AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
November 09, 2009

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, 2009

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.)
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 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 504 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 o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 Act.) Yes o No x

Shares of common stock outstanding at October 30, 2009: 58,294,559

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, 2009 (Unaudited)	December 31, 2008 (As Adjusted)
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2009 - $11,147,379; 2008 - $7,159,286)	$ 11,082,957	$ 6,629,046
Held for investment, at amortized cost (fair value: 2009 - $1,746,033; 2008 - $3,588,114)	1,758,747	3,604,149
Equity securities, available for sale, at fair value (cost: 2009 - $84,512; 2008 - $125,157)	94,076	99,552
Trading securities	371,338	
Mortgage loans on real estate	2,375,833	2,329,824
Derivative instruments	364,041	56,588
Other investments	9,332	446
Total investments	16,056,324	12,719,605
Cash and cash equivalents	249,862	214,862
Restricted cash and short-term investments	177,149	
Coinsurance deposits	2,010,084	1,528,981
Accrued investment income	132,621	91,756
Deferred policy acquisition costs	1,553,709	1,579,871
Deferred sales inducements	936,512	843,377
Deferred income taxes	143,773	82,409
Other assets	36,445	20,879
Total assets	$ 21,296,479	$ 17,081,740

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

	September 30, 2009 (Unaudited)	December 31, 2008 (As Adjusted)
Liabilities and Stockholders Equity		
Liabilities:		
Policy benefit reserves:		
Traditional life and accident and health insurance products	$ 134,490	$ 121,914
Annuity products	18,331,332	15,687,625
Other policy funds and contract claims	110,690	111,205
Notes payable	287,697	247,750
Subordinated debentures	268,312	268,209
Amounts due under repurchase agreements	410,254	
Funds withheld reinsurance liability	463,100	
Income taxes payable	25,631	14,133
Other liabilities	513,689	134,060
Total liabilities	20,545,195	16,584,896
Stockholders equity:		
Common stock, par value $1 per share, 125,000,000 shares authorized; issued and outstanding: 2009 - 56,203,159 shares (excluding 5,936,696 treasury shares); 2008 - 50,739,355 shares (excluding 6,263,700 treasury shares)	56,203	50,739
Additional paid-in capital	406,234	376,782
Unallocated common stock held by ESOP: 2009 - 563,265 shares; 2008 - 588,312 shares	(5,930)	(6,336)
Accumulated other comprehensive income (loss)	14,011	(147,376)
Retained earnings	280,766	223,035
Total stockholders equity	751,284	496,844
Total liabilities and stockholders equity	$ 21,296,479	$ 17,081,740

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

(Unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008 (As Adjusted)	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008 (As Adjusted)
Revenues:				
Traditional life and accident and health insurance premiums	$ 3,166	$ 3,223	$ 9,519	$ 9,419
Annuity product charges	15,835	13,328	47,501	37,271
Net investment income	241,471	209,978	688,928	607,546
Change in fair value of derivatives	121,507	(83,753)	108,178	(314,431)
Net realized gains on investments, excluding other than temporary impairment (OTTI) losses	5,510	2,258	10,587	3,343
OTTI losses on investments:				
Total OTTI losses	(94,216)	(61,232)	(171,668)	(94,755)
Portion of OTTI losses recognized in other comprehensive income	49,641		108,012	
Net OTTI losses recognized in operations	(44,575)	(61,232)	(63,656)	(94,755)
Gain (loss) on extinguishment of debt		(28)	3,098	(1,356)
Total revenues	342,914	83,774	804,155	247,037
Benefits and expenses:				
Insurance policy benefits and change in future policy benefits	2,737	2,126	6,910	7,056
Interest sensitive and index product benefits	75,288	50,387	207,028	154,032
Amortization of deferred sales inducements	(8,081)	6,760	17,814	34,193
Change in fair value of embedded derivatives	259,737	(37,100)	414,636	(237,969)
Interest expense on notes payable	3,370	5,014	11,288	15,127
Interest expense on subordinated debentures	3,841	4,669	12,078	14,549
Interest expense on amounts due under repurchase agreements	100	2,698	344	7,694
Amortization of deferred policy acquisition costs	(2,972)	19,285	44,938	118,595
Other operating costs and expenses	13,961	13,549	45,305	38,550
Total benefits and expenses	347,981	67,388	760,341	151,827
Income (loss) before income taxes	(5,067)	16,386	43,814	95,210
Income tax expense (benefit)	(2,089)	28,102	11,305	55,214
Net income (loss)	$ (2,978)	$ (11,716)	$ 32,509	$ 39,996
Earnings (loss) per common share	$ (0.05)	$ (0.22)	$ 0.59	$ 0.74
Earnings (loss) per common share - assuming dilution	$ (0.05)	$ (0.22)	$ 0.57	$ 0.72

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands)

(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, 2008, as adjusted	$ 50,739	$ 376,782	$ (6,336)	$ (147,376)	$ 223,035	$ 496,844
Cumulative effect of noncredit OTTI, net				(20,094)	25,240	5,146
Other comprehensive income:						
Net income for period					32,509	32,509
Change in net unrealized investment gains/losses				251,689		251,689
Noncredit component of OTTI losses, available for sale securities, net				(70,208)		(70,208)
Other comprehensive income						213,990
Issuance of treasury stock	5	50			(18)	37
Acquisition of 12,362 shares of common stock	(12)	(40)				(52)
Allocation of 37,667 shares of common stock by ESOP, including excess income tax benefits		(114)	406			292
Share-based compensation, including excess income tax benefits		2,814				2,814
Issuance of 5,000,000 shares of common stock in exchange for notes payable	5,000	26,226				31,226
Issuance of 132,300 shares of common stock	132	855				987
Issuance of 339,015 shares of common stock under compensation plans	339	(339)				
Balance at September 30, 2009	$ 56,203	$ 406,234	$ (5,930)	$ 14,011	$ 280,766	$ 751,284
Balance at December 31, 2007	$ 53,556	$ 387,302	$ (6,781)	$ (38,929)	$ 216,487	$ 611,635
Retrospective application of accounting for convertible debt		15,355			(5,888)	9,467
Other comprehensive loss:						
Net income for period, as adjusted					39,996	39,996
Change in net unrealized investment gains/losses				(104,227)		(104,227)
Other comprehensive loss, as adjusted						(64,231)
	(3,735)	(28,875)				(32,610)

Acquisition of 3,734,938 shares of common stock						
Allocation of 29,337 shares of common stock by ESOP, including excess income tax benefits		(26)	309			283
Share-based compensation, including excess income tax benefits		2,063				2,063
Issuance of 889,729 shares of common stock under compensation plans, including excess income tax benefits	890	(626)				264
Conversion of $250 of subordinated debentures	31	182				213
Balance at September 30, 2008, as adjusted	$ 50,742	$ 375,375	$ (6,472)	$ (143,156)	$ 250,595	$ 527,084

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, 2009	Nine Months Ended September 30, 2008 (As Adjusted)
Operating activities		
Net income	$ 32,509	$ 39,996
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	207,028	154,032
Amortization of deferred sales inducements	17,814	34,193
Annuity product charges	(47,501)	(37,271)
Change in fair value of embedded derivatives	414,636	(237,969)
Increase in traditional life and accident and health insurance reserves	6,331	2,724
Policy acquisition costs deferred	(244,164)	(200,267)
Amortization of deferred policy acquisition costs	44,938	118,595
Provision for depreciation and other amortization	4,323	5,250
Amortization of discount and premium on investments	(160,338)	(195,443)
Trading securities purchases, sales and maturities, net	(360,418)	
Change in restricted cash and short-term investments	(177,149)	
Net realized gains on investments, excluding OTTI losses	(10,587)	(3,343)
Net OTTI losses recognized in operations	63,656	94,755
Change in fair value of derivatives	(109,563)	313,853
Deferred income taxes	(114,669)	57,891
Loss (gain) on extinguishment of debt	(3,098)	1,356
Share-based compensation	3,183	1,920
Change in accrued investment income	(40,865)	(16,724)
Change in income taxes payable	11,498	10,721
Change in other assets	(4,111)	50
Change in other policy funds and contract claims	(515)	(6,296)
Change in funds withheld reinsurance liability	452,180	
Change in other liabilities	276,056	12,200
Other	(2,010)	(309)
Net cash provided by operating activities	259,164	149,914
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	2,236,834	1,094,762
Fixed maturity securities - held for investment	1,918,418	955,560
Equity securities - available for sale	11,778	12,211
Mortgage loans on real estate	87,898	91,446
Derivative instruments	6,534	29,323
Acquisition of investments:		
Fixed maturity securities - available for sale	(5,987,086)	(2,575,652)
Equity securities - available for sale		(102,881)
Mortgage loans on real estate	(149,624)	(418,293)
Derivative instruments	(189,424)	(221,702)
Policy loans	(28)	(10)
Purchases of property, furniture and equipment	(1,001)	(176)

Net cash used in investing activities	(2,065,701)	(1,135,412)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

(Unaudited)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008 (As Adjusted)
Financing activities		
Receipts credited to annuity policyholder account balances	$ 2,777,615	$ 1,735,001
Coinsurance deposits	(371,897)	132,761
Return of annuity policyholder account balances	(1,038,657)	(975,384)
Financing fees incurred and deferred	(320)	
Proceeds from notes payable	75,000	40,000
Repayments of notes payable	(3,082)	(35,353)
Increase in amounts due under repurchase agreements	410,254	115,914
Acquisition of common stock	(34)	(27,051)
Excess tax benefits realized from share-based compensation plans	63	197
Proceeds from issuance of common stock	987	219
Change in checks in excess of cash balance	(8,404)	(2,302)
Other	12	
Net cash provided by financing activities	1,841,537	984,002
Increase (decrease) in cash and cash equivalents	35,000	(1,496)
Cash and cash equivalents at beginning of period	214,862	18,888
Cash and cash equivalents at end of period	$ 249,862	$ 17,392
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$ 19,669	$ 30,228
Income taxes	117,850	
Non-cash operating activity:		
Deferral of sales inducements	229,739	145,595
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	8,949	
Non-cash financing activities:		
Conversion of subordinated debentures		213
Stock acquired in satisfaction of obligations		5,559
Stock issued in extinguishment of debt	31,250	

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2009

(Unaudited)

1. Organization and 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 month and nine month periods ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. 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, 2008.

Reclassifications have been made to prior period financial statements to conform with the September 30, 2009 presentation. See Adopted Accounting Pronouncements for impact of new accounting guidance on prior period financial statements.

Restricted Cash and Short-Term Investments

We consider all cash and short term investments held that we are legally restricted from using in our normal operations and investing activities as restricted cash. The restricted cash at September 30, 2009 is cash and short term investments held in trust as funds withheld in connection with coinsurance agreements.

Adopted Accounting Pronouncements

On January 1, 2009, we adopted accounting standards that enhance the required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how an entity uses derivative instruments and how derivative instruments and related hedged items are accounted for and affect an entity s financial position, financial performance and cash flows. The adoption of these disclosure requirements did not have a material impact on our financial position or results of operations as it impacts financial statement disclosure only.

In April 2009, the Financial Accounting Standards Board (FASB) issued further guidance on the recognition and presentation of other than temporary impairments. This guidance amends the other than temporary impairment guidance for debt securities only to make the guidance more operational and to expand the presentation and disclosure of other than temporary impairments on debt and equity securities in the financial statements. This guidance requires management to determine cash flows expected to be collected on each debt security for which an other than temporary impairment is being recognized. In accordance with this guidance, the reporting entity shall allocate its other than temporary impairments on debt securities between credit and noncredit components with the noncredit portion of the other than temporary impairments recognized as a component of other comprehensive income (loss) and the credit loss portion included in operations. Credit loss is defined as the amount that the amortized cost basis of the impaired security exceeds the present value of cash flows expected to be collected. This guidance also requires a cumulative effect adjustment to the opening balance of retained earnings and accumulated other comprehensive income (loss) in the period of adoption for other than temporary impairments on debt securities recognized in prior periods which are still held as investments at the date of adoption. This guidance was effective for interim and annual reporting periods ending after June 15, 2009; however, early application was permitted. We elected to adopt these accounting standards effective January 1, 2009. The cumulative effect adjustment as of January 1, 2009 increased retained earnings by $25.2 million and decreased accumulated other comprehensive income by $20.1 million.

In April 2009, the FASB issued additional guidance for estimating fair value of financial instruments including investment securities when the volume and level of activity for the asset or liability have significantly decreased, as well as guidance on identifying circumstances that indicate a transaction is not orderly. This guidance was effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively, with early adoption permitted. We elected to adopt this guidance as of January 1, 2009, and it did not have a material impact on our consolidated financial statements.

On January 1, 2009, we adopted and applied retrospectively to all periods presented an accounting standard for convertible debt instruments that may be settled in whole or in part with cash. This standard specifies that issuers of such instruments should separately account for the liability component and the equity component represented by the embedded conversion option in a manner that will reflect the issuer s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Upon settlement, the issuer shall allocate consideration transferred and transaction costs incurred to the extinguishment of the liability component and the reacquisition of the equity component.

In December 2004, we issued $260 million of contingent convertible senior notes with a fixed rate of 5.25% and a maturity date of December 6, 2024. On the date of issuance bifurcation of these notes into a debt component and an equity component is required. The difference between the fair value of the debt component at the date of issuance and the initial proceeds at the date of issuance is recorded as a component of equity. The fair value of the notes without the embedded conversion option (liability component) at the date of issuance was $221.4 million. The fair value of the embedded conversion option (equity component) at the date of issuance was $39.1 million. The fair value of the equity component at issuance has been recorded as a debt discount to the notes, with a corresponding increase to additional paid-in capital, net of income tax. The debt discount is being amortized over the expected life of the debt.

The following summarizes the effects of the retrospective adoption of the accounting for convertible debt on the balance sheet, statements of operations and earnings per share:

	December 31, 2008		
	As Originally Reported	**Adjustments**	**As Adjusted**
	(Dollars in thousands)		
Deferred income taxes	$ 85,700	$ (3,291)	$ 82,409
Other assets	23,661	(2,782)	20,879
Total assets	17,087,813	(6,073)	17,081,740
Notes payable	258,462	(10,712)	247,750
Total liabilities	16,595,608	(10,712)	16,584,896
Additional paid-in capital	361,427	15,355	376,782
Retained earnings	233,751	(10,716)	223,035
Total stockholders equity	492,205	4,639	496,844

	Three Months Ended September 30, 2008			Nine Months Ended September 30, 2008		
	As Originally Reported	Adjustments	As Adjusted	As Originally Reported	Adjustments	As Adjusted
	(Dollars in thousands, except per share data)					
Gain (loss) on extinguishment of debt (1)	$ 59	$ (87)	$ (28)	$ 242	$ (1,598)	$ (1,356)
Interest expense on notes payable	3,881	1,133	5,014	11,732	3,395	15,127
Income tax expense	28,608	(506)	28,102	57,286	(2,072)	55,214
Net income (loss)	(11,002)	(714)	(11,716)	42,917	(2,921)	39,996
Earnings per common share	$ (0.21)	$ (0.01)	$ (0.22)	$ 0.79	$ (0.05)	$ 0.74
Earnings per common share - assuming dilution	$ (0.21)	$ (0.01)	$ (0.22)	$ 0.77	$ (0.05)	$ 0.72

(1) the gain on extinguishment of debt was originally reported as part of other operating costs and expenses in the consolidated statements of operations for the three and nine months ended September 30, 2008.

In May 2009, the FASB issued an accounting standard that requires reporting entities to recognize in their financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing those financial statements. In addition, a reporting entity shall disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. These requirements were effective for periods ending after June 15, 2009. Accordingly, we adopted the subsequent event reporting requirements effective June 30, 2009 and it did not have a material effect on our consolidated financial statements.

In April 2009, the FASB issued disclosure guidance that requires disclosures about fair value of financial instruments within the scope of existing standards for interim reporting periods as well as in annual financial statements. This guidance also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim and annual basis and to highlight any changes from prior periods and was effective for financial statements issued for interim and annual periods ending after June 15, 2009. We adopted these disclosure requirements as of and for the periods ended June 30, 2009.

New Accounting Pronouncements

In June 2009, the FASB amended accounting standards for transfers and servicing of financial assets and extinguishments of liabilities. The new standards removes the concept of a qualifying special-purpose entity (QSPE) from existing standards and removes the exception of QSPE s from consolidation requirements. Additionally, more stringent conditions for reporting a transfer of a portion of a financial asset as a sale were created, derecognition criteria was clarified, how retained interests are initially measured was revised, the guaranteed mortgage securitization recharacterization provisions were removed and disclosure requirements were added. This standard must be applied as of the beginning of our first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently assessing the impact of this standard.

In June 2009, the FASB issued amendments to the accounting standards for consolidation of variable interest entities. The new standard replaces the quantitative-based risks and rewards calculation of existing standards for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with a primarily qualitative approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impacts the entity s economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. This amendment is effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. We are currently assessing the impact of this standard.

In September 2009, the FASB issued an accounting standards update that allows for net asset value per share to be used as a means to estimate fair value for an investment if the fair value of that investment is not readily determinable. Investments that qualify are those that calculate a net asset value per share or its equivalent as of the investor s measurement date. This standard is effective for interim and annual periods ending after December 15, 2009, with early application permitted. We are currently assessing the impact of this accounting standards update.

In August 2009, the FASB issued an accounting standards update that amends the fair value measurement of liabilities. The update provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using the quoted price of the identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities when traded as assets, or another valuation technique that is consistent with the principles of fair value. This guidance is effective for the first reporting period beginning after issuance, which will be our three months and year ending December 31, 2009. We are currently assessing the impact of this accounting standards update.

2. Other Comprehensive Income (Loss)

Other comprehensive income (loss) is as follows:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(Dollars in thousands)			
Net income (loss)	$ (2,978)	$ (11,716)	$ 32,509	$ 39,996
Change in net unrealized investment gains/losses	171,044	(54,731)	251,689	(104,227)
Noncredit component of OTTI losses, available for sale securities, net	(32,267)		(70,208)	
	$ 135,799	$ (66,447)	$ 213,990	$ (64,231)

3. Fair Values of Financial Instruments

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 for use of inputs in determining fair value. The hierarchy defines the highest priority inputs (Level 1) as quoted prices in active markets for identical assets. 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. 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. The types of financial instruments included in Level 1 are listed equities, United States treasuries and non-interest bearing cash. 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. The types of financial instruments included in Level 2 are U.S. Government sponsored agency securities, corporate preferred securities, corporate bonds and mortgage and asset backed securities.

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.

We used the following valuation techniques in estimating the fair values of financial instruments:

I. Fair values of fixed maturity securities are obtained primarily from a broker who starts by obtaining a price from an independent pricing source and adjusts for observable data. These prices from the independent broker undergo evaluation by our internal investment professionals. We generally obtain one price per security, which is compared to relevant credit information, perceived market movements and sector news. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by both the broker and the pricing service include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. If the issuer has had trades in similar debt outstanding but not necessarily the same rank in the capital structure, spread information is used to support fair value. If discrepancies are identified, additional quotes are obtained and the quote that best reflects a fair value exit price at the reporting date is selected. In the case of private placement bonds, the broker typically starts with a price of a publicly traded bond of an entity that is comparable to size and financial position of the issuer of the private bond. The broker adjusts the price for factors such as marketability and risk factors specific to each security.

II. Amounts reported as fair value of embedded derivatives are estimated by projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and discounting the excess of the projected contract value amounts. The projections of the policy contract values are based on best estimate assumptions for future policy growth and future policy decrements. 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 that will be purchased 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. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in the fair values of call options purchased to fund the annual index credits and changes in the discount rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values. The fair value of the embedded derivatives includes an adjustment through the discount rate for our non performance risk.

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 review the prices received from the independent brokers to ensure that the prices represent a reasonable estimate of fair value. This process involves quantitative and qualitative analysis and is administered by our investment department. This review process includes, but is not limited to, initial and on-going review of methodologies used by the independent broker, review of pricing statistics and trends, back testing recent trades, comparing prices to those obtained from other third party pricing services, reviewing cash flow activity in the subsequent period, monitoring credit rating upgrades and downgrades and monitoring of trading volumes. Most all of the information used by the pricing service and the independent broker can be corroborated by our procedures of investigating market data and tying that data to the facts utilized by the broker.

The fixed income markets in 2008 and early 2009 experienced a period of extreme volatility and limited market liquidity conditions, which affected a broad range of asset classes and sectors. In addition, there were credit downgrade events and an increased probability of default for many fixed income instruments. These volatile market conditions increased the difficulty of valuing certain instruments as trading was less frequent and/or market data was less observable. There were certain instruments that were in active markets with significant observable data that became illiquid due to the current financial environment or market conditions. As a result, certain valuations require greater estimation and judgment as well as valuation methods which are more complex. These values may not ultimately be realizable in a market transaction, and such values may change very rapidly as market conditions change and valuation assumptions are modified.

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 trading securities: The fair values of fixed maturity securities and trading securities are obtained from third parties and are based on quoted market prices when 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.

Equity securities: The fair values of equity securities are based on quoted market prices.

Mortgage loans on real estate: 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.

Derivative instruments: The fair values of our derivative instruments 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 and are adjusted for the non-performance risk of each counterparty net of any collateral held. The non-performance 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 index annuity policy liabilities.

Other investments: Other investments is comprised of policy loans and real estate held for sale. We have not attempted to determine the fair values associated with our policy loans, as management believes any differences between carrying value and the fair values afforded these instruments are immaterial to our financial position and, accordingly, the cost to provide such disclosure is not worth the benefit to be derived. The fair value of our real estate held for sale was determined by estimating the net operating income of the commercial rental property and dividing that by a current market capitalization rate.

Cash and cash equivalents and restricted cash: 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.

Annuity 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). 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.

Notes payable and amounts due under repurchase agreements: The fair value of the contingent convertible senior notes is based upon quoted market prices. Fair values for other notes payable with fixed interest rates are estimated by discounting expected cash flows using current market interest rates currently being offered for similar securities. The amounts reported in the consolidated balance sheets for short term indebtedness under repurchase agreements with variable interest rates approximate their fair values.

Subordinated debentures: The carrying amount of subordinated debentures with variable interest rates reported in the consolidated balance sheets approximates fair value. Fair values for subordinated debentures with fixed interest rates are estimated by discounting expected cash flows using current market interest rates currently being offered for similar securities.

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

	September 30, 2009		**December 31, 2008**	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
	(Dollars in thousands)			
Assets				

Fixed maturity securities:				
Available for sale	$ 11,082,957	$ 11,082,957	$ 6,629,046	$ 6,629,046
Held for investment	1,758,747	1,746,033	3,604,149	3,588,114
Equity securities, available for sale	94,076	94,076	99,552	99,552
Mortgage loans on real estate	2,375,833	2,338,065	2,329,824	2,284,583
Derivative instruments	364,041	364,041	56,588	56,588
Trading securities	371,338	371,338		
Other investments	9,332	9,332	446	446
Cash and cash equivalents	249,862	249,862	214,862	214,862
Restricted cash and short-term investments	177,149	177,149		
Coinsurance deposits	2,010,084	1,726,909	1,528,981	1,366,149
Liabilities				
Annuity benefit reserves	18,331,332	15,539,193	15,687,625	13,391,244
Notes payable	287,697	285,661	247,750	193,267
Subordinated debentures	268,312	208,256	268,209	248,283
Amounts due under repurchase agreements	410,254	410,254		
Interest rate swaps	2,227	2,227		

Our assets and liabilities which are measured at fair value on a recurring basis as of September 30, 2009 and December 31, 2008 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, 2009				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 3,292	$ 2,585	$ 707	$
United States Government sponsored agencies	4,224,437		4,224,437	
U.S. states, territories and political subdivisions	305,128		305,128	
Corporate securities	3,966,748	69,502	3,879,464	17,782
Mortgage and asset backed securities	2,583,351		2,580,704	2,647
Equity securities, available for sale: finance, insurance and real estate	94,073	85,665	8,408	
Trading securities	371,338		371,338	
Derivative instruments	364,041		364,041	
Cash and cash equivalents	249,862	249,862		
Restricted cash and short-term investments	177,149	177,149		
	$ 12,339,419	$ 584,763	$ 11,734,227	$ 20,429
Liabilities				
Interest rate swaps	$ 2,227	$	$ 2,227	$
Index annuities-embedded derivatives	1,248,912			1,248,912
	$ 1,251,139	$	$ 2,227	$ 1,248,912
December 31, 2008				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 22,050	$ 3,404	$ 18,646	$
United States Government sponsored agencies	3,104,853		3,104,853	
Corporate securities	1,688,869	84,946	1,586,174	17,749
Mortgage and asset backed securities	1,813,274		1,810,941	2,333
Equity securities, available for sale: finance, insurance and real estate	99,552	84,554	14,998	
Derivative instruments	56,588		56,588	
Cash and cash equivalents	214,862	214,862		
	$ 7,000,048	$ 387,766	$ 6,592,200	$ 20,082
Liabilities				
Index annuities-embedded derivatives	$ 998,015	$	$	$ 998,015

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, 2009 and 2008:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2009	**2008**	**2009**	**2008**
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$ 19,140	$ 19,099	$ 20,082	$
Transfers in to or out of Level 3		2,364		29,398
Disposals	(52)		(126)	
Total gains (losses) (unrealized/realized):				
Included in other comprehensive income	1,628	(4,664)	1,586	(4,664)
Net OTTI losses recognized in operations	(287)		(1,113)	(7,935)
	$ 20,429	$ 16,799	$ 20,429	$ 16,799

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2009	**2008**	**2009**	**2008**
	(Dollars in thousands)			
Index annuities-embedded derivatives				
Beginning balance	$ 1,050,769	$ 1,168,050	$ 998,015	$ 1,432,746
Reinsurance adjustment	(14,567)		(14,567)	
Premiums less benefits	2,377	2,478	(2,464)	71,463
Change in unrealized losses (gains), net	210,333	(102,533)	267,928	(436,214)
	$ 1,248,912	$ 1,067,995	$ 1,248,912	$ 1,067,995

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

4. Investments

At September 30, 2009 and December 31, 2008, 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, 2009				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 3,000	$ 292	$	$ 3,292
United States Government sponsored agencies	4,233,286	13,345	(22,195)	4,224,436
U.S. states, territories and political subdivisions	287,926	17,245	(42)	305,129
Corporate securities	3,737,905	314,766	(85,923)	3,966,748
Mortgage and asset backed securities	2,885,262	58,010	(359,920)	2,583,352
	$ 11,147,379	$ 403,658	$ (468,080)	$ 11,082,957
Held for investment:				
United States Government sponsored agencies	$ 1,683,131	$ 5,682	$ (136)	$ 1,688,677
Corporate security	75,616		(18,260)	57,356
	$ 1,758,747	$ 5,682	$ (18,396)	$ 1,746,033
Equity securities, available for sale:				
Finance, insurance and real estate	$ 84,512	$ 13,411	$ (3,847)	$ 94,076
December 31, 2008				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 21,664	$ 515	$ (129)	$ 22,050
United States Government sponsored agencies	3,090,458	15,528	(1,133)	3,104,853
Corporate securities	1,951,308	14,939	(277,378)	1,688,869
Mortgage and asset backed securities	2,095,856	6,055	(288,637)	1,813,274
	$ 7,159,286	$ 37,037	$ (567,277)	$ 6,629,046
Held for investment:				
United States Government sponsored agencies	$ 3,528,628	$ 6,421	$ (4,984)	$ 3,530,065
Corporate security	75,521		(17,472)	58,049
	$ 3,604,149	$ 6,421	$ (22,456)	$ 3,588,114
Equity securities, available for sale:				
Finance, insurance and real estate	$ 125,157	$ 373	$ (25,978)	$ 99,552

During the nine months ended September 30, 2009 and 2008, we received $3.6 billion and $1.5 billion, respectively, in net redemption proceeds related to calls of our callable United States Government sponsored agency securities, of which $1.9 billion and $1.0 billion, respectively, were classified as held for investment. We reinvested the proceeds from these redemptions primarily in United States Government sponsored agency securities, corporate securities and mortgage backed securities classified as available for sale. At September 30, 2009, 50% of our fixed income securities have call features and 8% were subject to call redemption. Another 9% will become subject to call redemption through December 31, 2009.

The amortized cost and fair value of fixed maturity securities at September 30, 2009, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and asset backed securities provide for periodic payments throughout their lives and are shown below as a separate line.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$ 26,586	$ 25,896	$	$
Due after one year through five years	399,912	417,416		
Due after five years through ten years	1,445,204	1,573,290		
Due after ten years through twenty years	1,831,095	1,852,315	555,000	555,981
Due after twenty years	4,559,320	4,630,688	1,203,747	1,190,052
	8,262,117	8,499,605	1,758,747	1,746,033
Mortgage and asset backed securities	2,885,262	2,583,352		
	$ 11,147,379	$ 11,082,957	$ 1,758,747	$ 1,746,033

Net unrealized losses 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, 2009	December 31, 2008
	(Dollars in thousands)	
Net unrealized losses on available for sale fixed maturity securities and equity securities	$ (54,859)	$ (555,845)
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	28,965	329,113
Deferred tax valuation allowance reversal	30,842	
Deferred income tax asset	9,063	79,356
Net unrealized losses reported as accumulated other comprehensive income (loss)	$ 14,011	$ (147,376)

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 . We had 90% and 96% of our fixed maturity portfolio rated investment grade at September 30, 2009 and December 31, 2008, respectively.

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

		September 30, 2009		December 31, 2008	
NAIC Designation	NRSRO Equivalent Credit Rating	Amortized Cost	Fair Value	Amortized Cost	Fair Value

		(Dollars in thousands)							
1	Aaa/Aa/A	$	9,104,618	$	9,226,240	$	8,764,338	$	8,512,209
2	Baa		2,221,614		2,325,360		1,509,399		1,292,303
3	Ba		343,704		293,539		276,519		208,122
4	B		210,541		185,126		140,754		135,989
5	Caa and lower		689,830		548,962		35,391		31,375
6	In or near default		335,819		249,763		37,034		37,162
		$	12,906,126	$	12,828,990	$	10,763,435	$	10,217,160

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 280 and 394 securities, respectively) have been in a continuous unrealized loss position, at September 30, 2009 and December 31, 2008:

	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, 2009						
Fixed maturity securities:						
Available for sale:						
United States Government sponsored agencies	$ 1,451,941	$ (22,195)	$	$	$ 1,451,941	$ (22,195)
U.S. states, territories and political subdivisions	8,433	(42)			8,433	(42)
Corporate securities:						
Finance, insurance and real estate	58,283	(6,729)	265,006	(40,040)	323,289	(46,769)
Manufacturing, construction and mining	68,579	(4,263)	97,692	(10,943)	166,271	(15,206)
Utilities and related sectors	36,888	(1,933)	83,243	(9,383)	120,131	(11,316)
Wholesale/retail trade	35,258	(1,090)	52,812	(6,162)	88,070	(7,252)
Services, media and other			71,535	(5,380)	71,535	(5,380)
Mortgage and asset backed securities	256,466	(27,243)	1,164,958	(332,677)	1,421,424	(359,920)
	$ 1,915,848	$ (63,495)	$ 1,735,246	$ (404,585)	$ 3,651,094	$ (468,080)
Held for investment:						
United States Government sponsored agencies	$	$	$ 149,864	$ (136)	$ 149,864	$ (136)
Corporate security:						
Finance, insurance and real estate			57,356	(18,260)	57,356	(18,260)
	$	$	$ 207,220	$ (18,396)	$ 207,220	$ (18,396)
Equity securities, available for sale:						
Finance, insurance and real estate	$ 3,050	$ (118)	$ 35,271	$ (3,729)	$ 38,321	$ (3,847)
December 31, 2008						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$	$	$ 18,645	$ (129)	$ 18,645	$ (129)
United States Government sponsored agencies	60,475	(57)	298,925	(1,076)	359,400	(1,133)
Corporate securities:						
Finance, insurance and real estate	205,148	(44,478)	146,226	(46,761)	351,374	(91,239)
Manufacturing, construction and mining	294,428	(37,589)	65,578	(27,978)	360,006	(65,567)
Utilities and related sectors	192,110	(22,816)	116,173	(32,307)	308,283	(55,123)
Wholesale/retail trade	120,056	(16,557)	11,825	(9,680)	131,881	(26,237)
Services, media and other	119,297	(22,425)	79,664	(16,787)	198,961	(39,212)
	1,117,973	(221,480)	297,442	(67,157)	1,415,415	(288,637)

Mortgage and asset backed securities												
	$	2,109,487	$	(365,402)	$	1,034,478	$	(201,875)	$	3,143,965	$	(567,277)
Held for investment:												
United States Government sponsored agencies	$		$		$	360,016	$	(4,984)	$	360,016	$	(4,984)
Corporate security:												
Finance, insurance and real estate						58,049		(17,472)		58,049		(17,472)
	$		$		$	418,065	$	(22,456)	$	418,065	$	(22,456)
Equity securities, available for sale:												
Finance, insurance and real estate	$	30,093	$	(14,360)	$	20,358	$	(11,618)	$	50,451	$	(25,978)

The following is a description of the factors causing the temporary unrealized losses by investment category as of September 30, 2009:

United States Government sponsored agencies and U.S. states, territories and political subdivisions: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. During the last nine months spreads on agency securities have improved; however, long term interest rates have risen by a greater amount. These securities carry yields less than those available at September 30, 2009 as the result of these rising interest rates.

Corporate securities: The unrealized losses in these securities are due partially to a rise in interest rates in 2009 as well as the continuation in wider than historic credit spreads. While credit spreads have improved on a recovering economy, several industries remain at much wider spreads, such as financials and economic sensitive issuers. As the result of wider spreads, these issues carry yields less than those available in the market as of September 30, 2009.

Mortgage and asset backed securities: At September 30, 2009, we had no exposure to subprime mortgage-backed securities. All of our mortgage-backed securities are pools of residential mortgage loans. Substantially all of the securities that we own are in the highest rated tranche of the pool in which they are structured and are not subordinated to any other tranche. Our Alt-A mortgage-backed securities are comprised of 36 securities with a total amortized cost basis of $536.4 million and a fair value of $402.5 million. Fair values of residential mortgage-backed securities have continued at prices significantly less than amortized cost as spreads in this sector have not improved like other sectors of the fixed income market. With the uncertainty of future foreclosures and high delinquencies on residential mortgages, these security prices will likely remain below our cost basis until the housing market conditions improve.

Equity securities: The unrealized losses on equity securities, which are primarily investment grade perpetual preferred stocks with exposure to REITS, investment banks and finance companies, are due to the instability in the financial markets and a further deterioration in the economy. All of the equity securities in an unrealized loss position for 12 months or more are investment grade perpetual preferred stocks that are absent credit deterioration. A deepening recession due to tight credit markets and a difficult housing market have 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 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 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.

Approximately 36% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2009 are on securities that are rated investment grade, defined as being the highest two NAIC designations. Approximately 64% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2009 are on securities rated below investment grade. All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized losses on investments for the nine months ended September 30, 2009 and 2008 are as follows:

	September 30, 2009	September 30, 2008
	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$ 3,321	$ 44,389
Investments carried at fair value:		
Fixed maturity securities, available for sale	$ 465,818	$ (346,486)
Equity securities, available for sale	35,169	(8,427)
	500,987	(354,913)
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	(300,148)	202,376
Change in deferred tax valuation allowance	30,842	(5,078)
Deferred income tax asset	(70,294)	53,388
	(339,600)	250,686
Decrease (increase) in net unrealized losses on investments carried at fair value	$ 161,387	$ (104,227)

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Net realized gains on investments, excluding other than temporary impairment losses for the three and nine months ended September 30, 2009 and 2008 are as follows:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$ 10,334	$ 2,228	$ 16,461	$ 3,371
Gross realized losses	(2,619)	(170)	(2,672)	(283)
	7,715	2,058	13,789	3,088
Equity securities:				
Gross realized gains	3,279	200	3,282	255
	3,279	200	3,282	255
Mortgage loans on real estate:				
Impairment losses	(5,484)		(6,484)	
	$ 5,510	$ 2,258	$ 10,587	$ 3,343

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 or cost basis of each investment that has a fair value that is materially lower than its amortized cost or 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 an impairment that is 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:

- 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;
- 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 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 and 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 the 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. The difference between the present value of expected future cash flows and the amortized cost basis of the security is the amount of credit loss recognized in operations. The remaining amount of the other than temporary impairment is recognized in other comprehensive income.

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

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

The cash flow modeling is performed on a security-by-security basis and incorporates actual cash flows on the 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 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 mortgage-backed securities 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**
Prime	2005	7.7%	7.7%	7%	7%	50%	50%
	2006	6.5%	9.2%	8%	14%	35%	55%
	2007	5.8%	7.9%	10%	31%	40%	50%
Alt-A	2005	5.6%	8.7%	10%	16%	10%	55%
	2006	6.0%	7.3%	18%	27%	50%	60%
	2007	6.2%	7.4%	15%	52%	45%	70%

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, large 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 by asset type:

	Three Months Ended September 30, 2009			Three Months Ended September 30, 2008
	Total Other Than Temporary Losses	**Included in Other Comprehensive Income**	**Net Impairment Losses in Operations**	**Impairment Losses in Operations**
		(Dollars in thousands)		
Fixed maturity securities:				
Available for sale:				
Corporate securities	$ (3,830)	$ (2,953)	$ (6,783)	$ (15,848)
Residential mortgage-backed securities	(78,712)	52,594	(26,118)	
Equity securities, available for sale	(11,674)		(11,674)	(45,384)
	$ (94,216)	$ 49,641	$ (44,575)	$ (61,232)

	Nine Months Ended September 30, 2009			Nine Months Ended September 30, 2008
	Total Other Than Temporary Losses	**Included in Other Comprehensive Income**	**Net Impairment Losses in Operations**	**Impairment Losses in Operations**
		(Dollars in thousands)		
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ (245)	$	$ (245)	$
Corporate securities	(9,785)	(2,756)	(12,541)	(33,673)
Residential mortgage-backed securities	(140,454)	110,768	(29,686)	(3,249)
Equity securities, available for sale	(21,184)		(21,184)	(57,833)
	$ (171,668)	$ 108,012	$ (63,656)	$ (94,755)

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, 2009	Nine Months Ended September 30, 2009
	(Dollars in thousands)	
Cumulative credit loss at beginning of period	$ (43,554)	$ (34,229)
Credit losses on securities for which an other than temporary impairment was not previously recognized	(6,015)	(13,083)
Additional credit losses on securities for which an other than temporary impairment was previously recognized	(26,887)	(29,389)
Losses included in beginning balance on securities sold during the period	5,210	5,455
	$ (71,246)	$ (71,246)

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, 2009:

	September 30, 2009 Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	September 30, 2009 Fair Value
		(Dollars in thousands)		
Corporate securities	$ 35,725	$ (12,982)	$ 7,426	$ 30,169
Residential mortgage-backed securities	701,034	(180,224)	8,353	529,163
Equity securities:				
Finance, insurance and real estate	37,227		13,168	50,395
	$ 773,986	$ (193,206)	$ 28,947	$ 609,727

Trading securities consist of fixed maturity and equity securities in designated portfolios, which support funds withheld reinsurance arrangements. Investment results for these portfolios, including gains and losses from sales, are passed directly to the reinsurer pursuant to contractual terms of the reinsurance arrangements. Trading securities are carried at fair value and changes in fair value are recorded as changes in the funds withheld reinsurance liability, as the funds withheld are being held on deposit to support the amount of reinsurance recoverable. The fair value of our trading securities is determined in the same manner as our securities classified as available for sale.

Trading securities at fair value retained in connection with reinsurance arrangements consisted of the following:

	September 30, 2009	December 31, 2008
	(Dollars in thousands)	
United States Government sponsored agencies	$ 3,517	$
U.S. states, territories and political subdivisions	24,763	
Corporate securities	66,841	
Mortgage-backed securities	229,334	
Equity securities	46,883	
Total trading securities	$ 371,338	$

5. Mortgage Loans on Real Estate

Our mortgage loan portfolio totaled $2.4 billion and $2.3 billion at September 30, 2009 and December 31, 2008, respectively, with commitments outstanding of $31.5 million at September 30, 2009. 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 reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	September 30, 2009 Carrying Amount	September 30, 2009 Percent	December 31, 2008 Carrying Amount	December 31, 2008 Percent
	(Dollars in thousands)			
Geographic distribution				
East	$ 541,057	22.7%	$ 537,303	23.1%
Middle Atlantic	165,905	7.0%	161,222	6.9%
Mountain	379,368	16.0%	386,988	16.6%
New England	44,953	1.9%	44,517	1.9%
Pacific	208,349	8.8%	194,301	8.3%
South Atlantic	443,566	18.6%	421,507	18.1%
West North Central	410,342	17.3%	397,375	17.1%
West South Central	182,293	7.7%	186,611	8.0%
	$ 2,375,833	100.0%	$ 2,329,824	100.0%
Property type distribution				
Office	$ 651,572	27.4%	$ 655,278	28.1%
Medical Office	141,016	5.9%	142,409	6.1%
Retail	546,014	23.0%	551,172	23.7%
Industrial/Warehouse	583,588	24.6%	552,012	23.7%
Hotel	156,146	6.6%	154,671	6.6%
Apartment	119,163	5.0%	111,933	4.8%
Mixed use/other	178,334	7.5%	162,349	7.0%
	$ 2,375,833	100.0%	$ 2,329,824	100.0%

As of September 30, 2009, we have two mortgage loans that we completed foreclosure proceedings and obtained the underlying collateral which we are accounting for as real estate held for sale. The principal balance outstanding on the loans at the dates of foreclosure was $8.9 million and no loss was recognized since the fair value of the properties acquired less the estimated costs to sell exceeds the amounts outstanding on the loan. We have five mortgage loans with a total outstanding balance of $14.6 million that were in default and we have commenced foreclosure proceedings.

We evaluate our mortgage loan portfolio for the purpose of determining the need to establish a loan loss reserve. We accomplish this by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. 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. Based upon this process and analysis, we have determined that no general loan loss allowance was necessary. 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. We recorded impairment losses of $5.5 million and $6.5 million during the three and nine months ended September 30, 2009, respectively, on specific mortgage loans with a total outstanding balance of $12.5 million and $18.4 million during the three and nine months ended September 30, 2009, respectively, for which principal amounts outstanding exceed the fair value of the collateral real estate less projected costs to sell the properties.

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A summary of impaired commercial mortgage loans as of September 30, 2009 and December 31, 2008 is as follows:

	September 30, 2009	December 31, 2008
	(Dollars in thousands)	
Impaired mortgage loans with allowances for losses	$ 18,384	$
Impaired mortgage loans with no allowance for losses	58,862	20,983
Allowance for probable loan losses	(6,484)	
Net carrying value of impaired mortgage loans	$ 70,762	$ 20,983

Mortgage loans summarized in the preceding table represent all loans that we are either not currently collecting, or those we feel it is probable we will not be able to collect, all amounts due according to the contractual terms of the loan agreements. We have not recognized an allowance on any of our impaired mortgage loans for which the present value of our expected future cash flows have not decreased. Should the delinquency rate or loss performance of our commercial mortgage loan portfolio increase significantly, the increase could have an adverse effect on our results.

6. 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 index annuity contracts, presented in the consolidated balance sheets are as follows:

	September 30, 2009	December 31, 2008
	(Dollars in thousands)	
ASSETS		
Derivative instruments		