
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	$26,917,463	$23,655,807
Other policy funds and contract claims	375,368	222,860
Notes payable	340,552	330,835
Subordinated debentures	268,552	268,435
Other liabilities	614,465	1,010,779
Total liabilities	28,516,400	25,488,716
Stockholders' equity:		
Preferred stock, no par value, 2,000,000 shares authorized, 2011 and 2010 no shares issued and outstanding	—	—
Common stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding:	57,855	56,968

2011 - 57,855,375 shares (excluding 5,569,610 treasury shares); 2010 - 56,968,446 shares (excluding 5,874,392 treasury shares)		
Additional paid-in capital	464,768	454,454
Unallocated common stock held by ESOP; 2011 - 395,859 shares; 2010 - 447,048 shares	(3,965)	(4,815)
Accumulated other comprehensive income	454,710	81,820
Retained earnings	386,169	349,620
Total stockholders' equity	1,359,537	938,047
Total liabilities and stockholders' equity	$29,875,937	$26,426,763

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenues:				
Traditional life and accident and health insurance premiums	$3,126	$3,181	$9,331	$9,111
Annuity product charges	20,405	18,538	57,259	52,673
Net investment income	305,502	260,475	894,508	758,230
Change in fair value of derivatives	(333,621)	93,980	(206,997)	(32,742)
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	(17,292)	11,298	(19,339)	22,264
OTTI losses on investments:				
Total OTTI losses	(5,133)	(2,160)	(10,346)	(16,347)
Portion of OTTI losses recognized in (from) other comprehensive income	(3,758)	(1,830)	(7,345)	8,316
Net OTTI losses recognized in operations	(8,891)	(3,990)	(17,691)	(8,031)
Loss on extinguishment of debt	—	—	—	(292)
Total revenues	(30,771)	383,482	717,071	801,213
Benefits and expenses:				
Insurance policy benefits and change in future policy benefits	1,888	2,128	6,282	6,629
Interest sensitive and index product benefits	223,232	159,155	621,317	584,842
Amortization of deferred sales inducements	(28,065)	5,184	22,892	21,516
Change in fair value of embedded derivatives	(205,565)	114,823	(138,225)	(11,513)
Interest expense on notes payable	7,984	4,940	23,723	14,264
Interest expense on subordinated debentures	3,488	3,805	10,435	11,206
Interest expense on amounts due under repurchase agreements	—	—	5	—
Amortization of deferred policy acquisition costs	(28,930)	45,795	65,155	73,980
Other operating costs and expenses	15,903	16,213	50,011	48,900
Total benefits and expenses	(10,065)	352,043	661,595	749,824
Income (loss) before income taxes	(20,706)	31,439	55,476	51,389
Income tax expense (benefit)	(7,638)	10,925	18,927	17,494
Net income (loss)	$(13,068)	$20,514	$36,549	$33,895
Earnings (loss) per common share	$(0.22)	$0.35	$0.62	$0.58
Earnings (loss) per common share - assuming dilution	$(0.22)	$0.33	$0.59	$0.56

See accompanying notes to unaudited consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2010	$56,968	$454,454	$(4,815)	$81,820	$349,620	$938,047
Other comprehensive income:						
Net income for period	—	—	—	—	36,549	36,549
Change in net unrealized investment gains/losses	—	—	—	370,694	—	370,694
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	2,196	—	2,196
Other comprehensive income						409,439
Acquisition of 1,250 shares of common stock	(1)	(12)	—	—	—	(13)
Allocation of 78,897 shares of common stock by ESOP, including excess income tax benefits	—	65	850	—	—	915
Share-based compensation, including excess income tax benefits	—	6,575	—	—	—	6,575
Issuance of 888,179 shares of common stock under compensation plans, including excess income tax benefits	888	3,686	—	—	—	4,574
Balance at September 30, 2011	$57,855	$464,768	$(3,965)	$454,710	$386,169	$1,359,537
Balance at December 31, 2009	$56,203	$422,225	$(5,679)	$(30,456)	$312,330	$754,623
Other comprehensive income:						
Net income for period	—	—	—	—	33,895	33,895
Change in net unrealized investment gains/losses	—	—	—	234,529	—	234,529
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	(2,302)	—	(2,302)
Other comprehensive income						266,122
Conversion of $60 of subordinated debentures	7	49	—	—	—	56
Acquisition of 6,300 shares of common stock	(6)	(44)	—	—	—	(50)
Allocation of 44,641 shares of common stock by ESOP, including excess income tax benefits	—	(31)	484	—	—	453
	—	6,800	—	—	—	6,800

Share-based compensation, including excess income tax benefits						
Issuance of 488,725 shares of common stock under compensation plans, including excess income tax benefits	489	2,296	—	—	—	2,785
Issuance of warrants	—	15,600	—	—	—	15,600
Balance at September 30, 2010	$56,693	$446,895	$(5,195)	$201,771	$346,225	$1,046,389

See accompanying notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30, 2011	2010
Operating activities		
Net income	$36,549	$33,895
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	621,317	584,842
Amortization of deferred sales inducements	22,892	21,516
Annuity product charges	(57,259)	(52,673)
Change in fair value of embedded derivatives	(138,225)	(11,513)
Increase in traditional life and accident and health insurance reserves	70,612	20,777
Policy acquisition costs deferred	(342,299)	(260,837)
Amortization of deferred policy acquisition costs	65,155	73,980
Provision for depreciation and other amortization	14,113	7,391
Amortization of discounts and premiums on investments	(115,340)	(188,044)
Realized gains on investments and net OTTI losses recognized	37,030	(14,233)
Change in fair value of derivatives	205,264	30,876
Deferred income taxes	(78,920)	(100,804)
Loss on extinguishment of debt	—	292
Share-based compensation	5,591	6,624
Change in accrued investment income	(45,147)	(34,854)
Change in income taxes recoverable/payable	(11,902)	95,924
Change in other assets	4,375	(10,061)
Change in other policy funds and contract claims	152,508	64,545
Change in collateral held for derivatives	(284,870)	(157,791)
Change in other liabilities	(61,921)	25,439
Other	516	421
Net cash provided by operating activities	100,039	135,712
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	3,433,977	3,084,551
Fixed maturity securities - held for investment	—	1,585,267
Equity securities - available for sale	2,958	31,665
Mortgage loans on real estate	133,560	111,305
Derivative instruments	432,411	406,563
Other investments	91	—
Acquisition of investments:		
Fixed maturity securities - available for sale	(3,685,523)	(5,620,989)
Fixed maturity securities - held for investment	(1,940,163)	(215,870)
Equity securities - available for sale	—	(10,125)
Mortgage loans on real estate	(413,536)	(203,606)
Derivative instruments	(295,099)	(241,962)
Short-term investments	—	(599,746)
Other investments	(77,189)	(533)

Purchases of property, furniture and equipment	(4,643)	(5,342)
Net cash used in investing activities	(2,413,156)	(1,678,822)

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

	Nine Months Ended September 30,	
	2011	2010
Financing activities		
Receipts credited to annuity policyholder account balances	$3,718,010	$3,114,235
Coinsurance deposits	(80,932)	(248,488)
Return of annuity policyholder account balances	(1,357,892)	(1,189,388)
Financing fees incurred and deferred	(1,566)	(6,742)
Proceeds from notes payable	—	200,000
Repayments of notes payable	—	(156,641)
Purchase of call spread - 2015 Notes Hedges	—	(37,000)
Acquisition of common stock	(13)	(50)
Excess tax benefits realized from share-based compensation plans	1,060	256
Proceeds from issuance of common stock	4,461	2,723
Proceeds from issuance of warrants	—	15,600
Change in checks in excess of cash balance	4,537	(14,878)
Net cash provided by financing activities	2,287,665	1,679,627
Increase (decrease) in cash and cash equivalents	(25,452)	136,517
Cash and cash equivalents at beginning of period	597,766	528,002
Cash and cash equivalents at end of period	$572,314	$664,519
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$22,129	$17,101
Income taxes	108,800	121,488
Income tax refunds received	—	100,000
Non-cash operating activity:		
Deferral of sales inducements	281,376	244,979
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	17,358	7,408
Mortgage loan on real estate sold	1,215	—
Non-cash financing activities:		
Conversion of subordinated debentures	—	56

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2011
(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, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2010.
During 2011, we discovered a prior period error related to policy benefit reserves for our single premium immediate annuity products. Accordingly, we made an adjustment in the first quarter of 2011 which resulted in a decrease of policy benefit reserves and a decrease in interest sensitive and index product benefits of $4.2 million. On an after-tax basis, the adjustment resulted in a $2.7 million increase in net income for the nine months ended September 30, 2011.
Adopted Accounting Pronouncements
In January 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity is now required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. Clarification on existing disclosure requirements is also provided in this update relating to the level of disaggregation of information as to determining appropriate classes of assets and liabilities as well as disclosure requirements regarding valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This standard was effective for us on January 1, 2011, and has not had a material impact on our consolidated financial statements.
In April 2011, the FASB issued an accounting standards update that gives creditors guidance in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. Troubled debt restructures are considered impaired receivables for which an amount of impairment loss is determined at the time the loan is restructured. This standard update was effective for us on July 1, 2011, was applied retrospectively to restructures that we have completed on or after January 1, 2011, and has not had a material impact on our consolidated financial statements.
New Accounting Pronouncements
In October 2010, as a result of a consensus of the FASB Emerging Issues Task Force, the FASB issued an accounting standards update that modifies the definition of the types of costs incurred that can be capitalized in the acquisition of new and renewal insurance contracts. This guidance defines the costs that qualify for deferral as incremental direct costs that result directly from and are essential to successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. In addition, it lists certain costs as deferrable as those that are directly related to underwriting, policy issuance and processing, medical and inspection, and sales force contract selling as deferrable, as well as the portion of an employee's total compensation related directly to time spent performing those activities for actual acquired contracts and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. This amendment to current GAAP should be applied

prospectively and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with retrospective application permitted. We are currently evaluating the impact of the guidance on our consolidated financial statements and we expect to apply prospectively. See note 6 to our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010, for the policy issue costs that could be subject to non-deferral.

In May 2011, the FASB issued an accounting standards update that addresses fair value measurement and disclosure as part of its convergence efforts with the International Accounting Standards Board. The result is common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. This accounting standards update changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Some changes clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing informations about fair value measurements. The disclosure requirements add information about transfers between Level 1 and Level 2 of the fair value hierarchy, information about the sensitivity of a fair value measurement categorized within Level 3 of the fair value hierarchy to changes in unobservable inputs and any interrelationships between those unobservable inputs, and the categorization by level of the fair value hierarchy for items that are not measured at fair value in the statement of financial position, but for which the fair value of such items is required to be disclosed. This accounting standards update is effective during interim and annual periods beginning after December 15, 2011 and early application is not permitted. We do not anticipate any effect to our financial position, results of operations or cash flows upon adoption.

In June 2011, the FASB issued an accounting standards update that expands the disclosure requirements related to other comprehensive income. A reporting entity is now required to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both choices, the reporting entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income and a total amount for comprehensive income. This standard also requires the reporting entity to present reclassification adjustments from other comprehensive income to net income and eliminates the presentation of other comprehensive income as part of the statements of stockholders' equity. This accounting standards update is effective during interim and annual periods beginning after December 15, 2011 and should be applied retrospectively. We do not anticipate any effect to our financial position, results of operations or cash flows upon adoption.

2. Fair Values of Financial Instruments

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

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$17,378,812	$17,378,812	$15,830,663	$15,830,663
Held for investment	2,827,461	2,838,736	822,200	781,748
Equity securities, available for sale	65,401	65,401	65,961	65,961
Mortgage loans on real estate	2,838,893	2,942,195	2,598,641	2,670,009
Derivative instruments	171,905	171,905	479,786	479,786
Other investments	78,051	78,129	558	558
Cash and cash equivalents	572,314	572,314	597,766	597,766
Coinsurance deposits	2,759,735	2,479,722	2,613,191	2,282,998
2015 notes hedges	21,695	21,695	66,595	66,595
Liabilities				
Policy benefit reserves	26,651,672	22,412,815	23,464,810	19,594,396
Notes payable	340,552	389,243	330,835	489,097
Subordinated debentures	268,552	243,135	268,435	213,369
2015 notes embedded derivatives	21,695	21,695	66,595	66,595
Interest rate swaps	387	387	1,976	1,976

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

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

We categorize financial assets and liabilities recorded at fair value in the consolidated balance sheets as follows:

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

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security, however there were no transfers between levels during the nine months ended September 30, 2011.

Our assets and liabilities which are measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
September 30, 2011				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,681	$4,681	$—	$—
United States Government sponsored agencies	1,232,751	—	1,232,751	—
United States municipalities, states and territories	3,157,337	—	3,157,337	—
Corporate securities	9,757,306	58,734	9,698,572	—
Residential mortgage backed securities	2,841,189	—	2,839,094	2,095
Other asset backed securities	385,548	—	385,548	—
Equity securities, available for sale: finance, insurance and real estate	65,401	43,499	21,902	—
Derivative instruments	171,905	—	171,905	—
Cash and cash equivalents	572,314	572,314	—	—
2015 notes hedges	21,695	—	21,695	—
	$18,210,127	$679,228	$17,528,804	$2,095
Liabilities				
Interest rate swaps	$387	$—	$387	$—
2015 notes embedded derivatives	21,695	—	21,695	—
Fixed index annuities - embedded derivatives	2,399,097	—	—	2,399,097
	$2,421,179	$—	$22,082	$2,399,097
December 31, 2010				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,388	$4,388	$—	$—
United States Government sponsored agencies	3,003,651	—	3,003,651	—
United States municipalities, states and territories	2,367,003	—	2,367,003	—
Corporate securities	7,372,537	71,230	7,301,307	—
Residential mortgage backed securities	2,878,557	—	2,875,855	2,702
Other asset backed securities	204,527	—	204,527	—
Equity securities, available for sale: finance, insurance and real estate	65,961	46,925	19,036	—
Derivative instruments	479,786	—	479,786	—
Cash and cash equivalents	597,766	597,766	—	—
2015 notes hedges	66,595	—	66,595	—
	$17,040,771	$720,309	$16,317,760	$2,702
Liabilities				
Interest rate swaps	$1,976	$—	$1,976	$—
2015 notes embedded derivatives	66,595	—	66,595	—

Fixed index annuities - embedded derivatives	1,971,383	—	—	1,971,383
	$2,039,954	$—	$68,571	$1,971,383

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

Fixed maturity securities 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 two broker quotes and take the average of two broker prices received. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis of inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of September 30, 2011 and December 31, 2010.

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 which are not fair value exit prices. 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.

Derivative instruments

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

Other investments

None of the assets included in other investments are measured at fair value on a recurring basis. Other investments is comprised of policy loans, an equity method investment, 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 value of of our equity method investment was determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread, and a liquidity discount. The fair value of our COLI approximates the carrying value which is equal to the cash surrender value.

Cash and cash equivalents

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

2015 notes hedges

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

Policy benefit reserves and coinsurance deposits

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. We are not required to and have not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value. Neither policy benefit reserves nor coinsurance deposits are measured at fair value on a recurring basis.

Notes payable

The fair value of the convertible senior notes is based upon quoted market prices, and 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. Subordinated debentures are not measured at fair value on a recurring basis.

Interest rate swaps

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

2015 notes embedded derivatives

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

Fixed index annuities - embedded derivatives

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

The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$2,193	$8,910	$2,702	$17,918
Sales	—		—	(14,838)
Principal returned	(80)	(181)	(346)	(495)
(Amortization)/accretion of premium/discount	29	10	37	42
Transfers out of Level 3	—	(6,155)	—	(6,155)
Total gains (losses) (realized/unrealized):				
Included in other comprehensive income (loss)	105	115	384	8,457
Included in operations	(152)	—	(682)	(2,230)
Ending balance	$2,095	$2,699	$2,095	$2,699

The transfers out of Level 3 were corporate debt and equity securities in the home building sector that were issued as a result of a bankruptcy reorganization in late 2009. The operation that has resulted from this emergence from bankruptcy has become a stable business to which a third party broker has applied observable market data such as similar securities and credit spreads in determining fair value of these securities.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives				
Beginning balance	$2,368,533	$1,482,429	$1,971,383	$1,375,866
Premiums less benefits	274,579	156,984	742,255	571,719
Change in unrealized gains, net	(244,015)	66,849	(314,541)	(241,323)
Ending balance	$2,399,097	$1,706,262	$2,399,097	$1,706,262

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

3. Investments

At September 30, 2011 and December 31, 2010, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
September 30, 2011				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,083	$598	$—	$4,681
United States Government sponsored agencies	1,215,879	16,981	(109)	1,232,751
United States municipalities, states and territories	2,813,263	344,132	(58)	3,157,337
Corporate securities	8,780,244	1,049,175	(72,113)	9,757,306
Residential mortgage backed securities	2,747,860	168,051	(74,722)	2,841,189
Other asset backed securities	363,208	26,196	(3,856)	385,548
	$15,924,537	$1,605,133	$(150,858)	$17,378,812
Held for investment:				
United States Government sponsored agencies	$2,751,566	$30,739	$—	$2,782,305
Corporate security	75,895	—	(19,464)	56,431
	$2,827,461	$30,739	$(19,464)	$2,838,736
Equity securities, available for sale:				
Finance, insurance, and real estate	$59,197	$9,030	$(2,826)	$65,401
December 31, 2010				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$4,082	$324	$(18)	$4,388
United States Government sponsored agencies	2,994,174	11,123	(1,646)	3,003,651
United States municipalities, states and territories	2,397,622	22,765	(53,384)	2,367,003
Corporate securities	7,124,316	380,124	(131,903)	7,372,537
Residential mortgage backed securities	2,900,028	86,950	(108,421)	2,878,557
Other asset backed securities	201,672	7,792	(4,937)	204,527
	$15,621,894	$509,078	$(300,309)	$15,830,663
Held for investment:				
United States Government sponsored agencies	$746,414	$—	$(15,309)	$731,105
Corporate security	75,786	—	(25,143)	50,643
	$822,200	$—	$(40,452)	$781,748
Equity securities, available for sale:				
Finance, insurance, and real estate	$61,185	$6,722	$(1,946)	$65,961

During the nine months ended September 30, 2011 and 2010, we received $2.9 billion and $4.0 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 $1.6 billion were classified as held for investment for the nine months ended September 30, 2010. There were no calls of held for investment securities during the nine months ended September 30, 2011. We reinvested the proceeds from these redemptions primarily in United States Government sponsored agencies, United States municipalities, states, and territories, corporate securities and residential mortgage and other asset backed securities. At September 30, 2011, 36% of our fixed income securities have call features and 1% ($0.1 billion) were subject to call redemption. Another 21% ($4.0 billion) will become subject to call redemption during the next twelve months (principally the first three quarters of 2012).

The amortized cost and fair value of fixed maturity securities at September 30, 2011, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our residential mortgage 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	$44,455	$45,218	$—	$—
Due after one year through five years	438,413	492,808	—	—
Due after five years through ten years	1,993,044	2,202,168	—	—
Due after ten years through twenty years	3,960,426	4,283,903	—	—
Due after twenty years	6,377,131	7,127,978	2,827,461	2,838,736
	12,813,469	14,152,075	2,827,461	2,838,736
Residential mortgage backed securities	2,747,860	2,841,189	—	—
Other asset backed securities	363,208	385,548	—	—
	$15,924,537	$17,378,812	$2,827,461	$2,838,736

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, 2011	December 31, 2010
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	$1,460,479	$213,545
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(795,593)	(122,336)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax benefit	(232,710)	(31,923)
Net unrealized gains reported as accumulated other comprehensive income	$454,710	$81,820

The National Association of Insurance Commissioners ("NAIC") assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations ("NRSRO's"). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered "investment grade" while NAIC Class 3 through 6 designations are considered "non-investment grade." Based on the NAIC designations, we had 99% and 98% of our fixed maturity portfolio rated investment grade at September 30, 2011 and December 31, 2010, respectively.

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

	September 30, 2011		December 31, 2010	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$14,135,552	$15,232,031	$12,152,552	$12,246,954
2	4,376,651	4,771,912	3,892,680	4,012,076
3	221,596	194,853	368,680	323,113
4	9,876	9,041	19,820	19,178
5	5,041	5,861	6,089	6,262
6	3,282	3,850	4,273	4,828
	$18,751,998	$20,217,548	$16,444,094	$16,612,411

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The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 233 and 780 securities, respectively) have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
September 30, 2011						
Fixed maturity securities:						
Available for sale:						
United States Government sponsored agencies	$52,933	$(109)	$—	$—	$52,933	$(109)
United States municipalities, states and territories	3,487	(58)	—	—	3,487	(58)
Corporate securities:						
Finance, insurance and real estate	520,139	(37,487)	116,744	(9,711)	636,883	(47,198)
Manufacturing, construction and mining	141,465	(3,515)	29,093	(2,669)	170,558	(6,184)
Utilities and related sectors	206,963	(9,784)	26,043	(3,755)	233,006	(13,539)
Wholesale/retail trade	22,029	(477)	9,100	(1,371)	31,129	(1,848)
Services, media and other	13,284	(137)	21,232	(3,207)	34,516	(3,344)
Residential mortgage backed securities	279,160	(15,088)	781,104	(59,634)	1,060,264	(74,722)
Other asset backed securities	28,790	(1,257)	10,762	(2,599)	39,552	(3,856)
	$1,268,250	$(67,912)	$994,078	$(82,946)	$2,262,328	$(150,858)
Held for investment:						
Corporate security:						
Insurance	$—	$—	$56,431	$(19,464)	$56,431	$(19,464)
Equity securities, available for sale:						
Finance, insurance and real estate	$11,593	$(1,406)	$6,237	$(1,420)	$17,830	$(2,826)
December 31, 2010						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$548	$(18)	$—	$—	$548	$(18)
United States Government sponsored agencies	110,101	(1,646)	—	—	110,101	(1,646)
United States municipalities, states and territories	1,510,354	(51,989)	7,525	(1,395)	1,517,879	(53,384)
Corporate securities:						
Finance, insurance and real estate	570,978	(27,603)	114,128	(13,001)	685,106	(40,604)
Manufacturing, construction and mining	1,024,454	(33,239)	34,490	(2,333)	1,058,944	(35,572)
Utilities and related sectors	927,476	(34,630)	14,157	(4,552)	941,633	(39,182)
Wholesale/retail trade	153,699	(4,947)	9,175	(1,304)	162,874	(6,251)
Services, media and other	181,857	(10,294)	—	—	181,857	(10,294)
	396,083	(14,100)	966,332	(94,321)	1,362,415	(108,421)

Residential mortgage backed securities						
Other asset backed securities	83,011	(4,937)	—	—	83,011	(4,937)
	$4,958,561	$(183,403)	$1,145,807	$(116,906)	$6,104,368	$(300,309)
Held for investment:						
United States Government sponsored agencies	$731,105	$(15,309)	$—	$—	$731,105	$(15,309)
Corporate security:						
Insurance	—	—	50,643	(25,143)	50,643	(25,143)
	$731,105	$(15,309)	$50,643	$(25,143)	$781,748	$(40,452)
Equity securities, available for sale:						
Finance, insurance and real estate	$14,583	$(1,199)	$16,253	$(747)	$30,836	$(1,946)

The following is a description of the factors causing the temporary unrealized losses by investment category as of September 30, 2011:

United States Government sponsored agencies; and United States municipalities, states and territories: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. We purchase these securities regularly over time at different interest rates available at time of purchase; thus, some securities carry yields less than those available at September 30, 2011.

Corporate securities: The unrealized losses in these securities are due partially to the timing of purchases in 2011 and a small number of securities seeing their yield spreads widen due to issuer specific news. In addition, the financial sector credit spreads widened during the quarter on declining fiscal policy and continued stress in the European Union.

Residential mortgage backed securities: At September 30, 2011, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A"

residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $445.3million and a fair value of $405.6 million. Despite recent improvements in the capital markets, the fair values of RMBS continue at prices below amortized cost. RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.
Equity securities: Equity securities in an unrealized loss position have exposure to the economic uncertainty surrounding the European Union which has resulted in unrealized losses in this category. A majority of these securities have been in an unrealized loss position for 12 months or more and are investment grade perpetual preferred stocks that are absent credit deterioration. A continued difficult investment environment has raised concerns in regard to earnings and dividend stability in many companies which directly affect the values of these securities.
Where the decline in market value of debt securities is attributable to changes in market interest rates or to factors such as market volatility, liquidity and spread widening, and we anticipate recovery of all contractual or expected cash flows, we do not consider these investments to be other than temporarily impaired because we do not intend to sell these investments and it is not more likely than not we will be required to sell these securities before a recovery of amortized cost, which may be maturity. For equity securities, we recognize an impairment charge in the period in which we do not have the intent and ability to hold the securities until a recovery of cost or we determine that the security will not recover to book value within a reasonable period of time. We determine what constitutes a reasonable period of time on a security-by-security basis based upon consideration of all the evidence available to us, including the magnitude of an unrealized loss and its duration. In any event, this period does not exceed 18 months from the date of impairment for perpetual preferred securities for which there is evidence of deterioration in credit of the issuer and common equity securities. For perpetual preferred securities absent evidence of a deterioration in credit of the issuer we apply an impairment model, including an anticipated recovery period, similar to a debt security. For equity securities we measure impairment charges based upon the difference between the book value of a security and its fair value.
All of the securities with unrealized losses are current with respect to the payment of principal and interest.
Changes in net unrealized gains on investments for the nine months ended September 30, 2011 and 2010 are as follows:

	Nine Months Ended September 30,	
	2011	2010
	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$51,727	$3,993
Investments carried at fair value:		
Fixed maturity securities, available for sale	$1,245,506	$838,344
Short-term investments	—	11
Equity securities, available for sale	1,428	1,223
	1,246,934	839,578
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	(673,257)	(482,306)
Deferred income tax asset	(200,787)	(125,045)
	(874,044)	(607,351)
Increase in net unrealized gains on investments carried at fair value	$372,890	$232,227

Proceeds from sales of available for sale securities for the nine months ended September 30, 2011 and 2010 were $144.4 million and $271.5 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the nine months ended September 30, 2011 and 2010 were $3.3 billion and $2.7 billion, respectively.

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Realized gains (losses) on investments, excluding net OTTI losses for the three and nine months ended September 30, 2011 and 2010 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$169	$9,732	$4,711	$22,019
Gross realized losses	—	—	(1,423)	(2,359)
	169	9,732	3,288	19,660
Equity securities:				
Gross realized gains	—	3,264	966	9,471
Gross realized losses	—	(71)	—	(71)
	—	3,193	966	9,400
Mortgage loans on real estate:				
Increase in allowance for credit losses	(17,461)	(1,043)	(23,581)	(6,212)
Other investments:				
Impairment losses	—	(584)	(12)	(584)
	$(17,292)	$11,298	$(19,339)	$22,264

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 residential mortgage and asset backed securities.

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

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

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

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

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

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

The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the nine months ended September 30, 2011 and 2010 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, 2011							
Prime	2005	5.8 %	7.7 %	6 %	13 %	45 %	55 %
	2006	6.4 %	7.6 %	8 %	14 %	45 %	60 %
	2007	5.8 %	7.9 %	8 %	30 %	40 %	60 %
Alt-A	2005	5.8 %	7.7 %	11 %	25 %	5 %	55 %
	2006	6.0 %	6.5 %	23 %	33 %	50 %	55 %
	2007	6.2 %	7.4 %	29 %	41 %	50 %	70 %
Nine months ended September 30, 2010							
Prime	2005	7.5 %	7.5 %	11 %	11 %	45 %	45 %
	2006	7.3 %	7.3 %	7 %	11 %	45 %	55 %
	2007	5.8 %	6.6 %	11 %	19 %	45 %	60 %
Alt-A	2005	6.2 %	7.4 %	12 %	27 %	45 %	50 %
	2007	7.0 %	7.0 %	44 %	45 %	57 %	60 %

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

The following table summarizes other than temporary impairments for the three months and nine months ended September 30, 2011 and 2010, by asset type:

	Number of Securities	Total OTTI Losses	Portion of OTTI Losses Recognized in (from) Other Comprehensive Income	Net OTTI Losses Recognized in Operations
		(Dollars in thousands)		
Three months ended September 30, 2011				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	37	$(5,133)	$(3,758)	$(8,891)
	37	$(5,133)	$(3,758)	$(8,891)
Three months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	7	—	(1,830)	(1,830)
	9	$(2,160)	$(1,830)	$(3,990)
Nine months ended September 30, 2011				
Fixed maturity securities, available for sale:				
Residential mortgage backed securities	47	$(10,346)	$(7,345)	$(17,691)
	47	$(10,346)	$(7,345)	$(17,691)
Nine months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	10	(14,187)	8,316	(5,871)
	12	$(16,347)	$8,316	$(8,031)

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,	
	2011	2010	2011	2010
	(Dollars in thousands)			
Cumulative credit loss at beginning of period	$(104,480)	$(81,962)	$(96,893)	$(82,930)
Credit losses on securities for which OTTI has not previously been recognized	(1,243)	(2,160)	(2,032)	(4,847)
Additional credit losses on securities for which OTTI has previously been recognized	(7,648)	(1,830)	(15,659)	(3,184)
Accumulated losses on securities that were disposed of during the period	—	1,855	1,213	6,864
Cumulative credit loss at end of period	$(113,371)	$(84,097)	$(113,371)	$(84,097)

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, 2011 and December 31, 2010:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
September 30, 2011				
Corporate fixed maturity securities	$3,296	$(2,151)	$4,673	$5,818
Residential mortgage backed securities	964,254	(193,577)	128,447	899,124
Equity securities:				
Finance, insurance and real estate	12,779	—	5,727	18,506
	$980,329	$(195,728)	$138,847	$923,448
December 31, 2010				
Corporate fixed maturity securities	$5,055	$(2,151)	$5,437	$8,341
Residential mortgage backed securities	904,704	(200,921)	124,240	828,023
Equity securities:				
Finance, insurance and real estate	14,771	—	5,783	20,554
	$924,530	$(203,072)	$135,460	$856,918

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio totaled $2.8 billion and $2.6 billion at September 30, 2011 and December 31, 2010, respectively, with commitments outstanding of $37.6 million at September 30, 2011. The portfolio consists of commercial mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	September 30, 2011			December 31, 2010		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Geographic distribution						
East	$714,735	24.9	%	$618,250	23.6	%
Middle Atlantic	178,842	6.2	%	172,443	6.6	%
Mountain	410,779	14.3	%	402,965	15.4	%
New England	42,974	1.5	%	42,695	1.6	%
Pacific	308,788	10.8	%	247,254	9.5	%
South Atlantic	494,149	17.2	%	496,606	19.0	%
West North Central	479,750	16.7	%	419,002	16.0	%
West South Central	239,687	8.4	%	215,650	8.3	%
	2,869,704	100.0	%	2,614,865	100.0	%
Loan loss allowance	(30,811	)		(16,224	)	
	$2,838,893			$2,598,641		
Property type distribution						
Office	$766,184	26.7	%	$683,404	26.1	%
Medical Office	173,406	6.0	%	166,930	6.4	%
Retail	644,240	22.5	%	589,369	22.5	%
Industrial/Warehouse	707,523	24.7	%	666,908	25.6	%
Hotel	140,374	4.9	%	151,516	5.8	%
Apartment	187,399	6.5	%	131,682	5.0	%
Mixed use/other	250,578	8.7	%	225,056	8.6	%
	2,869,704	100.0	%	2,614,865	100.0	%
Loan loss allowance	(30,811	)		(16,224	)	
	$2,838,893			$2,598,641		

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. A mortgage loan is impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. 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.

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 more than 60 days at the reporting date, and loans we have determined to be collateral dependent).

	September 30, 2011	December 31, 2010
	(Dollars in thousands)	
Mortgage loans with allowances - individually evaluated for impairment	$69,792	$31,027
Mortgage loans with no specific allowance for losses - collectively evaluated for impairment	56,495	81,994
Allowance for probable loan losses	(25,111)	(13,224)
Net carrying value	$101,176	$99,797

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

Since 2008, we have had a population of mortgage loans that we have been carrying with workout terms (e.g. short-term interest only periods, short-term suspended payments, etc.) and a population of mortgage loans that have been in a delinquent status (i.e. more than 60 days past due). It is from this population that we have been recognizing impairment loss due to nonpayment and 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.

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

The following table presents a rollforward of our specific and general valuation allowances for commercial mortgage loans for the three and nine months ended September 30, 2011:

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2011	
	Specific Allowance	General Allowance	Specific Allowance	General Allowance
	(Dollars in thousands)			
Beginning allowance balance	$(15,027)	$(4,200)	$(13,224)	$(3,000)
Charge-offs	5,877	—	8,994	—
Recoveries	—	—	—	—
Provision for credit losses	(15,961)	(1,500)	(20,881)	(2,700)
Ending allowance balance	$(25,111)	$(5,700)	$(25,111)	$(5,700)

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

During the nine months ended September 30, 2011, nine mortgage loans were satisfied by taking ownership of the real estate serving as collateral. These loans had an aggregate principal amount outstanding of $26.4 million and specific loan loss allowances totaling $8.9 million, of which $1.8 million were established and recognized during the nine months ended September 30, 2011. Additional impairment of $0.1 million was recognized on one loan at foreclosure during the second quarter of 2011 based on the fair value received from a third party appraisal less costs to sell.

During the nine months ended September 30, 2010, five mortgage loans were satisfied by taking ownership of the real estate serving as collateral. These loans had a total aggregate principal amount outstanding of $11.7 million, for which specific loan loss allowances totaling $4.3 million were established and recognized during the nine months ended September 30, 2010.

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, 2011	December 31, 2010
	(Dollars in thousands)	
Credit Exposure--By Payment Activity		
Performing	$2,761,195	$2,501,843
In workout	71,221	68,477
Delinquent	6,425	20,482
Collateral dependent	30,863	24,063
	$2,869,704	$2,614,865

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Mortgage loans are considered delinquent when they become 60 days past due. When loans become 90 days past due, become collateral dependent or enter a period with no debt service payments required we place them on non-accrual status and discontinue recognizing interest income. If payments are received on a delinquent loan, interest income is recognized to the extent it would have been recognized if normal principal and interest would have been received timely. If payments are received to bring a delinquent loan current we will resume accruing interest income on that loan. Outstanding principal of loans in a non-accrual status at September 30, 2011 and December 31, 2010 totaled $39.2 million and $41.0 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. The current depressed and somewhat inactive commercial real estate market has resulted in some of our borrowers experiencing both a reduction in cash flow on their mortgage property as well as a reduction in the fair value of the real estate collateral. If these borrowers are unable to replace lost rent revenue and increases in the fair value of their property do not materialize we could potentially incur more losses than what we have allowed for in our specific and general loan loss allowances.

Aging of commercial mortgage loans, 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)						
September 30, 2011	$—	$3,701	$2,724	$6,425	$2,832,416	$30,863	$2,869,704
December 31, 2010	$3,002	$9,169	$11,313	$23,484	$2,567,318	$24,063	$2,614,865

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)				
September 30, 2011					
Mortgage loans with an allowance	$44,681	$69,792	$(25,111)	$55,098	$2,436
Mortgage loans with no related allowance	56,495	56,495	—	56,648	2,254
	$101,176	$126,287	$(25,111)	$111,746	$4,690
December 31, 2010					
Mortgage loans with an allowance	$17,803	$31,027	$(13,224)	$24,062	$656
Mortgage loans with no related allowance	81,994	81,994	—	82,535	4,921
	$99,797	$113,021	$(13,224)	$106,597	$5,577

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 one case we have allowed a borrower no debt service payments for 24 months. We have agreed to a lump sum cash payment to allow the borrower to settle this loan in full at the end of the 24 month 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 12 months. In these situations new loan amortization schedules are calculated based on the principal not collected during this 12 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 experiencing financial difficulty and the new terms constituting a concession on our part. We analyze all loans that we agree 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 TDR are individually evaluated and measured for impairment. As stated in Note 1 to these financial statements, we adopted an accounting standards update that provides guidance on determining what constitutes a TDR and applied it to all workouts, refinances and restructures that we have entered into in 2011.

A summary of mortgage loans on commercial real estate that we have granted or extended workout terms in 2011 that we determined to be TDR's are as follows:

Geographic Region	Number of Workouts	Principal Balance Outstanding	Specific Loan Loss Allowance	Net Carrying Amount	Loss Recognized in Connection with TDR
		(Dollars in thousands)			
Three months ended September 30, 2011:					
East	2	$8,033	$(3,154)	$4,879	$(536)
South Atlantic	1	1,081	—	1,081	—
	3	$9,114	$(3,154)	$5,960	$(536)
Nine months ended September 30, 2011:					
East	3	$9,677	$(3,154)	$6,523	$(536)
Mountain	7	20,862	(1,021)	19,841	(1,021)
South Atlantic	7	19,859	(4,091)	15,768	(3,848)
	17	$50,398	$(8,266)	$42,132	$(5,405)

In addition to the TDR's on workout loans, we also have TDR's on mortgage loans that will be satisfied by obtaining ownership of the commercial real estate collateral from the borrower. Due to financial difficulties experienced by the borrowers, we have conceded that foreclosure or deed in lieu of foreclosure as the best means for maximizing the collection of the debt outstanding. We determine a TDR to have taken place at the time we initiate foreclosure proceedings or negotiations in the event of a deed in lieu of foreclosure. During 2011 we initiated foreclosure proceedings or negotiations of a deed in lieu of foreclosure, but have not yet obtained ownership, on the following mortgage loans:

Geographic Region	Number of Loans	Principal Balance Outstanding	Specific Loan Loss Allowance	Net Carrying Amount	Loss Recognized in Connection with TDR
		(Dollars in thousands)			
Three months ended September 30, 2011:					
East	3	$8,908	$(2,311)	$6,597	$(2,311)
Mountain	1	1,840	(377)	1,463	(377)
West North Central	1	1,937	(269)	1,668	(269)
	5	$12,685	$(2,957)	$9,728	$(2,957)
Nine months ended September 30, 2011:					
East	3	$8,908	$(2,311)	$6,597	$(2,311)
Mountain	3	8,834	(377)	8,457	(377)
South Atlantic	1	2,731	(799)	1,932	(799)
West North Central	1	1,937	(269)	1,668	(269)
	8	$22,410	$(3,756)	$18,654	$(3,756)

Finally, we have loans that have been fully satisfied by transfer of ownership of the real estate. The following loans were determined to be TDR during the reporting periods as we initiated proceedings to obtain ownership of the real estate serving as collateral on the loans within the reporting period.

Geographic Region	Number of Loans	Principal Balance Outstanding at Foreclosure	Specific Loan Loss Allowance	Net Carrying Amount at Foreclosure	Loss Recognized in Connection with TDR
		(Dollars in thousands)			
Three months ended September 30, 2011:					
East	1	$5,783	$(723)	$5,060	$(723)
Nine months ended September 30, 2011:					
East	2	$7,944	$(1,136)	$6,808	$(1,136)
Mountain	1	2,404	(650)	1,754	(650)
South Atlantic	1	1,483	(618)	865	(618)
	4	$11,831	$(2,404)	$9,427	$(2,404)

For those mortgage loans that are modified but not considered to be TDR's, it was determined that either the borrower was not in financial difficulty or for those modifications where the borrower was in financial difficulty no concession was granted by us to the borrower. In these instances the modified terms of the mortgage loans are consistent with competitive market conditions, the borrower could obtain similar terms in the open market, and the quality of the loans meet our underwriting guidelines. These loans are subject to our standard impaired loan procedures discussed above.

5. Derivative Instruments

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations.

The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the unaudited consolidated balance sheets are as follows:

	September 30, 2011	December 31, 2010
	(Dollars in thousands)	
Assets		
Derivative Instruments		
Call options	$171,905	$479,786
Other Assets		
2015 notes hedges	21,695	66,595
	$193,600	$546,381
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$2,399,097	$1,971,383
Other liabilities		
2015 notes embedded derivatives	21,695	66,595
Interest rate swaps	387	1,976
	$2,421,179	$2,039,954

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Change in fair value of derivatives:				
Call options	$(292,167)	$93,109	$(161,953)	$(31,720)
2015 notes hedges	(41,446)	1,483	(44,900)	1,483
Interest rate swaps	(8)	(612)	(144)	(2,505)
	$(333,621)	$93,980	$(206,997)	$(32,742)
Change in fair value of embedded derivatives:				
2015 notes embedded derivatives	$(41,446)	$1,483	$(44,900)	$1,483
Fixed index annuities	(164,119)	113,340	(93,325)	(12,996)
	$(205,565)	$114,823	$(138,225)	$(11,513)

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

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

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

Counterparty	Credit Rating (S&P)	Credit Rating (Moody's)	September 30, 2011	December 31, 2010