AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-K
February 22, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2018
or

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 or other jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)
6000 Westown Parkway West Des Moines, Iowa (Address of principal executive offices)	50266 (Zip Code)

Registrant's telephone number, including area code: (515) 221-0002
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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o	Emerging growth company o

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

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was $3,203,746,848 based on the closing price of $36.00 per share, the closing price of the common stock on the New York Stock Exchange on June 29, 2018.

Shares of common stock outstanding as of February 18, 2019: 90,502,491

Documents incorporated by reference: Portions of the registrant's definitive proxy statement for the annual meeting of shareholders to be held June 6, 2019, which will be filed within 120 days after December 31, 2018, are incorporated by reference into Part III of this report.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2018
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PART I

Item 1. Business

Introduction

We are a leader in the development and sale of fixed index and fixed rate annuity products. We were incorporated in the state of Iowa on December 15, 1995. We issue fixed annuity products through our wholly-owned life insurance subsidiaries, American Equity Investment Life Insurance Company ("American Equity Life"), American Equity Investment Life Insurance Company of New York and Eagle Life Insurance Company ("Eagle Life"). We have one business segment which represents our core business comprised of the sale of fixed index and fixed rate annuities. Our business strategy is focused on growing our policyholder funds and earning predictable returns by managing investment spreads and investment risk. We are licensed to sell our products in 50 states and the District of Columbia. Throughout this report, unless otherwise specified or the context otherwise requires, all references to "American Equity", the "Company", "we", "our" and similar references are to American Equity Investment Life Holding Company and its consolidated subsidiaries.

Investor related information, including periodic reports filed on Forms 10-K, 10-Q and 8-K and any amendments may be found on our website at www.american-equity.com as soon as reasonably practicable after such reports are filed with the Securities and Exchange Commission ("SEC"). In addition, we have available on our website our: (i) code of business conduct and ethics; (ii) audit committee charter; (iii) compensation committee charter; (iv) nominating and corporate governance committee charter and (v) corporate governance guidelines. The information incorporated herein by reference is also electronically accessible from the SEC's website at www.sec.gov.

Annuity Market Overview

Our target market includes the group of individuals ages 45-75 who are seeking to accumulate tax-deferred savings or create guaranteed lifetime income. We believe that significant growth opportunities exist for annuity products because of favorable demographic and economic trends. According to the U.S. Census Bureau, there were approximately 39 million Americans age 65 and older in 2010, representing 13% of the U.S. population and this group has grown to 49.2 million in 2016. By 2030, this sector of the population is expected to increase to 20% of the total population. Our fixed index and fixed rate annuity products are particularly attractive to this group due to their principal protection, competitive rates of credited interest, tax-deferred growth, guaranteed lifetime income and alternative payout options. Our competitive fixed index and fixed rate annuity products have enabled us to enjoy favorable growth in recent years and since our formation.

According to Wink's Sales and Market Report published by Wink, Inc., total industry sales of fixed index annuities increased 22% to $49.3 billion for the first three quarters of 2018 from $40.4 billion for the first three quarters of 2017. Total industry sales of fixed index annuities have increased 40% over the five-year period from 2012 to 2017 (data provided in the following table according to Wink's Sales and Market Report published by Wink, Inc.), which we believe is attributable to more Americans reaching retirement age and seeking products that will provide principal protection and guaranteed lifetime income.

	For the Year Ended December 31,				
	2017	2016	2015	2014	2013
	(Dollars in thousands)				
Total industry sales of fixed index annuities	$53,992,850	$58,235,265	$53,069,850	$46,896,350	$38,646,864
Increase (decrease) from prior year	(4,242,415)	5,165,415	6,173,500	8,249,486	4,671,422
Increase (decrease) from prior year	(7.3)%	9.7%	13.2%	21.3%	13.7%

Strategy

Key elements of executing our strategy include the following:

Expand and Enhance our Distribution Network. We currently distribute through several distribution channels, including independent agents, broker/dealers, banks and registered investment advisors. American Equity Life has relationships with 32 national marketing organizations, through which nearly 24,000 independent agents are under contract. Our objective is to improve the productivity and efficiency of our independent agent distribution channel by focusing our marketing and recruiting efforts on those independent agents capable of selling $1 million or more of annuity premium annually. We will also be alert for opportunities to establish relationships with successful national marketing organizations and agents not presently associated with us. Eagle Life has relationships with 12 third party wholesale distribution partners, through which there are 70 selling agreements and more than 7,300 representatives. Thirteen of these selling agreements are with broker/dealers affiliated with banks. We are also building out our employee wholesaling model. Our employee wholesalers will work with those accounts who do not work with third party wholesalers. According to Wink's Sales and Market Report published by Wink, Inc., sales of fixed index annuities through broker/dealers and banks represented 38% of industry sales in the third quarter of 2018. Eagle Life is focused solely on the broker/dealer, bank and registered investment advisor channel and is developing a network of broker/dealers, banks and registered investment advisors that have the ability to distribute fixed index and fixed rate annuity products in large volume. We also offer broker/dealer and bank friendly products for those broker/dealers and banks that choose to associate with us through American Equity Life. We continue to strive to provide all of our distribution partners with the highest quality service possible.

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Continue to Introduce Innovative and Competitive Products. We intend to be at the forefront of the fixed index and fixed rate annuity industry in developing and introducing innovative and competitive products. We were one of the first companies to offer a fixed index annuity that allows a choice among interest crediting strategies including both equity and bond indices as well as a traditional fixed rate strategy. We were one of the first companies to include a lifetime income benefit rider with our fixed index annuities and first to have a lifetime income benefit rider with gender-based income payments. We believe that our continued focus on anticipating and being responsive to the product needs of the ever-growing population of retirees will lead to increased customer loyalty, revenues and profitability.

Use our Expertise to Achieve Targeted Spreads on Annuity Products. We have had a successful track record in achieving the targeted spreads on our annuity products. This historical success has been challenged in the current extended low interest rate environment. However, we intend to continue to leverage our experience and expertise in managing the investment spread during a range of interest rate environments to achieve, or work towards achieving, our targeted spreads.

Maintain our Profitability Focus and Improve Operating Efficiency. We are committed to improving our profitability by advancing the scope and sophistication of our investment management and spread capabilities and continuously seeking out efficiencies within our operations. The expanded use of technological resources will continue to allow us to improve our processes, scalability and response times.

Take Advantage of the Growing Popularity of Index Products. We believe the growing popularity of fixed index annuity products that allow equity market participation without the risk of loss of the premium deposit presents an attractive opportunity to grow our business. The popularity of fixed index annuity products has increased in recent years with the availability of lifetime income benefit riders that provide an attractive alternative for converting accumulated retirement savings into lifetime income. We intend to capitalize on our reputation as a leading provider of fixed index annuities in this expanding segment of the annuity market.

Focus on High Quality Service to Agents and Policyholders. We have maintained high quality personal service as one of our highest priorities since our inception and continue to strive for an unprecedented level of timely and accurate service to both our agents and policyholders. Examples of our high quality service include a live person answering phone calls and issuing policies within 24 hours of receiving the application if the paperwork is in good order. We also continue to focus on technological advancements to enable us to maintain high quality service to agents and policyholders. Our goal is to achieve digital service on par with the high quality personal service provided by our employees. We believe high quality service is one of our strongest competitive advantages.

Be Proactive in the Changing Regulatory Environment. We have been a strong and vocal defender of our products and our industry through continued regulatory challenges and have long been an advocate for appropriate regulation. We intend to remain flexible and responsive to the ever changing regulatory environment and will continue to engage with our key regulators to ensure policyholder protections are in place and adequate while permitting continued access to our much needed retirement products.

Products

Annuities offer our policyholders a tax-deferred means of accumulating retirement savings, as well as a reliable source of income during the payout period. When our policyholders deposit cash to annuities, we account for these receipts as policy benefit reserves in the liability section of our consolidated balance sheet. The annuity deposits collected, by product type, during the three most recent fiscal years are as follows:

	Year Ended December 31,								
	2018			2017			2016		
Product Type	Deposits Collected	Deposits as a % of Total		Deposits Collected	Deposits as a % of Total		Deposits Collected	Deposits as a % of Total	
	(Dollars in thousands)								
Fixed index annuities	$4,221,282	96	%	$3,966,839	95	%	$5,724,758	80	%
Annual reset fixed rate annuities	47,191	1	%	74,829	2	%	64,317	1	%

Multi-year fixed rate annuities	112,677	3	%	110,596	3	%	1,303,273	18	%
Single premium immediate annuities	23,813	—	%	24,946	—	%	35,851	1	%
	$4,404,963	100	%	$4,177,210	100	%	$7,128,199	100	%

Fixed Index Annuities

Fixed index annuities allow policyholders to earn index credits based on the performance of a particular index without the risk of loss of their account value. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more index based strategies and a traditional fixed rate strategy. Bonus products represented 81%, 87% and 88% of our net annuity account values at December 31, 2018, 2017 and 2016, respectively. The initial annuity deposit on these policies is increased at issuance by a specified premium bonus ranging from 3% to 10%. Generally, the surrender charge and bonus vesting provisions of our policies are structured such that we have comparable protection from early termination between bonus and non-bonus products.

The annuity contract value is equal to the sum of premiums paid, premium bonuses and interest credited ("index credits" for funds allocated to an index based strategy), which is based upon an overall limit (or "cap") or a percentage (the "participation rate") of the appreciation (based in certain situations on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. Caps and participation rates limit the amount of interest the policyholder may earn in any one contract year and may be adjusted by us annually subject to stated minimums. Caps generally range from 1% to 12% and participation rates range from 10% to 175%. In addition, some products have a spread or "asset fee" generally ranging from 0.75% to 4.5%, which is deducted from interest to be credited. For products with asset fees, if the appreciation in the index does not exceed the asset fee, the policyholder's index credit is zero. The minimum guaranteed surrender values are equal to no less than 87.5% of the premium collected plus interest credited at an annual rate ranging from 1% to 3%.

The initial caps and participation rates are largely a function of the cost of the call options we purchase to fund the index credits, the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to caps and participation rates, we take into account the cost of the call options we purchase to fund the index credits, yield on our investment portfolio, annuity surrender and withdrawal assumptions and crediting rate history for particular groups of annuity policies with similar characteristics.

Fixed Rate Annuities

Fixed rate deferred annuities include annual reset and multi-year rate guaranteed products. Our annual reset fixed rate annuities have an annual interest rate (the "crediting rate") that is guaranteed for the first policy year. After the first policy year, we have the discretionary ability to change the crediting rate once annually to any rate at or above a guaranteed minimum rate. Our multi-year rate guaranteed annuities are similar to our annual reset products except that the initial crediting rate is guaranteed for up to seven years before it may be changed at our discretion. The minimum guaranteed rate on our annual reset fixed rate deferred annuities ranges from 1% to 4% and the initial guaranteed rate on our multi-year rate guaranteed policies ranges from 1.7% to 3.35%.

The initial crediting rate is largely a function of the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to crediting rates, we take into account the yield on our investment portfolio, annuity surrender and withdrawal assumptions and crediting rate history for particular groups of annuity policies with similar characteristics. As of December 31, 2018, crediting rates on our outstanding fixed rate deferred annuities generally ranged from 1.0% to 4.0%. The average crediting rates on our outstanding annual reset and multi-year rate guaranteed fixed rate deferred annuities at December 31, 2018 were 1.82% and 2.74%, respectively.

We also sell single premium immediate annuities ("SPIAs"). Our SPIAs provide a series of periodic payments for a fixed period of time or for life, according to the policyholder's choice at the time of issue. The amounts, frequency and length of time of the payments are fixed at the outset of the annuity contract. SPIAs are often purchased by persons at or near retirement age who desire a steady stream of payments over a future period of years.

Withdrawal Options - Fixed Index and Fixed Rate Annuities

Policyholders are typically permitted penalty-free withdrawals up to 10% of the contract value in each year after the first year, subject to limitations. Withdrawals in excess of allowable penalty-free amounts are assessed a surrender charge during a penalty period which ranges from 5 to 17 years for fixed index annuities and 5 to 15 years for fixed rate annuities from the date the policy is issued. This surrender charge initially ranges from 5% to 20% for fixed index annuities and 8% to 20% for fixed rate annuities of the contract value and generally decreases by approximately one-half to two percentage points per year during the surrender charge period. For certain policies, the premium bonus is considered in the establishment of the surrender charge percentages. For other policies, there is a vesting schedule ranging from 10 to 14 years that applies to the premium bonus and any interest earned on that premium bonus. Surrender charges and bonus vesting are set at levels aimed at protecting us from loss on early terminations and reducing the likelihood of policyholders terminating their policies during periods of increasing interest rates. This practice enhances our ability to maintain profitability on such policies. Policyholders may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years or a combination of these payment options. Information on surrender charge protection and net account values are as follows:

	December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Annuity Surrender Charges:			
Average years at issue	13.2	13.4	13.5
Average years remaining	7.5	8.1	8.6
Average surrender charge percentage remaining	12.1 %	13.0 %	13.8 %
Annuity Account Value (net of coinsurance)	$51,053,450	$48,400,755	$45,204,015

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Beginning in July 2007 a significant amount of our fixed index annuity policies and many of our annual reset fixed rate deferred annuities were issued with a lifetime income benefit rider. This rider provides an additional liquidity option to policyholders. With the lifetime income benefit rider, a policyholder can elect to receive guaranteed payments for life from their contract without requiring them to annuitize their contract value. The amount of the lifetime income benefit available is determined by the growth in the policy's income account value and the policyholder's age at the time the policyholder elects to begin receiving lifetime income benefit payments. The growth in the policy's income account value is based on the growth rate specified in the policy which ranges from 3.0% to 8.5% and the time period over which that growth rate is applied which ranges from 5 to 20 years for the majority of these policies. Generally, the time period consists of an initial period of up to 10 years and the policyholder has the option to elect to continue the time period for an additional period of up to 10 years. We have the option to either increase the rider fee or decrease the specified growth rate depending on the specifics of the policy at the time the policyholder elects to continue the time period. Lifetime income benefit payments may be stopped and restarted at the election of the policyholder. During 2013, we introduced new versions of our lifetime income benefit rider that had an optional wellbeing benefit or optional death benefit. Policyholders have the choice of selecting a rider with a base level of benefit for no explicit fee or paying a fee for a rider that has a higher level of benefits, and beginning in 2013 we introduced products where the addition of a rider to the policy is completely optional. Rider fees range from 0.15% to 1.20% of the policy's account value. The additional value to the policyholder provided by this rider through the income account value is not transferable to other contracts and we believe will improve the persistency of the contract.

Investments/Spread Management

Investment activities are an integral part of our business, and net investment income is a significant component of our total revenues. Profitability of our annuity products is significantly affected by spreads between interest yields on investments, the cost of options to fund the index credits on our fixed index annuities and rates credited on our fixed rate annuities and the fixed rate strategy in our fixed index annuities. We manage the index-based risk component of our fixed index annuities by purchasing call options on the applicable indices to fund the index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect the change in the cost of such options which varies based on market conditions. All options are purchased on the respective policy anniversary dates, and new options are purchased on each of the anniversary dates to fund the next index credits. All credited rates on annual reset fixed rate deferred annuities and the fixed rate strategy in fixed index annuities may be changed annually, subject to minimum guarantees. Changes in caps, participation rates and asset fees on fixed index annuities and crediting rates on fixed rate and fixed index annuities may not be sufficient to maintain targeted investment spreads in all economic and market environments. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or to maintain caps, participation rates, asset fees and crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

For additional information regarding the composition of our investment portfolio and our interest rate risk management, see Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Investments, Quantitative and Qualitative Disclosures About Market Risk and Note 3 to our audited consolidated financial statements.

Marketing/Distribution

We market our products through a variable cost distribution network, including independent agents through national marketing organizations, broker/dealers, banks and registered investment advisors. We emphasize high quality service to our agents, distribution partners and policyholders along with the prompt payment of commissions to our agents and distribution partners. We believe this has been significant in building excellent relationships with our distribution network.

Our independent agents and agencies range in profile from national sales organizations to personal producing general agents. We actively recruit new agents and terminate those agents who have not produced business for us in recent periods and are unlikely to sell our products in the future. In our recruitment efforts, we emphasize that agents have direct access to our senior leadership, giving us an edge in recruiting over larger and foreign-owned competitors. We also emphasize our products, service and our focused fixed annuity expertise. We also have favorable relationships with our national marketing organizations, which have enabled us to efficiently sell through an expanded number of independent agents.

The independent agent distribution system is comprised of insurance brokers and marketing organizations. We are pursuing a strategy to increase the efficiency of our independent agent distribution network by strengthening our relationships with key national and regional marketing organizations and are alert for opportunities to establish relationships with organizations not presently associated with us. These organizations typically recruit agents for us by advertising our products and our commission structure through direct mail advertising or seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing our products. We compensate marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited by such organizations. We generally do not enter into exclusive arrangements with these marketing organizations.

Agents contracted with us through two national marketing organizations accounted for more than 34% of the annuity deposits and insurance premiums collected during 2018 by American Equity Life, and we expect these organizations to continue as marketers for American Equity Life with a focus on selling our products. The states with the largest share of direct premium collected during 2018 were: Florida (8.8%), Texas (8.0%), Pennsylvania (6.4%), North Carolina (5.1%) and California (5.0%).

Eagle Life's fixed index and fixed rate annuities are distributed pursuant to selling agreements with broker/dealers, banks and registered investment advisors. Relationships with these firms are facilitated by third party wholesalers who promote Eagle Life and are compensated based upon the sales of the firms that they have contracted with Eagle Life. We are also building out our employee wholesaling model. Our employee wholesalers will work with those accounts that do not work with third party wholesalers. American Equity Life to a lesser extent also sells through broker/dealers and we have introduced products specifically for this distribution channel.

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Competition and Ratings

We operate in a highly competitive industry. Our annuity products compete with fixed index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank products and other investment and retirement funding alternatives offered by asset managers, banks, and broker/dealers. Our insurance products compete with products of other insurance companies, financial intermediaries and other institutions based on a number of features, including crediting rates, index options, policy terms and conditions, service provided to distribution channels and policyholders, ratings, reputation and distributor compensation.

The sales agents for our products use the ratings assigned to an insurer by independent rating agencies as one factor in determining which insurer's annuity to market. The degree to which ratings adjustments have affected and will affect our sales and persistency is unknown. Following is a summary of American Equity Life's financial strength ratings:

	Financial Strength Rating	Outlook Statement
A.M. Best Company, Inc.		
January 2011 - current	A-	Stable
S&P Global		
August 2015 - current	A-	Stable
June 2013 - August 2015	BBB+	Positive
October 2011 - June 2013	BBB+	Stable
Fitch Ratings Ltd.		
September 2018 - current	BBB+	Positive
May 2013 - September 2018	BBB+	Stable

Financial strength ratings generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to policyholders, agents and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell or hold securities.

In addition to the financial strength ratings, rating agencies use an "outlook statement" to indicate a medium or long-term trend which, if continued, may lead to a rating change. A positive outlook indicates a rating may be raised and a negative outlook indicates a rating may be lowered. A stable outlook is assigned when ratings are not likely to be changed. Outlook statements should not be confused with expected stability of the insurer's financial or economic performance. A rating may have a "stable" outlook to indicate that the rating is not expected to change, but a "stable" outlook does not preclude a rating agency from changing a rating at any time without notice.

In December 2018, A.M. Best changed its rating outlook on the U.S. life/annuity sector to 'stable' from 'negative', reflecting its view that the sector is well-capitalized and insurers balance sheets are expected to benefit from the lower effective corporate tax rate resulting from the Tax Cuts and Jobs Act of 2017 ("Tax Reform"), and that operating performance is benefiting from improved product pricing, modest increases in interest rates and a decline in regulatory uncertainty. In November 2018, Fitch affirmed its rating outlook on the U.S. life insurance sector as 'stable', reflecting its view that financial performance will benefit from a continued benign credit environment and reduced pressure from low interest rates and will be relatively stable across the industry in 2019. In January 2019, S&P affirmed its rating outlook on the U.S. life insurance sector as 'stable', reflecting its view that insurers continue to exhibit strong capitalization and liquidity.

A.M. Best financial strength ratings currently range from "A++" (superior) to "F" (in liquidation), and include 16 separate ratings categories. Within these categories, "A++" (superior) and "A+" (superior) are the highest, followed by "A" (excellent) and "A-" (excellent) then followed by "B++" (good) and "B+" (good). Publications of A.M. Best indicate that the "A-" rating is assigned to those companies that, in A.M. Best's opinion, have demonstrated an excellent ability to meet their ongoing obligations to policyholders.

S&P financial strength ratings currently range from "AAA" (extremely strong) to "R" (under regulatory supervision), and include 21 separate ratings categories, while "NR" indicates that S&P has no opinion about the insurer's financial strength. Within these categories, "AAA" and "AA" are the highest, followed by "A" and "BBB". Publications of S&P indicate that an insurer rated "A-" is regarded as having strong financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are higher rated insurers.

Fitch financial strength ratings currently range from "AAA" (exceptionally strong) to "C" (distressed). Ratings of "BBB-" and higher are considered to be "secure," and those of "BB+" and lower are considered to be "vulnerable."

A.M. Best, S&P and Fitch review their ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue for any given period of time or that it will not be changed or withdrawn entirely if, in their judgment, circumstances so warrant. If our ratings were to be negatively adjusted for any reason, we could experience a material decline in the sales of our products and the persistency of our existing business, as well as an increase in the cost of debt or equity financing.

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Reinsurance

We follow the industry practice of reinsuring a portion of our annuity risks with unaffiliated reinsurers. Our reinsurance agreements play a part in managing our regulatory capital.

Coinsurance

American Equity Life has three coinsurance agreements with Athene Life Re Ltd. ("Athene"), an unauthorized life reinsurer domiciled in Bermuda. One agreement ceded 20% of certain of American Equity Life's fixed index annuities issued from January 1, 2009 through March 31, 2010. The business reinsured under this agreement is no longer eligible for recapture. The second agreement ceded 80% of American Equity Life's multi-year rate guaranteed annuities issued from July 1, 2009 through December 31, 2013 and 80% of Eagle Life's multi-year rate guaranteed annuities issued from November 20, 2013 through December 31, 2013. The business reinsured under this agreement may not be recaptured. The third agreement cedes 80% of American Equity Life's and Eagle Life's multi-year rate guaranteed annuities issued on or after January 1, 2014, 80% of Eagle Life's fixed index annuities issued prior to January 1, 2017, 50% of Eagle Life's fixed index annuities issued from January 1, 2017 through December 31, 2018 and 80% of certain of American Equity Life's fixed index annuities issued from August 1, 2016 through December 31, 2016. The reinsurance agreement specifies that the coinsurance percentage for Eagle Life's fixed index annuities decreases to 20% for policies issued on or after January 1, 2019. The business reinsured under this agreement may not be recaptured. American Equity Life is an intermediary for reinsurance of Eagle Life's business ceded to Athene. American Equity Life and Eagle Life remain liable to policyholders with respect to the policy liabilities ceded to Athene should Athene fail to meet the obligations it has coinsured. The annuity deposits that have been ceded to Athene are held in trusts and American Equity Life is named as the sole beneficiary of the trusts. The assets in the trusts are required to remain at a value that is sufficient to support the current balance of policy benefit liabilities of the ceded business on a statutory basis. If the value of the trust accounts would ever be less than the amount of the ceded policy benefit liabilities on a statutory basis, Athene is required to either establish a letter of credit or deposit securities in the trusts for the amount of any shortfall. Athene has received a financial strength rating of "A" (Excellent) with a stable outlook from A.M. Best. None of the coinsurance deposits with Athene are deemed by management to be uncollectible.

American Equity Life has two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), covering 70% of certain of American Equity Life's fixed index and fixed rate annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003, and 20% of those contracts issued from January 1, 2004 to July 31, 2004. The business reinsured under these agreements may not be recaptured. We remain liable to policyholders with respect to the policy liabilities ceded to EquiTrust should EquiTrust fail to meet the obligations it has coinsured. EquiTrust has received a financial strength rating of "B++" (Good) with a stable outlook from A.M. Best. None of the coinsurance deposits with EquiTrust are deemed by management to be uncollectible.

Financing Arrangements

American Equity Life has a reinsurance agreement with Hannover Life Reassurance Company of America, ("Hannover"), which is treated as reinsurance under statutory accounting practices and as a financing arrangement under U.S. generally accepted accounting principles ("GAAP"). The statutory surplus benefit under this agreement is eliminated under GAAP and the associated charges are recorded as risk charges and included in other operating costs and expenses in the consolidated statements of operations. The agreement became effective July 1, 2013 and is a yearly renewable term reinsurance agreement for statutory purposes covering 45.6% of waived surrender charges related to penalty free withdrawals, deaths and lifetime income benefit rider payments as well as lifetime income benefit rider payments in excess of policy fund values on certain business. We may recapture the risks reinsured under this agreement as of the end of any quarter after December 31, 2020 and the agreement, as amended, makes it punitive to us if we do not recapture the business ceded by the first quarter of 2021.

For more information regarding reinsurance, see Note 7 to our audited consolidated financial statements. For risks involving reinsurance see "Item 1A. Risk Factors."

Regulation

Life insurance companies are subject to regulation and supervision by the states in which they transact business. State insurance laws establish supervisory agencies with broad regulatory authority, including the power to:

- grant and revoke licenses to transact business;
- regulate and supervise trade practices and market conduct;
- establish guaranty associations;
- license agents;
- approve policy forms;
- approve premium rates for some lines of business;
- establish reserve requirements;
- prescribe the form and content of required financial statements and reports;
- determine the reasonableness and adequacy of statutory capital and surplus;
- perform financial, market conduct and other examinations;
- define acceptable accounting principles for statutory reporting;
- regulate the type and amount of permitted investments; and
- limit the amount of dividends and surplus note payments that can be paid without obtaining regulatory approval.

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Our life subsidiaries are subject to periodic examinations by state regulatory authorities. In 2015, the Iowa Insurance Division completed financial examinations of American Equity Life and Eagle Life for the five-year period ending December 31, 2013. There were no adjustments to American Equity Life's or Eagle Life's statutory financial statements as a result of these examinations. In 2017, the New York Insurance Department completed its financial examination of American Equity Investment Life Insurance Company of New York for the three-year period ending December 31, 2013. There were no adjustments to American Equity Investment Life Insurance Company of New York's statutory financial statements as a result of this examination.

The payment of dividends or the distributions, including surplus note payments, by our life subsidiaries is subject to regulation by each subsidiary's state of domicile's insurance department. Currently, American Equity Life may pay dividends or make other distributions without the prior approval of the Iowa Insurance Commissioner, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's statutory net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory surplus at the preceding December 31. For 2019, up to $325.2 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Commissioner. In addition, dividends and surplus note payments may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. American Equity Life had $1.9 billion of statutory earned surplus at December 31, 2018.

Most states have also enacted regulations on the activities of insurance holding company systems, including acquisitions, extraordinary dividends, the terms of surplus notes, the terms of affiliate transactions and other related matters. We are registered pursuant to such legislation in Iowa. A number of state legislatures have also considered or have enacted legislative proposals that alter and, in many cases, increase the authority of state agencies to regulate insurance companies and holding company systems.

Most states, including Iowa and New York where our life subsidiaries are domiciled, have enacted legislation or adopted administrative regulations affecting the acquisition of control of insurance companies as well as transactions between insurance companies and persons controlling them. The nature and extent of such legislation and regulations currently in effect vary from state to state. However, most states require administrative approval of the direct or indirect acquisition of 10% or more of the outstanding voting securities of an insurance company incorporated in the state. The acquisition of 10% of such securities is generally deemed to be the acquisition of "control" for the purpose of the holding company statutes and requires not only the filing of detailed information concerning the acquiring parties and the plan of acquisition, but also administrative approval prior to the acquisition. In many states, the insurance authority may find that "control" in fact does not exist in circumstances in which a person owns or controls more than 10% of the voting securities.

Historically, the federal government has not directly regulated the business of insurance. However, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation can significantly affect the insurance business. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") generally provides for enhanced federal supervision of financial institutions, including insurance companies in certain circumstances, and financial activities that represent a systemic risk to financial stability or the U.S. economy. Under the Dodd-Frank Act, a Federal Insurance Office has been established within the U.S. Treasury Department to monitor all aspects of the insurance industry and its authority may extend to our business, although the Federal Insurance Office is not empowered with any general regulatory authority over insurers. The director of the Federal Insurance Office serves in an advisory capacity to the Financial Stability Oversight Council ("FSOC").

State insurance regulators and the National Association of Insurance Commissioners ("NAIC") are continually reexamining existing laws and regulations and developing new legislation for passage by state legislatures and new regulations for adoption by insurance authorities. Proposed laws and regulations or those still under development pertain to insurer solvency and market conduct and in recent years have focused on:

- insurance company investments;
- risk-based capital ("RBC") guidelines, which consist of regulatory targeted surplus levels based on the relationship of statutory capital and surplus, with prescribed adjustments, to the sum of stated percentages of each element of a

specified list of company risk exposures;
- suitability/best interest standard;
- the implementation of non-statutory guidelines and the circumstances under which dividends may be paid;
- principles-based reserving;
- own risk solvency and enterprise risk management assessment;
- cybersecurity assessments;
- product approvals;
- agent licensing;
- underwriting and suitability practices; and
- life insurance and annuity sales practices.

The NAIC's RBC requirements are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. The RBC formula defines a minimum capital standard which supplements low, fixed minimum capital and surplus requirements previously implemented on a state-by-state basis. Such requirements are not designed as a ranking mechanism for adequately capitalized companies.

The NAIC's RBC requirements provide for four levels of regulatory attention depending on the ratio of a company's total adjusted capital to its RBC. Adjusted capital is defined as the total of statutory capital and surplus, asset valuation reserve and certain other adjustments. Calculations using the NAIC formula at December 31, 2018, indicated that American Equity Life's ratio of total adjusted capital to the highest level at which regulatory action might be initiated was 360%.

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Our life subsidiaries also may be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. These assessments may be deferred or forgiven under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium taxes.

Federal Income Tax

The annuity and life insurance products that we market generally provide the policyholder with a federal income tax advantage, as compared to certain other savings investments such as certificates of deposit and taxable bonds, in that federal income taxation on any increases in the contract values (i.e., the "inside build-up") of these products is deferred until it is received by the policyholder. With other savings investments, the increase in value is generally taxed each year as it is realized. Additionally, life insurance death benefits are generally exempt from income tax.

From time to time, various tax law changes have been proposed that could have an adverse effect on our business, including the elimination of all or a portion of the income tax advantage described above for annuities and life insurance. If legislation were enacted to eliminate the tax deferral for annuities, such a change would have an adverse effect on our ability to sell non-qualified annuities. Non-qualified annuities are annuities that are not sold to an individual retirement account or other qualified retirement plan.

Employees

As of December 31, 2018, we had 554 full-time employees. We have experienced no work stoppages or strikes and consider our relations with our employees to be excellent. None of our employees are represented by a union.

Item 1A.   Risk Factors

We are exposed to significant financial and capital risk, including changing interest rates and credit spreads which could adversely affect our business, financial condition, results of operations and cash flows.

Future changes in interest rates and credit spreads may result in fluctuations in the income derived from our investments. These and other factors could have an adverse effect on our financial condition, results of operations or cash flows.

Interest rate and credit spread risk. Our interest rate risk is related to market price and changes in cash flow. Substantial and sustained increases and decreases in market interest rates can adversely affect the profitability of our products, our ability to earn predictable returns, the fair value of our investments and the reported value of stockholders' equity. A rise in interest rates, in the absence of other countervailing changes, will increase the unrealized loss position of our investment portfolio. With respect to our available for sale fixed maturity securities, declines in value (net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements) reduce our reported stockholders' equity and book value per share.

If interest rates rise dramatically within a short period of time, our business may be exposed to disintermediation risk. Disintermediation risk is the risk that our policyholders may surrender all or part of their contracts in a rising interest rate environment, which may require us to sell assets in an unrealized loss position. Alternatively, we may increase crediting rates to retain business and reduce the level of assets that may need to be sold at a loss. However, such action would reduce our investment spread and net income.

Sustained declines in long-term interest rates may result in increased redemptions of our fixed maturity securities that are subject to call redemption prior to maturity by the issuer or prepayments of commercial mortgage loans and expose us to reinvestment risk. If we are unable to reinvest the proceeds from such redemptions into investments with credit quality and yield characteristics of the redeemed or prepaid investments, our net income and overall financial performance may be adversely affected. We have a certain ability to mitigate this risk by lowering crediting rates on our products subject to certain restrictions as discussed below.

Our exposure to credit spreads is related to market price and changes in cash flows related to changes in credit spreads. If credit spreads widen significantly it could result in greater investment income on new investments but would also indicate growing concern about the ability of credit issuers to service their debt which could result in additional other than temporary impairments. If credit spreads tighten significantly it could result in reduced net investment income from new purchases of fixed maturity securities or funding of commercial mortgage loans.

Credit risk. We are subject to the risk that the issuers of our fixed maturity securities and other debt securities and borrowers on our commercial mortgages will default on principal and interest payments, particularly if a major downturn in economic activity occurs. An increase in defaults on our fixed maturity securities and commercial mortgage loan portfolios could harm our financial strength and reduce our profitability.

Credit and cash flow assumption risk is the risk that issuers of securities, mortgagees on mortgage loans or other parties, including derivatives counterparties, default on their contractual obligations or experience adverse changes to their contractual cash flow streams. We attempt to minimize the adverse impact of this risk by monitoring portfolio diversification and exposure by asset class, creditor, industry, and by complying with investment limitations governed by state insurance laws and regulations as applicable. We also consider all relevant objective information available in estimating the cash flows related to residential and commercial mortgage backed securities.

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We use derivative instruments to fund the index credits on our fixed index annuities. We purchase derivative instruments, consisting primarily of one-year call options, from a number of counterparties. Our policy is to acquire such options only from counterparties rated "A-"or better by a nationally recognized rating agency and the maximum credit exposure to any single counterparty is subject to concentration limits. In addition, we have entered into credit support agreements with our counterparties which allow us to require our counterparties to post collateral to secure their obligations to us under the derivative instruments. If our counterparties fail to honor their obligations under the derivative instruments, our revenues may not be sufficient to fund the index credits on our fixed index annuities. Any such failure could harm our financial strength and reduce our profitability.

Liquidity risk. We could have difficulty selling certain investments such as privately placed securities, below investment grade securities and mortgage loans because they are less liquid than our publicly traded securities. If we require significant amounts of cash on short notice, we may have difficulty selling these securities and loans at attractive prices or in a timely manner, or both.

Fluctuations in interest rates and investment spread could adversely affect our business, financial condition, results of operations and cash flows.

A key component of our net income is the investment spread. A narrowing of investment spreads may adversely affect operating results. Although we have the right to adjust interest crediting rates (caps, participation or asset fee rates for fixed index annuities) on most products, changes to crediting rates may not be sufficient to maintain targeted investment spreads in all economic and market environments. In general, our ability to lower crediting rates is subject to minimum crediting rates filed with and approved by state regulators. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid the narrowing of spreads under certain market conditions. Our policy structure generally provides for resetting of policy crediting rates at least annually and imposes withdrawal penalties for withdrawals during the first 5 to 17 years a policy is in force.

We manage the index-based risk component of our fixed index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the caps, participation rates and asset fees on policy anniversary dates to reflect changes in the cost of such options which varies based on market conditions. The price of such options generally increases with increases in the volatility in both the options and interest rates, which may either narrow the spread or cause us to lower caps or participation rates. Thus, the volatility of the cost of the options adds an additional degree of uncertainty to the profitability of the index products. We attempt to mitigate this risk by resetting caps, participation rates and asset fees annually on the policy anniversaries.

Persistent environment of low interest rates may adversely affect our business, financial condition, results of operations and cash flows.

Prolonged periods of low interest rates may have a negative impact on our ability to sell our fixed index annuities as consumers look for other financial instruments with potentially higher returns to fund retirement. In times of low interest rates, such as we have been experiencing since 2010 and which we may continue to experience in 2019, it is difficult to offer attractive rates and benefits to customers while maintaining profitability, which may limit sales growth of interest sensitive products.

Sustained declines in interest rates may subject us to lower returns on our invested assets, and we have had to and may have to continue to invest the cash we receive from premiums and interest or return of principal on our investments in instruments with yields less than those we currently own. This may reduce our future net investment income and compress the spread on our annuity products. Further, borrowers may prepay fixed maturity securities and commercial mortgage loans in order to borrow at lower market rates. Any related prepayment fees are recorded in net investment income and may create income statement volatility.

An environment of rising interest rates may adversely affect our business, financial condition, results of operations and cash flows.

Periods of rising interest rates may cause increased policy surrenders and withdrawals as policyholders seek financial instruments with higher returns, commonly referred to as disintermediation. This may lead to net cash outflows and the resulting liquidity demands may require us to sell investment assets when the prices of those assets are adversely affected by the increase in interest rates, which may result in realized investment losses. Further, a portion of our investment portfolio consists of privately placed securities, below investment grade securities and commercial mortgage loans, which are relatively illiquid, thus increasing our liquidity risk in the event of disintermediation. We may also be required to accelerate the amortization of deferred policy acquisition costs and deferred sales inducements related to surrendered contracts, which would adversely affect our results of operations.

During such times, we may offer higher crediting rates on new sales of annuity products and increase crediting rates on existing annuity products to maintain or enhance product competitiveness. We may not be able to purchase enough higher yielding assets necessary to fund higher crediting rates and maintain our desired spread, which could result in lower profitability on our business. Alternatively, if we seek to maintain profitability of our products in rising interest rate environments it may be difficult to position our products to offer attractive rates and benefits to customers which may limit sales growth of interest sensitive products.

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Our valuation of fixed maturity securities may include methodologies, estimates and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may adversely affect our financial condition and results of operations.

Fixed maturity securities are reported at fair value in our consolidated balance sheets. During periods of market disruption including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain of our securities if trading becomes less frequent and/or market data becomes less observable. Prices provided by independent pricing services or independent broker quotes that are used in the determination of fair value can vary significantly for a particular security. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to changes in the financial environment. As such, valuations may include inputs and assumptions that are less observable or require greater judgment as well as valuation methods that require greater judgment. Further, rapidly changing and unprecedented credit conditions could negatively impact the valuation of securities as reported in our consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have an adverse effect on our results of operations or financial condition.

Defaults on commercial mortgage loans and volatility in performance may adversely affect our business, financial condition, results of operations and cash flows.

Commercial mortgage loans have the potential to face heightened delinquency and default risk depending on economic conditions which could have a negative impact on the performance of the underlying collateral, resulting in declining values and an adverse impact on the obligors of such instruments. An increase in the default rate of our commercial mortgage loan investments could have an adverse effect on our business, financial condition, results of operations and cash flows.

In addition, the carrying value of commercial mortgage loans is negatively impacted by such factors. The carrying value of commercial mortgage loans is stated as outstanding principal less any loan loss allowances recognized. Considerations in determining allowances include, but are not limited to, the following: (i) declining debt service coverage ratios and increasing loan to value ratios; (ii) bankruptcy filings of major tenants or affiliates of the borrower on the property; (iii) catastrophic events at the property; and (iv) other subjective events or factors, including whether the terms of the debt will be restructured. There can be no assurance that management's assessment of loan loss allowances on commercial mortgage loans will not change in future periods, which could lead to investment losses.

Equity market volatility could adversely impact our business, financial condition and results of operations.

Equity market volatility could adversely affect our profitability in various ways, particularly as a result of the lifetime income benefit riders in most of our policies. The liability for lifetime income benefit riders incorporates assumptions about the overall performance of equity markets over the estimated lives of the policies. Periods of equity market performance that are lower than our expectations could result in an increase in the portion of the liability for lifetime income benefit riders associated with such policies that is not funded by growth in the policy account value which could result in a reduction in our net income. In addition, periods of equity market performance that are lower than our expectations could result in accelerating the amortization of expenses we deferred in connection with the acquisition of the policies.

Conditions in the U.S. and global capital markets and economies could deteriorate in the near future and adversely affect our business, financial condition, results of operations and cash flows.

Our business is affected by conditions in the U.S. and global capital markets and economies. Future economic downturn or market disruption could negatively impact our ability to invest funds. Specifically, if market conditions deteriorate in 2019 or beyond:

- our investment portfolio could incur additional other than temporary impairments;
- our commercial mortgage loans could experience a greater amount of loss;
- due to potential downgrades in our investment portfolio, we could be required to raise additional capital to sustain our current business in force and new sales of our annuity products, which may be difficult in a distressed market. If capital would be available, it may be at terms that are not favorable to us;
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- we may be required to limit growth in sales of our annuity products; and/or
- our liquidity could be negatively affected and we could be forced to limit our operations and our business could suffer, as we need liquidity to pay our policyholder benefits, operating expenses, dividends on our capital stock, and to service our debt obligations.

The principal sources of our liquidity are annuity deposits, investment income and proceeds from the sale, maturity and call of investments. Sources of additional capital in normal markets include the issuance of short and long-term instruments, including equity, debt or other types of securities.

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We face competition from companies that have greater financial resources, broader arrays of products and higher ratings, which may limit our ability to retain existing customers, attract new customers and maintain our profitability and financial strength.

We operate in a highly competitive industry. Many of our competitors are substantially larger and enjoy substantially greater financial resources, higher ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships. Our annuity products compete with fixed index, fixed rate and variable annuities sold by other insurance companies and also with mutual fund products, traditional bank products and other retirement funding alternatives offered by asset managers, banks and broker/dealers. Our insurance products compete with those of other insurance companies, financial intermediaries and other institutions based on a number of factors, including caps, participation rates and crediting rates, policy terms and conditions, service provided to distributors and policyholders, ratings by rating agencies, reputation and distributor compensation.

Our ability to compete depends in part on returns and other benefits we make available to our policyholders through our annuity contracts. We will not be able to accumulate and retain assets under management for our products if our investment results underperform the market or the competition, since such underperformance likely would result in lower rates to policyholders which could lead to withdrawals and reduced sales.

Our ability to compete also depends on financial strength ratings we receive from rating agencies. A ratings downgrade, or the potential for a ratings downgrade, could have a number of adverse effects on our business. For example, distributors and sales agents for annuity products use the ratings as one factor in determining which insurer's annuities to market. A ratings downgrade could cause those distributors and agents to seek alternative carriers.

We compete for distribution sources for our products. We believe that our success in competing for distributors depends on our financial strength, the services we provide to and the relationships we develop with these distributors, as well as offering competitive commission structures. Our distributors are generally free to sell products from whichever providers they wish, which makes it important for us to continually offer distributors products and services they find attractive. If our products or services fall short of distributors' needs, we may not be able to establish and maintain satisfactory relationships with distributors of our products. Our ability to compete in the past has also depended in part on our ability to develop innovative new products. In order for us to compete in the future, we will need to continue to bring innovative products to market in a timely fashion. Otherwise, our revenues and profitability could suffer.

Our reinsurance program involves risks because we remain liable with respect to the liabilities ceded to reinsurers if the reinsurers fail to meet the obligations assumed by them.

Our life insurance subsidiaries cede certain policies to other insurance companies through reinsurance agreements. American Equity Life has three coinsurance agreements with Athene covering $4.4 billion of policy benefit reserves at December 31, 2018 and two coinsurance agreements with EquiTrust covering $0.6 billion of policy benefit reserves at December 31, 2018. Since Athene is an unauthorized reinsurer, the annuity deposits ceded to Athene are held in trusts and American Equity Life is named as the sole beneficiary of the trusts. The assets in the trusts are required to remain at a value that is sufficient to support the current balance of policy benefit liabilities of the ceded business on a statutory basis. If the value of the assets in the trusts would ever be less than the amount of the ceded policy benefit liabilities on a statutory basis, Athene is required to either establish a letter of credit or deposit securities in the trusts for the amount of any shortfall. We remain liable with respect to the policy liabilities ceded to EquiTrust and Athene should either fail to meet the obligations assumed by them.

In addition, we have entered into other types of reinsurance contracts including financing arrangements. Should any of these reinsurers fail to meet the obligations assumed under such contracts, we remain liable with respect to the statutory liabilities ceded.

Any disruption in our ability to maintain our reinsurance program may hinder our ability to manage our regulatory capital.

No assurances can be made that reinsurance will remain continuously available to us to the same extent and on the same terms as are currently available. If we were unable to maintain our current level of reinsurance or purchase new reinsurance protection in amounts that we consider sufficient and at prices that we consider acceptable, we would have to accept an increase in our net liability exposure or a decrease in our statutory surplus, reduce the amount of business we write or develop other alternatives to reinsurance.

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We may experience volatility in net income due to the application of fair value accounting to our derivatives.
All of our derivative instruments and derivatives embedded in other contracts are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings. This impacts certain revenues and expenses we report for our fixed index annuity business as follows:

- We must present the call options purchased to fund the index credits on our fixed index annuity products at fair value. The fair value of the call options is based upon the amount of cash that would be required to settle the call options obtained from the counterparties adjusted for the nonperformance risk of the counterparty. We record the change in fair value of these options as a component of our revenues. The change in fair value of derivatives includes the gains or losses recognized at expiration of the option term and changes in fair value for open positions.
- The contractual obligations for future index credits are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. Increases or decreases in the fair value of embedded derivatives generally correspond to increases or decreases in equity market performance and changes in the interest rates used to discount the excess of the projected policy contract values over the projected minimum guaranteed contract values. We record the change in fair value of these embedded derivatives as a component of our benefits and expenses in our consolidated statements of operations.

The application of fair value accounting for derivatives and embedded derivatives in future periods to our fixed index annuity business may cause substantial volatility in our reported net income.
Our financial condition and results of operations depend on the accuracy of management assumptions and estimates.
Assumptions and estimates are made regarding expenses and interest rates, tax liability, contingent liabilities, investment performance and other factors related to our business and anticipated results. We rely on these assumptions and estimates when determining period end accruals, future earnings and various components of our consolidated balance sheet. All assumptions and estimates utilized incorporate many factors, none of which can be predicted with certainty. Our actual experiences, as well as changes in estimates, are used to prepare our consolidated statement of operations. To the extent our actual experience and changes in estimates differ from original estimates, our results of operations and financial condition could be adversely affected.
The calculations we use to estimate various components of our consolidated balance sheet and consolidated statement of operations are necessarily complex and involve analyzing and interpreting large quantities of data. The assumptions and estimates required for these calculations involve judgment and by their nature are imprecise and subject to changes and revisions over time. Accordingly, our results may be adversely affected from time to time by actual results differing from assumptions, by changes in estimates and by changes resulting from implementing more sophisticated administrative systems and procedures that facilitate the calculation of more precise estimates.
We may face unanticipated losses if there are significant deviations from our assumptions regarding the probabilities that our annuity contracts will remain in force from one period to the next and our assumptions regarding policyholders' utilization of lifetime income benefit riders.
The expected profitability of our annuity products is based in part upon expected patterns of premiums, expenses and benefits using a number of assumptions, including those related to the probability that a policy will remain in force, or persistency, and mortality. Since no insurer can precisely determine persistency or mortality, actual results could differ significantly from assumptions, and deviations from estimates and assumptions could have an adverse effect on our business, financial condition or results of operations. For example, actual persistency that is lower than our assumptions could have an adverse impact on future profitability, especially in the early years of a policy primarily because we would be required to accelerate the amortization of expenses we deferred in connection with the acquisition of the policy.
In addition, we set initial crediting rates for our annuity products based upon expected benefit payments using assumptions for, among other factors, mortality rates of our policyholders. The long-term profitability of these products depends upon how our actual experience compares with our pricing assumptions. For example, if mortality rates are lower than our pricing assumptions, we could be required to make more payments under certain annuity contracts than what we had projected.
In determining the liability from period to period of our lifetime income benefit riders, we must make significant assumptions such as expected index credits, the age when a policyholder may begin to utilize the rider and the number

of policyholders that may not utilize the rider at all. Changes in these assumptions can be significant. Our experience regarding policyholder activity is limited as we began issuing policies with this rider in 2007. Accordingly, our results of operations could be adversely affected from time to time by actual index credits being different than expected, actual policyholder behavior varying from what we have assumed in determining the liability associated with these riders and by changes in estimates based on this policyholder behavior.

If our estimated gross profits decrease significantly from initial expectations we may be required to expense our deferred policy acquisition costs and deferred sales inducements in an accelerated manner, which would reduce our profitability.

Deferred policy acquisition costs are costs that vary with and primarily relate to the successful acquisition of new business. Deferred sales inducements are contract enhancements such as first-year premium and interest bonuses that are credited to policyholder account balances. These costs are capitalized when incurred and are amortized over the expected life of the contracts. Current amortization of these costs is generally in proportion to expected gross profits from interest margins and, to a lesser extent, from surrender charges and rider fees. Unfavorable experience with regard to expected expenses, investment returns, mortality or withdrawals may cause acceleration of the amortization of these costs resulting in an increase of expenses and lower profitability.

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If we do not manage our growth effectively, our business, financial condition and results of operations could be adversely affected; our historical growth rates may not be indicative of our future growth.

We have experienced rapid growth since our formation in December 1995. We intend to continue to grow and further growth will impose significant added responsibilities on our management, including the need to identify, recruit, maintain and integrate additional employees, including management. There can be no assurance that we will be successful in expanding our business or that our systems, procedures and controls will be adequate to support our operations as they expand. In addition, due to our rapid growth and resulting increased size, it may be necessary to expand the scope of our investing activities to asset classes in which we historically have not invested or have not had significant exposure. If we are unable to adequately manage our investments in these classes, our financial condition or operating results in the future could be less favorable than in the past. Further, we have utilized reinsurance in the past to support our growth. The future availability and cost of reinsurance is uncertain. Our failure to manage growth effectively, or our inability to recruit, maintain and integrate additional qualified employees could have an adverse effect on our business, financial condition or results of operations. In addition, our historical growth rates are not likely to accurately reflect our future growth rates or our growth potential. There is no assurance that our future revenues will increase or that we will continue to be profitable.

Our operations support complex transactions and are highly dependent on the proper functioning of information technology and communication systems. Any failure of our information technology or communications systems could adversely affect our reputation, business, financial condition, results of operations and cash flows.

While systems and processes are designed to support complex transactions and avoid systems failure, fraud, information security failures, processing errors and breaches of regulation, any failure could have an adverse effect on our business, financial condition, results of operations and cash flows. In addition, we must commit significant resources to maintain and enhance our existing systems in order to keep pace with industry standards and customer preferences. If we fail to keep up-to-date information systems, we may not be able to rely on information for product pricing, risk management and underwriting decisions. In addition, even though backup and recovery systems and contingency plans are in place, we cannot assure investors that interruptions, failures or breaches in security of these processes and systems will not occur, or if they do occur, that they can be remediated promptly. The occurrence of any of these events could have an adverse effect on our business, results of operations and financial condition.

An information technology failure or security breach could adversely affect our reputation, business, financial condition, results of operations and cash flows.

We use information technology ("IT") to store, retrieve, evaluate and utilize customer and company data and information. Our business is highly dependent on our ability to access IT systems to perform necessary business functions such as providing customer support, making changes to existing policies, filing and paying claims, managing our investment portfolios and producing financial statements. While we maintain comprehensive policies, procedures, automation and backup plans, and a broad range of information security technical and human controls designed to prevent or limit the effect of a failure, all IT systems are vulnerable to disruptions or data breaches as the result of natural or man-made disasters, criminal activity, pandemics or other events beyond an organization's control. The failure of our IT for any of these reasons could disrupt our operations, cause reputational harm resulting in the loss of customers, or otherwise negatively impact our business, financial condition, results of operations and cash flows.

We retain confidential information within our IT, and we rely on sophisticated commercial control technologies to maintain the security of those systems. Anyone who is able to circumvent our security measures and penetrate our IT could access, view, misappropriate, alter, or delete any information contained with the accessed systems, including personally identifiable policyholder information and proprietary business information. The NAIC has adopted the Insurance Data Security Model Law which established the standards for data security and investigation and notification of a breach of data security for insurance companies, and an increasing number of states require that affected persons be notified if a security breach results in the disclosure of their personally identifiable information. Any compromise of the security of our computer systems that results in the inappropriate disclosure of personally identifiable customer information could damage our reputation in the marketplace, deter people from purchasing our products, subject us to significant civil and criminal liability and require us to incur significant technical, legal and other expenses. While there have been attempts to penetrate our IT security defenses, there is no evidence that any the attacks have been successful or that an IT breach has occurred.

If we are unable to attract and retain national marketing organizations, independent agents, broker/dealers, banks and registered investment advisors, sales of our products may be reduced.

We must attract and retain marketing organizations and distributors, including agents to sell our products. Insurance companies compete vigorously for productive agents. We compete with other life insurance companies for marketers and agents primarily on the basis of our financial position, support services, compensation and product features. Such marketers and agents may promote products offered by other life insurance companies that may offer a larger variety of products than we do. Our competitiveness for such marketers and agents also depends upon the long-term relationships we develop with them. We are developing a network of broker/dealers, banks and registered investment advisors to distribute our products. If we are unable to attract and retain sufficient marketers, agents, broker/dealers, banks and registered investment advisors to sell our products, our ability to compete and our sales would suffer.

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We may require additional capital to support our business and sustain future growth which may not be available when needed or may be available only on unfavorable terms.

Our long-term strategic capital requirements will depend on many factors including the accumulated statutory earnings of our life insurance subsidiaries and the relationship between the statutory capital and surplus of our life insurance subsidiaries and various elements of required capital. For the purpose of supporting long-term capital requirements, we may need to increase or maintain the statutory capital and surplus of our life insurance subsidiaries through additional financings, which could include debt, equity, financing arrangements and/or other surplus relief transactions. Adverse market conditions have affected and continue to affect the availability and cost of capital. Such financings, if available at all, may be available only on terms that are not favorable to us. If we cannot maintain adequate capital, we may be required to limit growth in sales of new annuity products, and such action could adversely affect our business, financial condition or results of operations.

Changes in state and federal laws and regulation may adversely affect our business, financial condition, results of operations and cash flows.

We are subject to regulation under applicable insurance statutes, including insurance holding company statutes, in the various states in which our life insurance subsidiaries transact business. Our life insurance subsidiaries are domiciled in Iowa and New York. We are currently licensed to sell our products in 50 states and the District of Columbia. Insurance regulation is intended to provide safeguards for policyholders rather than to protect shareholders of insurance companies or their holding companies. As increased scrutiny has been placed upon the insurance regulatory framework, a number of state legislatures have considered or enacted legislative proposals that alter, and in many cases increase, state authority to regulate insurance companies and holding company systems.

Regulators oversee matters relating to trade practices, policy forms, claims practices, guaranty funds, types and amounts of investments, reserve adequacy, insurer solvency, minimum amounts of capital and surplus, transactions with related parties, changes in control and payment of dividends.

The NAIC and state insurance regulators continually reexamine existing laws and regulations. The NAIC may develop and recommend adoption of new or modify existing Model Laws and Regulations. State insurance regulators may impose those recommended changes, or others, in the future.

Our life insurance subsidiaries are subject to state insurance regulations based on the NAIC's risk-based capital requirements which are intended to be used by insurance regulators as an early warning tool to identify deteriorating or weakly capitalized insurance companies for the purpose of initiating regulatory action. Our life insurance subsidiaries also may be required, under solvency or guaranty laws of most states in which they do business, to pay assessments up to certain prescribed limits to fund policyholder losses or liabilities for insolvent insurance companies.

Although the federal government does not directly regulate the insurance business, federal legislation and administrative policies in several areas, including financial services regulation, securities regulation, federal taxation and employment matters, can significantly affect the insurance business. Heightened standards of conduct as a result of a fiduciary or best interest standard or other similar rules or regulations could also increase the compliance and regulatory burdens on our representatives. In addition, legislation has been enacted which could result in the federal government assuming some role in the regulation of the insurance industry.

In July 2010, the Dodd-Frank Act was enacted and signed into law. The Dodd-Frank Act made extensive changes to the laws regulating the financial services industry and requires various federal agencies to adopt a broad range of new rules and regulations. Among other things, the Dodd-Frank Act imposes a comprehensive new regulatory regime on the over-the-counter ("OTC") derivatives marketplace. It also requires central clearing for certain derivatives transactions that the U.S. Commodities Futures Trading Commission ("CFTC") determines must be cleared and are accepted for clearing by a "derivatives clearing organization" (subject to certain exceptions) and provides the CFTC with authority to impose position limits across markets. The Dodd-Frank Act and any such regulations may subject us to additional restrictions on our hedging positions which may have an adverse effect on our ability to hedge risks associated with our business, including our fixed index annuity business, or on the cost of our hedging activity.

The Dodd-Frank Act also created the FSOC. The FSOC may designate whether certain insurance companies and insurance holding companies pose a grave threat to the financial stability of the United States, in which case such companies would become subject to prudential regulation by the Board of Governors of the Federal Reserve. The

Dodd-Frank Act also established a Federal Insurance Office under the U.S. Treasury Department to monitor all aspects of the insurance industry other than certain health insurance, certain long-term care insurance and crop insurance. It is not possible at this time to assess the impact on our business of the establishment of the Federal Insurance Office and the FSOC. However, the regulatory framework at the state and federal level applicable to our insurance products is evolving. The changing regulatory framework could affect the design of such products and our ability to sell certain products. Any changes in these laws and regulations could adversely affect our business, financial condition or results of operations.

Changes in federal income taxation laws, including any reduction in individual income tax rates, may adversely affect our business, financial condition, results of operations and cash flows.

The annuity and life insurance products that we market generally provide the policyholder with certain federal income tax advantages. For example, federal income taxation on any increases in non-qualified annuity contract values (i.e., the "inside build-up") is deferred until it is received by the policyholder. With other savings instruments, such as certificates of deposit and taxable bonds, the increase in value is generally taxed each year as it is realized. Decreases in individual income tax rates would decrease the advantage of deferring the inside build-up.

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From time to time, various tax law changes have been proposed that could have an adverse effect on our business, including the elimination of all or a portion of the income tax advantages described above for annuities and life insurance. If legislation were enacted to eliminate all or a portion of the tax deferral for annuities, such a change would have an adverse effect on our ability to sell non-qualified annuities. Non-qualified annuities are annuities that are not sold to a qualified retirement plan.

We face risks relating to litigation and regulatory examination, including the costs of such litigation or examination, management distraction and the potential for damage awards, fines, penalties or other required remediation, which may adversely affect our business, financial condition, results of operations and cash flows.

We are occasionally involved in litigation, both as a defendant and as a plaintiff. In addition, state regulatory bodies, such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, Inc. ("FINRA"), the Department of Labor ("DOL") and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, the Employee Retirement Income Security Act of 1974, as amended, and laws governing the activities of broker/dealers. Companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims.

A downgrade in our credit or financial strength ratings may increase our cost of capital, reduce new sales, adversely affect relationships with distributors and increase policy surrenders and withdrawals.

Currently, our senior unsecured indebtedness carries a "BBB-" rating with a stable outlook from S&P, a "BB+" rating with a positive outlook from Fitch, and a "bbb-" rating with a stable outlook from A.M. Best. Our ability to maintain such ratings is dependent upon the results of operations of our subsidiaries and our financial strength. If we fail to preserve the strength of our balance sheet and to maintain a capital structure that rating agencies deem suitable, it could result in a downgrade of the ratings applicable to our senior unsecured indebtedness. A downgrade would likely reduce the fair value of the common stock and may increase our cost of capital.

Financial strength ratings are important factors in establishing the competitive position of life insurance and annuity companies. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. A ratings downgrade, or the potential for a ratings downgrade, could have a number of adverse effects on our business. For example, distributors and sales agents for life insurance and annuity products use the ratings as one factor in determining which insurer's annuities to market. A ratings downgrade could cause those distributors and agents to seek alternative carriers. In addition, a ratings downgrade could increase the number of policy or contract surrenders we experience, as well as our ability to obtain reinsurance or obtain reasonable pricing on reinsurance.

Financial strength ratings are measures of an insurance company's ability to meet policyholder obligations and generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their ratings upon information furnished to them by the insurer and upon their own investigations, studies and assumptions. Ratings are based upon factors of concern to agents, policyholders and intermediaries and are not directed toward the protection of investors and are not recommendations to buy, sell or hold securities.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We lease commercial office space in two buildings in West Des Moines, Iowa, one for our principal offices under an operating lease that expires on November 30, 2026 and one for our investment operations under a lease that expires on March 15, 2023. We believe these facilities are suitable and adequate for our current business operations.

Item 3. Legal Proceedings

See Note 13 to our audited consolidated financial statements.

Item 4. Mine Safety Disclosures

None

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol AEL. The following table sets forth the high and low sales prices of our common stock for each quarterly period within the two most recent fiscal years as quoted on the NYSE.

	High	Low
2018		
First Quarter	$35.79	$28.90
Second Quarter	$37.16	$27.06
Third Quarter	$38.57	$34.51
Fourth Quarter	$36.39	$25.27
2017		
First Quarter	$28.00	$21.66
Second Quarter	$26.65	$22.23
Third Quarter	$29.43	$25.43
Fourth Quarter	$32.54	$28.06

As of February 11, 2019, there were approximately 28,800 holders of our common stock. In 2018 and 2017, we paid an annual cash dividend of $0.28 and $0.26, respectively, per share on our common stock. We intend to continue to pay an annual cash dividend on such shares so long as we have sufficient capital and/or future earnings to do so. However, we anticipate retaining most of our future earnings, if any, for use in our operations and the expansion of our business. Any further determination as to dividend policy will be made by our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition and future prospects and such other factors as our board of directors may deem relevant.

Since we are a holding company, our ability to pay cash dividends depends in large measure on our subsidiaries' ability to make distributions of cash or property to us. Iowa insurance laws restrict the amount of distributions American Equity Life and Eagle Life can pay to us without the approval of the Iowa Insurance Commissioner. See Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 12 to our audited consolidated financial statements, which are incorporated by reference in this Item 5.

Issuer Purchases of Equity Securities

The following table presents the amount of our share purchase activity for the periods indicated:

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share
January 1, 2018 - January 31, 2018	—	$ —
February 1, 2018 - February 28, 2018	913	$ 31.92
March 1, 2018 - March 31, 2018	8,759	$ 31.82
April 1, 2018 - April 30, 2018	—	$ —
May 1, 2018 - May 31, 2018	—	$ —
June 1, 2018 - June 30, 2018	2,018	$ 35.70
July 1, 2018 - July 31, 2018	—	$ —
August 1, 2018 - August 31, 2018	—	$ —
September 1, 2018 - September 30, 2018	—	$ —
October 1, 2018 - October 31, 2018	—	$ —
November 1, 2018 - November 30, 2018	—	$ —
December 1, 2018 - December 31, 2018	—	$ —

Total	11,690

(a) Includes the number of shares of common stock utilized to execute certain stock incentive awards.

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Item 6. Selected Consolidated Financial Data

The summary consolidated financial and other data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements and related notes appearing elsewhere in this report. The results for past periods are not necessarily indicative of results that may be expected for future periods.

	Year ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Revenues					
Premiums and other considerations	$26,480	$34,228	$43,767	$36,048	$32,623
Annuity product charges	224,488	200,494	173,579	136,168	118,990
Net investment income	2,147,812	1,991,997	1,849,872	1,692,192	1,531,667
Change in fair value of derivatives	(777,848)	1,677,871	164,219	(336,146)	504,825
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	(37,178)	10,509	11,524	10,211	(4,003)
Net OTTI losses recognized in operations	(36,656)	(4,630)	(22,679)	(19,536)	(2,627)
Total revenues	1,547,098	3,891,652	2,220,282	1,518,937	2,168,973
Benefits and expenses					
Insurance policy benefits and change in future policy benefits	39,530	43,219	52,483	45,458	41,815
Interest sensitive and index product benefits	1,610,835	2,023,668	725,472	968,053	1,473,700
Change in fair value of embedded derivatives	(1,389,491)	919,735	543,465	(464,698)	32,321
Amortization of deferred sales inducements and policy acquisition costs	550,192	432,576	625,178	495,504	294,997
Interest expense on notes and loan payable and subordinated debentures	40,989	44,492	41,206	41,088	48,492
Other operating costs and expenses	129,301	111,691	102,231	96,218	81,584
Total benefits and expenses	981,356	3,575,381	2,090,035	1,181,623	1,972,909
Income before income taxes	565,742	316,271	130,247	337,314	196,064
Income tax expense	107,726	141,626	47,004	117,484	70,041
Net income	$458,016	$174,645	$83,243	$219,830	$126,023
Per Share Data:					
Earnings per common share	$5.07	$1.96	$0.98	$2.78	$1.69
Earnings per common share - assuming dilution	5.01	1.93	0.97	2.72	1.58
Dividends declared per common share	0.28	0.26	0.24	0.22	0.20
Non-GAAP Financial Measures (a):					
Reconciliation from net income to non-GAAP operating income:					
Net income	$458,016	$174,645	$83,243	$219,830	$126,023
Net realized investment (gains) losses, including OTTI	45,450	(5,093)	7,188	5,737	4,429
Change in fair value of derivatives and embedded derivatives - fixed index annuities	(72,181)	121,846	56,634	(44,055)	79,053
Change in fair value of derivatives - debt	(1,892)	(1,224)	(1,265)	1,296	104
Extinguishment of debt	—	—	—	—	12,503
Litigation reserve	—	—	(1,957)	—	(1,418)
Income taxes	(3,653)	(5,124)	(21,499)	13,012	(30,048)

Non-GAAP operating income	$425,740	$285,050	$122,344	$195,820	$190,646
Non-GAAP operating income per common share	$4.71	$3.20	$1.44	$2.48	$2.56
Non-GAAP operating income per common share - assuming dilution	4.66	3.16	1.43	2.42	2.39

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	As of and for the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands, except per share data)				
Consolidated Balance Sheet Data:					
Total investments	$49,427,498	$50,300,705	$44,757,568	$39,570,332	$35,981,858
Total assets	61,625,564	62,030,736	56,053,472	49,029,392	43,976,689
Policy benefit reserves	57,606,009	56,142,673	51,637,026	45,495,431	39,802,861
Notes and loan payable	494,591	494,093	493,755	393,227	413,805
Subordinated debentures	242,982	242,565	241,853	241,452	241,072
Accumulated other comprehensive income (loss) ("AOCI")	(52,432)	724,599	339,966	201,663	721,401
Total stockholders' equity	2,399,101	2,850,157	2,291,595	1,944,535	2,139,876
Other Data:					
Life subsidiaries' statutory capital and surplus and asset valuation reserve	3,542,339	3,260,328	2,933,193	2,593,472	2,327,335
Life subsidiaries' statutory net gain from operations before income taxes and realized capital gains (losses)	372,830	565,295	144,159	227,865	467,923
Life subsidiaries' statutory net income	222,734	386,274	80,699	132,723	344,666
Book value per share (b)	26.55	31.91	26.04	23.83	27.93
Book value per share, excluding AOCI (b)	27.13	23.79	22.17	21.36	18.52

(a) In addition to net income, we have consistently utilized non-GAAP operating income and non-GAAP operating income per common share—assuming dilution, non-GAAP financial measures commonly used in the life insurance industry, as economic measures to evaluate our financial performance. Non-GAAP operating income equals net income adjusted to eliminate the impact of items that fluctuate from year to year in a manner unrelated to core operations, and we believe measures excluding their impact are useful in analyzing operating trends. The most significant adjustments to arrive at non-GAAP operating income eliminate the impact of fair value accounting for our fixed index annuity business. These adjustments are not economic in nature but rather impact the timing of reported results. In addition, 2017 includes a $35.9 million adjustment to arrive at non-GAAP operating income resulting from the Tax Cuts and Jobs Act of 2017, which was enacted on December 22, 2017 and required a revaluation of our net deferred tax assets from 35% to 21%. We believe the combined presentation and evaluation of non-GAAP operating income together with net income provides information that may enhance an investor's understanding of our underlying results and profitability. The amounts included in the reconciliation of net income to non-GAAP operating income are presented net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs.

(b) Book value per share and book value per share excluding AOCI, non-GAAP financial measures, are calculated as total stockholders' equity and total stockholders' equity excluding AOCI divided by the total number of shares of common stock outstanding. Since AOCI fluctuates from year to year due to unrealized changes in the fair value of available for sale investments, we believe these non-GAAP financial measures provide useful supplemental information.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis reviews our consolidated financial position at December 31, 2018 and 2017, and our consolidated results of operations for the three years in the period ended December 31, 2018, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our audited consolidated financial statements, notes thereto and selected consolidated financial data appearing elsewhere in this report.

Cautionary Statement Regarding Forward-Looking Information

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

- general economic conditions and other factors, including prevailing interest rate levels and stock and credit market performance which may affect (among other things) our ability to sell our products, our ability to access capital resources and the costs associated therewith, the fair value of our investments, which could result in impairments and other than temporary impairments, and certain liabilities, and the lapse rate and profitability of policies;
- customer response to new products and marketing initiatives;
- changes in Federal income tax laws and regulations which may affect the relative income tax advantages of our products;
- increasing competition in the sale of fixed annuities;
- regulatory changes or actions, including those relating to regulation of financial services affecting (among other things) bank sales and underwriting of insurance products and regulation of the sale, underwriting and pricing of products; and
- the risk factors or uncertainties listed from time to time in our filings with the SEC.

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of this report.

Executive Summary

Excellent customer service teamed with our ability to offer innovative insurance products that provide principal protection and lifetime income continued to result in significant sales of our annuity products. In 2018, our sales were $4.4 billion which has resulted in cash and investments in excess of $49 billion at December 31, 2018. Our sales for the last five years have ranged from $4.2 billion to $7.1 billion. We have applied a conservative investment strategy to the annuity deposits we continue to manage which has provided reliable returns on our invested assets. Our profitability has also been driven by maintaining an efficient operation.

The economic and personal investing environments continued to be conducive for high sales levels as retirees and others look to put their money in instruments that will protect their principal and provide them with consistent cash flow sources in their retirement years. Our sales increased in 2018 as compared to 2017 due to the launch of new products during 2018 to improve our competitive position in the guaranteed lifetime income benefit market, the continued competitiveness of our accumulation products and higher yields which supported increases in payout factors on our guaranteed income products. In addition, we benefited from an increase in industry sales of fixed index annuities during 2018 in part due to the DOL conflict of interest fiduciary rule being vacated. These factors were partially mitigated by continued competitive pressures within each of our distribution channels. We continue to face a challenging environment for sales of fixed index annuities due to a highly competitive market.

We continue to be in the midst of an unprecedented period of low interest rates and low yields for investments with the credit quality we prefer which presents a strong headwind to achieving our target rate for investment spread. In response, we have been reducing policyholder crediting rates for new annuities and existing annuities since the fourth quarter of 2011. In addition, options costs for certain index strategies have been increasing in the last several quarters which has caused an increase in our aggregate cost of money. We continue to have flexibility to reduce our crediting rates if necessary and could decrease our cost of money by approximately 63 basis points if we reduce current rates to guaranteed minimums. In addition, starting in 2017 we began to invest in asset classes that were not traditionally in our portfolio, focusing on investments with less liquidity that provide higher yields and have a track record of positive credit performance. Investment yields available to us in 2018 increased compared to 2017 due to an increase in interest rates on the asset classes we targeted for purchase and investment in new asset classes as noted above. We are looking to improve our investment yield through the opportunistic replacement of lower yielding securities with higher yielding securities. During 2018 we sold $2.1 billion in book value of lower yielding securities for a yield pick-up of approximately 170 basis points on these investments. As book yields on the securities sold were less than market yields, we recognized losses of approximately $50 million with $38 million recognized in net realized gains (losses), and $12 million recognized as OTTI. These losses should be recovered from the higher yields on the securities acquired with the proceeds from the sales in less than two years. While we anticipate pursuing additional portfolio realignment opportunities in 2019, we would not expect the size to be as large as in 2018.

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Our Business and Profitability

We specialize in the sale of individual annuities (primarily fixed index deferred annuities). Under U.S. generally accepted accounting principles ("GAAP"), premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liabilities for policyholder account balances and not as expenses. Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders, net realized gains (losses) on investments and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest sensitive and index product benefits (primarily interest credited to account balances and changes in the liability for lifetime income benefit riders), changes in fair value of embedded derivatives, amortization of deferred sales inducements and deferred policy acquisition costs, other operating costs and expenses and income taxes.

Our business model contemplates continued growth in invested assets and non-GAAP operating income while maintaining a high quality investment portfolio that will not experience significant losses from impairments of invested assets. We are committed to maintaining a high quality investment portfolio with limited exposure to below investment grade securities and other riskier assets. Growth in invested assets is predicated on a continuation of our high sales achievements of the last five years while at the same time maintaining a high level of retention of the funds received.

Our profitability depends in large part upon:

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

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

	Year Ended December 31,		
	2018	2017	2016
Average yield on invested assets	4.47%	4.46%	4.51%
Aggregate cost of money	1.87%	1.74%	1.90%
Aggregate investment spread	2.60%	2.72%	2.61%
Impact of:			
Investment yield - additional prepayment income	0.08%	0.08%	0.06%
Cost of money benefit from over hedging	0.05%	0.06%	0.01%

The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies—Deferred Policy Acquisition Costs and Deferred Sales Inducements. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy and expenses we incur to fund the annual index credits. Proceeds received upon expiration of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments.

Aggregate investment spread decreased during 2018 as compared to 2017 primarily due to an increase in the cost of money resulting from an increase in option costs for certain index strategies over the last several quarters. See the Executive Summary for a discussion of our actions in response to the increase in option costs and the low interest rate environment.

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Results of Operations for the Three Years Ended December 31, 2018

Annuity deposits by product type collected during 2018, 2017 and 2016, were as follows:

	Year Ended December 31,		
Product Type	2018	2017	2016
	(Dollars in thousands)		
American Equity:			
Fixed index annuities	$3,560,881	$3,390,144	$5,114,178
Annual reset fixed rate annuities	45,636	74,829	64,317
Multi-year fixed rate annuities	3,581	23,424	450,474
Single premium immediate annuities	23,813	24,946	35,851
	3,633,911	3,513,343	5,664,820
Eagle Life:			
Fixed index annuities	660,401	576,695	610,580
Annual reset fixed rate annuities	1,555	—	—
Multi-year fixed rate annuities	109,096	87,172	852,799
	771,052	663,867	1,463,379
Consolidated:			
Fixed index annuities	4,221,282	3,966,839	5,724,758
Annual reset fixed rate annuities	47,191	74,829	64,317
Multi-year fixed rate annuities	112,677	110,596	1,303,273
Single premium immediate annuities	23,813	24,946	35,851
Total before coinsurance ceded	4,404,963	4,177,210	7,128,199
Coinsurance ceded	413,222	387,280	1,736,054
Net after coinsurance ceded	$3,991,741	$3,789,930	$5,392,145

Over these years competition has increased significantly within the fixed index annuity market. While we continue to be in the top three companies for sales of fixed index annuities within the independent agent channel, the new entrants into the market have expanded the overall market through other distribution channels and our overall market share has declined from second in 2016 to sixth based on information available through the nine-months ended September 30, 2018 according to Wink's Sales and Market Report published by Wink, Inc. We attribute our leading position to our attractive product offerings, our consistent presence in the fixed index annuity market, our continued strong relationships with and excellent service provided to our distribution partners, the increased attractiveness of safe money products in volatile markets and lower interest rates on competing products such as bank certificates of deposit.

Annuity deposits before coinsurance ceded increased 5% during 2018 compared to 2017 and decreased 41% during 2017 compared to 2016. Annuity deposits after coinsurance ceded increased 5% during 2018 as compared to 2017 and decreased 30% in 2017 as compared to 2016. The increase in sales in 2018 was due to the launch of new products during 2018 to improve our competitive position in the guaranteed lifetime income benefit market, the continued competitiveness of our accumulation products and higher yields which supported increases in payout factors on our guaranteed income products. In addition, we benefited from an increase in industry sales of fixed index annuities during 2018 in part due to the DOL conflict of interest fiduciary rule being vacated. These factors were partially mitigated by continued competitive pressures within each of our distribution channels. We continue to face a challenging environment for sales of fixed index annuities due to a highly competitive market.

2017 sales levels were negatively impacted by competitive pressures within each of our distribution channels. In addition, low interest rates, strong equity markets and uncertainty surrounding the DOL conflict of interest fiduciary rule were headwinds for sales of guaranteed income products. 2016 sales levels were supported by sales of multi-year rate guaranteed ("MYGA") fixed annuity products. These products are often emphasized by banks which are an expanding source of distribution for Eagle Life. Our rates on these products were more competitive during the first half of 2016 and together with the larger number of bank distribution relationships, translated into significant sales of those products.

We coinsure 80% of the annuity deposits received from MYGA fixed annuity products and 50% of the fixed index annuities sold by Eagle Life through broker/dealers and banks. Prior to January 1, 2017, the coinsurance percentage for fixed index annuities sold by Eagle Life was 80%. The changes in coinsurance ceded premiums are attributable to changes in premiums from these sources.

Net income increased 162% to $458.0 million in 2018 and 110% to $174.6 million in 2017 from $83.2 million in 2016. Net income, in general, has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. The average amount of annuity account balances outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 6% to $49.9 billion for the year ended December 31, 2018 compared to $46.8 billion in 2017 and 8% for the year ended December 31, 2017 compared to $43.5 billion in 2016. Our investment spread measured in dollars was $1.2 billion, $1.2 billion, and $1.0 billion for the years ended December 31, 2018, 2017 and 2016, respectively. As previously mentioned, our investment spread has been negatively impacted by the extended low interest rate environment (see Net investment income) and the increase in our aggregate cost of money due to an increase in option costs for certain index strategies we have been experiencing for the last several quarters.

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Net income for the year ended December 31, 2018 was also positively impacted by a decrease in the statutory federal income tax rate as a result of Tax Reform (see Income tax expense). In addition, net income for the year ended December 31, 2018 benefited from a discrete tax item for a worthless stock deduction related to a wholly-owned subsidiary which reduced income tax expense by approximately $7.4 million.

Net income for the year ended December 31, 2018 was negatively impacted by realized investment losses of $73.8 million, of which $37.1 million was recognized as net realized losses and $36.7 million was recognized as OTTI. See Net realized gains (losses) on investments, excluding OTTI losses and Net OTTI losses recognized in operations and Note 3 to our audited consolidated financial statements for discussion of net realized gains (losses) on investments and net OTTI losses recognized in operations.

Net income for the year ended December 31, 2017 was negatively impacted by $35.9 million related to the revaluation of our net deferred tax assets using the newly enacted federal tax rate as a result of Tax Reform. Net income for the year ended December 31, 2017 was also negatively impacted by an $18.4 million pretax loss on the extinguishment of our $400 million notes due 2021 (the "2021 Notes"), which reduced net income by $10.8 million. See Note 9 to our audited consolidated financial statements.

Net income is also impacted by the change in fair value of derivatives and embedded derivatives which fluctuates from year to year based upon changes in fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in the interest rate used to discount the embedded derivative liability. Net income for the year ended December 31, 2018 was positively impacted by an increase in the discount rate used to estimate our embedded derivative liabilities while net income for the years ended December 31, 2017 and 2016 was negatively impacted by a decrease in the discount rate used to estimate our embedded derivative liabilities.

We periodically revise the key assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements retrospectively through an unlocking process when estimates of current or future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. In addition, we periodically revise the assumptions used in determining the liability for lifetime income benefit riders as experience develops that is different from our assumptions.

Net income for 2018, 2017 and 2016 includes effects from revisions to assumptions as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Increase (decrease) in amortization of deferred sales inducements	$(21,465)	$(34,274)	$35,760
Increase (decrease) in amortization of deferred policy acquisition costs	(30,572)	(48,198)	48,164
Increase (decrease) in interest sensitive and index product benefits	(53,607)	21,608	42,002
Increase (decrease) in net income	82,825	39,196	(81,224)

We review these assumptions quarterly and as a result of these reviews, we made adjustments to assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements during 2018. The most significant revisions to such assumptions were account balance true-ups which were favorable to us due to stronger index credits than we assumed due to strong equity market performance and adjustments to generally decrease lapse rate assumptions to reflect better persistency experienced than assumed. The favorable impact of the account balance true-ups and lapse rate assumption changes was partially offset by revisions to lower our future investment spread assumptions primarily due to an increase in the cost of money we have been experiencing.

The most significant revisions made during 2017 as a result of our quarterly reviews were account balance true-ups which were favorable to us due to stronger index credits than we assumed due to strong equity market performance and adjustments to generally decrease lapse rate assumptions to reflect better persistency experienced than assumed. The favorable impact of the account balance true-ups and lapse rate assumption changes was partially offset by reductions in estimated future gross profits attributable to revisions to assumptions used in determining the liability for lifetime income benefit riders as well as an increase in estimated expenses associated with a reinsurance agreement with an unaffiliated reinsurer.

The most significant revisions during 2016 as a result of our quarterly reviews were adjustments to lower future spread assumptions as actual investment spreads being earned showed investment spread and gross profits being less than what we were assuming in our models due to decreases in the average yield on invested assets resulting from the continued low interest rate environment. We also made adjustments to extend the period of time in which we assume investment spread will grade up to our long-term spread targets by an additional two years as yields obtained on investment purchases were much lower than we had anticipated as a result of the overall decline in investment yields that followed the Brexit vote. In addition, revisions to assumptions used in determining the liability for lifetime income benefit riders during 2016 resulted in a decrease in estimated future gross profits.

The 2018, 2017 and 2016 revisions to the liability for lifetime income benefit riders were consistent with the revisions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements described above. The 2018 revisions were primarily attributable to account balance true-ups and future investment spread assumptions. The impact of the account balance true-ups and future investment spread changes was partially offset by the lapse rate assumptions changes described above. The 2017 revisions were primarily due to the lapse rate assumption changes described above and changes to our account value growth projections. The 2016 revisions were primarily due to actual index credits on policies being lower than projected over the past four quarters.

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Non-GAAP operating income, a non-GAAP financial measure (see reconciliation to net income in Item 6. Selected Consolidated Financial Data) increased 49% to $425.7 million in 2018 and 133% to $285.1 million in 2017 from $122.3 million in 2016.

In addition to net income, we have consistently utilized non-GAAP operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Non-GAAP operating income equals net income adjusted to eliminate the impact of items that fluctuate from year to year in a manner unrelated to core operations, and we believe measures excluding their impact are useful in analyzing operating trends. The most significant adjustments to arrive at non-GAAP operating income eliminate the impact of fair value accounting for our fixed index annuity business and are not economic in nature but rather impact the timing of reported results. In addition, 2017 includes a $35.9 million adjustment to arrive at non-GAAP operating income resulting from the Tax Cuts and Jobs Act of 2017, which was enacted on December 22, 2017 and required a revaluation of our net deferred tax assets from 35% to 21%. We believe the combined presentation and evaluation of non-GAAP operating income together with net income provides information that may enhance an investor's understanding of our underlying results and profitability.

Non-GAAP operating income is not a substitute for net income determined in accordance with GAAP. The adjustments made to derive non-GAAP operating income are important to understand our overall results from operations and, if evaluated without proper context, non-GAAP operating income possesses material limitations. As an example, we could produce a low level of net income in a given period, despite strong operating performance, if in that period we experience significant net realized losses from our investment portfolio. We could also produce a high level of net income in a given period, despite poor operating performance, if in that period we generate significant net realized gains from our investment portfolio. As an example of another limitation of non-GAAP operating income, it does not include the decrease in cash flows expected to be collected as a result of credit loss OTTI. Therefore, our management reviews net realized investment gains (losses) and analyses of our net investment income, including impacts related to OTTI write-downs, in connection with their review of our investment portfolio. In addition, our management examines net income as part of their review of our overall financial results.

Non-GAAP operating income for 2018, 2017 and 2016 includes effects from revisions to assumptions as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Increase (decrease) in amortization of deferred sales inducements	$(20,466)	$(31,317)	$36,127
Increase (decrease) in amortization of deferred policy acquisition costs	(28,702)	(43,716)	47,765
Increase (decrease) in interest sensitive and index product benefits	(53,607)	21,608	42,002
Increase (decrease) in non-GAAP operating income	80,576	34,405	(81,202)

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 12% to $224.5 million in 2018 and 16% to $200.5 million in 2017 from $173.6 million in 2016. The components of annuity product charges are set forth in the table that follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Surrender charges	$65,644	$54,624	$51,577
Lifetime income benefit riders (LIBR) fees	158,844	145,870	122,002
	$224,488	$200,494	$173,579
Withdrawals from annuity policies subject to surrender charges	$572,802	$456,084	$429,090
Average surrender charge collected on withdrawals subject to surrender charges	11.5 %	12.0 %	12.0 %
Fund values on policies subject to LIBR fees	$21,773,577	$20,440,431	$17,809,659

Weighted average per policy LIBR fee	0.73	%	0.71	%	0.69	%

The increases in annuity product charges were primarily attributable to increases in fees assessed for lifetime income benefit riders due to a larger volume of business in force subject to the fee and increases in the average fees being charged due to higher fees on new products as compared to prior periods. See Interest sensitive and index product benefits below for corresponding expense recognized on lifetime income benefit riders. In addition, surrender charges increased in 2018 and 2017 due to an increase in withdrawals from annuity policies subject to surrender charges as compared to prior years, which is due to a larger volume of business in force and policyholder behavior.

Net investment income increased 8% to $2.1 billion in 2018 and 8% to $2.0 billion in 2017 from $1.8 billion in 2016. The increases were principally attributable to the growth in our annuity business and corresponding increases in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 7% to $48.1 billion in 2018 and 9% to $44.8 billion in 2017 compared to $41.1 billion in 2016.

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The average yield earned on average invested assets was 4.47%, 4.46% and 4.51% for 2018, 2017 and 2016, respectively. The increase in yield earned on average invested assets in 2018 was attributable to the investment of new premiums and portfolio cash flows at rates above the overall portfolio yield and higher yields being earned on our floating rate investments. The decrease in yield earned on average invested assets in 2017 was attributable to investment of new premiums and portfolio cash flows during those periods at rates below the overall portfolio yield. The average yield on fixed income securities purchased and commercial mortgage loans funded was 4.79%, 4.16% and 3.66% for the years ended December 31, 2018, 2017 and 2016, respectively. The impact from these items was also impacted by non-trendable investment income items which added eight basis points to the average yield on invested assets in 2018 and 2017 and six basis points to the average yield on invested assets in 2016, respectively.
Change in fair value of derivatives consists of call options purchased to fund annual index credits on fixed index annuities, and an interest rate swap and interest rate caps that hedge our floating rate subordinated debentures. The components of change in fair value of derivatives are as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Call options:			
Gain (loss) on option expiration	$656,953	$1,062,328	$(282,574)
Change in unrealized gains/losses	(1,435,852)	615,955	447,603
Interest rate swap	869	255	(482)
Interest rate caps	182	(667)	(328)
	$(777,848)	$1,677,871	$164,219

The differences between the change in fair value of derivatives between years for call options are primarily due to the performance of the indices upon which our call options are based which impacts the fair values and changes in the fair values of those call options between years. A substantial portion of our call options are based upon the S&P 500 Index with the remainder based upon other equity and bond market indices. The range of index appreciation (after applicable caps, participation rates and asset fees) for options expiring during these years is as follows:

	Year Ended December 31,		
	2018	2017	2016
S&P 500 Index			
Point-to-point strategy	0.0 - 13.9%	1.0 - 13.3%	0.0 - 8.2%
Monthly average strategy	0.0 - 8.1%	0.1 - 10.6%	0.0 - 8.3%
Monthly point-to-point strategy	0.0 - 17.5%	0.0 - 17.0%	0.0 - 5.0%
Fixed income (bond index) strategies	0.0 - 5.1%	0.0 - 5.9%	0.0 - 10.0%

The change in fair value of derivatives is also influenced by the aggregate costs of options purchased. The aggregate cost of options has increased primarily due to an increased amount of fixed index annuities in force as well as an increase in the cost of options for certain index strategies which began during the second half of 2017. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities.
Net realized gains (losses) on investments, excluding OTTI losses include gains and losses on the sale of securities and impairment losses on mortgage loans on real estate which fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments, as well as gains (losses) recognized on real estate owned due to any sales and impairments on long-lived assets. See Note 3 to our audited consolidated financial statements for a detailed presentation of the types of investments that generated the gains (losses).
Losses on available for sale fixed maturity securities were realized primarily due to strategies to reposition the fixed maturity security portfolio that resulted in improved net investment income, risk or duration profiles as they pertain to our asset liability management. During 2018 we sold $2.1 billion in book value of lower yielding securities for a yield pick-up of approximately 170 basis points on these investments. As book yields on these securities sold were less than market yields, we recognized losses of approximately $38 million on these sales. In addition, securities were sold at losses in 2018, 2017 and 2016 due to our long-term fundamental concern with the issuers' ability to meet their future

financial obligations. See Note 4 to our audited consolidated financial statements for additional discussion of allowance for credit losses recognized on mortgage loans on real estate.

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Net OTTI losses recognized in operations increased to $36.7 million in 2018 and decreased to $4.6 million in 2017 from $22.7 million in 2016. The increase in impairments recognized in 2018 compared to 2017 is partially related to our strategy to reposition the fixed maturity security portfolio. We sold $384 million in book value of securities in early October and recognized OTTI of $12 million based on our intent to sell such securities as of September 30, 2018. In addition, during 2018 we recognized impairments on certain securities with exposure to various sectors, including the energy and utilities sectors, due to specific credit concerns and/or our intent to sell such securities. The impairments recognized in 2017 were primarily on a corporate security with exposure to the industrial sector in Latin America and additional impairments on previously impaired residential mortgage backed securities. The impairments recognized in 2016 were primarily on three corporate securities with exposure to the telecommunications, materials and energy sectors and two asset-backed securities with exposure to the energy sector. See Financial Condition - Other Than Temporary Impairments and Note 3 to our audited consolidated financial statements for additional discussion of write downs of securities for other than temporary impairments.

Interest sensitive and index product benefits decreased 20% to $1.6 billion in 2018 and increased 179% to $2.0 billion in 2017 from $0.7 billion in 2016. The components of interest sensitive and index product benefits are summarized as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Index credits on index policies	$1,285,555	$1,594,722	$267,995
Interest credited (including changes in minimum guaranteed interest for fixed index annuities)	221,554	257,896	276,032
Lifetime income benefit riders	103,726	171,050	181,445
	$1,610,835	$2,023,668	$725,472

The changes in index credits were attributable to changes in the level of appreciation of the underlying indices (see discussion above under Change in fair value of derivatives) and the amount of funds allocated by policyholders to the respective index options. Total proceeds received upon expiration of the call options purchased to fund the annual index credits were $1.3 billion, $1.6 billion and $0.3 billion for the years ended December 31, 2018, 2017 and 2016, respectively. The decrease in interest credited in 2018 and 2017 was primarily due to a decrease in the average rate credited to the annuity liabilities outstanding receiving a fixed rate of interest. The average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) increased 6% to $49.9 billion in 2018 and 8% to $46.8 billion in 2017 from $43.5 billion in 2016. The decrease in benefits recognized for lifetime income benefit riders in 2018 was primarily due to the impact of revisions of assumptions used in determining the liability for lifetime income benefit riders which caused a decrease of $53.6 million in the liability in 2018 as compared to an increase of $21.6 million in the liability in 2017. The decrease in the liability in 2018 due to assumption revisions was partially offset by an increase in the number of policies with lifetime income benefit riders which correlates to the increase in fees discussed in Annuity product charges. The decrease in benefits recognized for lifetime income benefit riders in 2017 was due to the impact of revisions of assumptions used in determining the liability for lifetime income benefit riders being less in 2017 than it was in 2016 which was partially offset by an increase in the number of policies with lifetime income benefit riders which correlates to the increase in fees discussed in Annuity product charges. See Net income above for discussion of the changes in the assumptions used in determining reserves for lifetime income benefit riders for the years ended December 31, 2018, 2017 and 2016.

Amortization of deferred sales inducements, in general, has been increasing each year due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 81%, 87% and 88% of our net annuity account values at December 31, 2018, 2017 and 2016, respectively. The increases in amortization from these factors have been affected by amortization associated with (1) fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, (2) net realized gains (losses) on investments and net OTTI losses recognized in operations and (3) changes in litigation reserves. Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options), because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected lives of the contracts which typically exceed ten years. Amortization of deferred sales inducements is summarized as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Amortization of deferred sales inducements before gross profit adjustments	$249,627	$240,562	$274,309
Gross profit adjustments:			
Fair value accounting for derivatives and embedded derivatives	(15,283)	(64,219)	(21,678)
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation reserves	(12,143)	269	(1,465)
Amortization of deferred sales inducements after gross profit adjustments	$222,201	$176,612	$251,166

See Net income and Non-GAAP operating income, a non-GAAP financial measure above and Critical Accounting Policies—Deferred Policy Acquisition Costs and Deferred Sales Inducements for discussion of the impact of unlocking on amortization of deferred sales inducements for the years ended December 31, 2018, 2017 and 2016.

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Change in fair value of embedded derivatives includes changes in the fair value of our fixed index annuity embedded derivatives (see Notes 5 to our audited consolidated financial statements). The components of change in fair value of embedded derivatives are as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Fixed index annuities - embedded derivatives	$(2,167,628)	$174,154	$145,045
Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting	778,137	745,581	398,420
	$(1,389,491)	$919,735	$543,465

The change in fair value of the fixed index annuity embedded derivatives resulted from (i) changes in the expected index credits on the next policy anniversary dates, which are related to the change in fair value of the call options acquired to fund those index credits discussed above in Change in fair value of derivatives; (ii) changes in the discount rate used in estimating our embedded derivative liabilities; and (iii) the growth in the host component of the policy liability. The amounts presented as "Other changes in difference between policy benefit reserves computed using derivative accounting vs. long-duration contracts accounting" represents the total change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date, less the change in fair value of our fixed index annuities embedded derivative. See Critical Accounting Policies—Policy Liabilities for Fixed Index Annuities.

The primary reasons for the decrease in the change in fair value of the fixed index annuity embedded derivatives for 2018 were decreases in the expected index credits on the next policy anniversary dates resulting from a decrease in the fair value of the call options acquired to fund these index credits during 2018 as compared to increases in the expected index credits resulting from an increase in the fair value of the call options during 2017 and an increase in the discount rate for 2018 as compared to a decrease in the discount rate for 2017. The primary reasons for the increase in the change in fair value of the fixed index annuity embedded derivatives for 2017 were a higher level of index credits during 2017 as compared to 2016 and a larger decrease in the discount rate used in estimating the fair value of the liability during 2017 as compared to 2016. The discount rate used in estimating our embedded derivative liabilities fluctuates from year to year based on changes in the general level of interest rates and credit spreads.

Interest expense on notes and loan payable decreased 16% to $25.5 million in 2018 and increased 8% to $30.4 million in 2017 from $28.2 million in 2016. Interest expense by debt instrument is as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
2027 Notes	$25,498	$13,801	$—
2021 Notes	—	15,024	27,540
Term loan due 2019	—	1,543	708
	$25,498	$30,368	$28,248

The decrease in interest expense in 2018 was due to the repayment of our outstanding $100 million term loan and the redemption of our $400 million 6.625% notes due 2021 with the proceeds from the issuance of $500 million aggregate principal amount of senior unsecured notes due 2027 which bear interest at 5.0% per year and will mature on June 15, 2027 (the "2027 Notes"). This lowered our senior notes costs to 5% from 6.625%. The increase in interest expense in 2017 was attributable to interest expense on the $100 million variable rate term loan originated on September 30, 2016 and prepaid on June 16, 2017 and interest expense on the 2027 Notes issued on June 16, 2017 which were partially offset by a decrease in interest expense as a result of the redemption of the 2021 Notes on July 17, 2017. See Note 9 to our audited consolidated financial statements.

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Amortization of deferred policy acquisition costs, in general, has been increasing each year due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The increases in amortization from these factors have been affected by amortization associated with (1) fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business, (2) net realized gains (losses) on investments and net OTTI losses recognized in operations, and (3) changes in litigation reserves. As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. Amortization of deferred policy acquisition costs is summarized as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Amortization of deferred policy acquisition costs before gross profit adjustments	$358,736	$340,191	$387,089
Gross profit adjustments:			
Fair value accounting for derivatives and embedded derivatives	(14,504)	(84,744)	(11,447)
Net realized gains (losses) on investments, net OTTI losses recognized in operations and changes in litigation reserves	(16,241)	517	(1,630)
Amortization of deferred policy acquisition costs after gross profit adjustments	$327,991	$255,964	$374,012

See Net income and non-GAAP operating income, a non-GAAP financial measure, above for discussion of the impact of unlocking on amortization of deferred policy acquisition costs for the years ended December 31, 2018, 2017 and 2016. See Critical Accounting Policies—Deferred Policy Acquisition Costs and Deferred Sales Inducements.

Other operating costs and expenses increased 16% to $129.3 million in 2018 and increased 9% to $111.7 million in 2017 from $102.2 million in 2016 and are summarized as follows:

	Year Ended December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Salary and benefits	$71,914	$58,043	$53,479
Risk charges	31,297	29,104	28,276
Other	26,090	24,544	20,476
Total other operating costs and expenses	$129,301	$111,691	$102,231

Salary and benefits expense increased in 2018 as compared to 2017 as a result of an increase in salary and benefits of $5.4 million due to an increased number of employees related to our growth and an increase of $6.8 million related to expense recognized under our equity and cash incentive compensation programs ("incentive compensation programs"). The increases in expense for our incentive compensation programs were primarily due to increases in the actual and expected payouts due to a larger number of employees participating in the programs, higher potential payouts for certain employees participating in the programs and an increase in the percentage of restricted stock units that were earned or expected to be earned. In addition, salary and benefits for 2017 reflected a benefit of $1.3 million related to a retirement agreement with our former executive chairman.

Salary and benefits expense increased in 2017 as compared to 2016 as a result of an increase in salary and benefits of $3.3 million due to an increased number of employees related to our growth, an increase of $3.7 million related to expense recognized under our incentive compensation programs as a result of the short-term incentive compensation program being paid out at a higher percentage of target than in 2016 and an increase of $0.8 million related to a deferred compensation liability that is based on the value of our common stock. These increases were partially offset by a decrease of $3.2 million in expenses related to a retirement agreement with our former executive chairman.

The increases in reinsurance risk charges expense during 2018 and 2017 were due to the growth in our policyholder liabilities subject to a reinsurance agreement pursuant to which we cede excess regulatory reserves to an unaffiliated reinsurer. The increase in risk charge expense in 2017 due to growth in the policyholder liabilities subject to the reinsurance was partially offset by a lower risk charge percentage which was included in an October 1, 2016 amendment to the reinsurance agreement. The regulatory reserves ceded at December 31, 2018, 2017 and 2016 were

$780.0 million, $737.3 million and $638.1 million, respectively.

Other expenses increased in 2018 primarily as a result of increases in professional and consulting fees, increases in depreciation and maintenance expenses primarily related to software and hardware assets and increases in licensing fees which are based on the level of policyholder funds under management allocated to index strategies. These increases were offset by decreases in commission expense related to the exit of the group life business effective January 1, 2018.

Other expenses increased in 2017 as compared to 2016 due primarily to 2016 benefiting from the release of a litigation liability of $2.8 million and the release of a guaranty fund assessment liability of $2.3 million. Other expenses adjusted for these nonrecurring items from 2016 decreased in 2017 as compared to 2016 due to decreases in general expenses that vary from period to period based on the level of annuity deposits collected that are not eligible for deferral.

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Income tax expense decreased in 2018 as Tax Reform reduced the statutory federal income tax rate from 35% to 21% effective January 1, 2018. The lower tax rate offset the expected increase in income tax expense from the increase in income before income taxes. Income tax expense increased in 2017 due to an increase in income before income taxes and the impact of Tax Reform discussed below. The effective income tax rates were 19.0%, 44.8% and 36.1% for 2018, 2017 and 2016, respectively.

Income tax expense and the resulting effective tax rate are based upon two components of income before income taxes ("pretax income") that are taxed at different tax rates. Life insurance income is generally taxed at an effective rate of approximately 21.6% reflecting the absence of state income taxes for substantially all of the states that the life insurance subsidiaries do business in. The income for the parent company and other non-life insurance subsidiaries (the "non-life insurance group") is generally taxed at an effective tax rate of 29.5% reflecting the combined federal / state income tax rates. Prior to Tax Reform, life insurance income was generally taxed at an effective rate of approximately 35.6% while income for the non-life insurance group was generally taxed at an effective tax rate of 41.5% reflecting the combined federal / state income tax rates. The effective income tax rates resulting from the combination of the income tax provisions for the life / non-life sources of income vary from year to year based primarily on the relative size of pretax income from the two sources.

The effective income tax rate for 2018 was impacted by capital losses being carried back to periods in which a 35% statutory tax rate was in effect. The impact of the higher capital loss carry back rate reduced income tax expense by approximately $2.5 million for the year ended December 31, 2018. In addition, the effective tax rate for the year ended December 31, 2018 benefited from a discrete tax item for a worthless stock deduction related to a wholly-owned subsidiary which reduced income tax expense by approximately $7.4 million.

The effective income tax rate for 2018 and 2017 was impacted by a discrete tax item related to share-based compensation that reduced income tax expense for 2018 and 2017 by approximately $2.7 million and $2.8 million, respectively.

Income tax expense for the year ended December 31, 2017 was increased by $35.9 million related to the revaluation of our net deferred tax assets using the newly enacted federal tax rate as a result of Tax Reform. The effective tax rate for 2017 adjusted to exclude the impact of Tax Reform was 32.3%. The effective tax rate adjusted to exclude the impact of Tax Reform decreased in 2017 as compared to 2016 as the portion of taxable income from the non-life insurance group decreased significantly and the level of permanent tax adjustments, including tax exempt investment income, compared to pretax income increased as compared to 2016.

Financial Condition

Investments

Our investment strategy is to maintain a predominantly investment grade fixed income portfolio, provide adequate liquidity to meet our cash obligations to policyholders and others and maximize current income and total investment return through active investment management. Consistent with this strategy, our investments principally consist of fixed maturity securities and mortgage loans on real estate.

Insurance statutes regulate the type of investments that our life subsidiaries are permitted to make and limit the amount of funds that may be used for any one type of investment. In light of these statutes and regulations and our business and investment strategy, we generally seek to invest in United States government and government-sponsored agency securities, corporate securities, residential and commercial mortgage backed securities, other asset backed securities and United States municipalities, states and territories securities rated investment grade by established nationally recognized statistical rating organizations ("NRSRO's") or in securities of comparable investment quality, if not rated and commercial mortgage loans on real estate.

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The composition of our investment portfolio is summarized as follows:

	December 31, 2018 Carrying Amount	Percent	2017 Carrying Amount	Percent
	(Dollars in thousands)			
Fixed maturity securities:				
United States Government full faith and credit	$11,652	— %	$11,876	— %
United States Government sponsored agencies	1,138,529	2.3 %	1,305,017	2.6 %
United States municipalities, states and territories	4,126,267	8.3 %	4,166,812	8.3 %
Foreign government obligations	230,274	0.5 %	239,360	0.5 %
Corporate securities	28,371,514	57.4 %	29,956,012	59.6 %
Residential mortgage backed securities	1,202,159	2.4 %	1,105,567	2.2 %
Commercial mortgage backed securities	5,379,003	10.9 %	5,544,850	11.0 %
Other asset backed securities	5,464,329	11.1 %	3,120,536	6.2 %
Total fixed maturity securities	45,923,727	92.9 %	45,450,030	90.4 %
Mortgage loans on real estate	2,943,091	6.0 %	2,665,531	5.3 %
Derivative instruments	205,149	0.4 %	1,568,380	3.1 %
Other investments	355,531	0.7 %	616,764	1.2 %
	$49,427,498	100.0%	$50,300,705	100.0%

Fixed Maturity Securities

Our fixed maturity security portfolio is managed to minimize risks such as interest rate changes and defaults or impairments while earning a sufficient and stable return on our investments. The largest portion of our fixed maturity securities are in investment grade (NAIC designation 1 or 2) publicly traded or privately placed corporate securities. A summary of our fixed maturity securities by NRSRO ratings is as follows:

Rating Agency Rating	December 31, 2018 Carrying Amount	Percent of Fixed Maturity Securities	2017 Carrying Amount	Percent of Fixed Maturity Securities
	(Dollars in thousands)			
Aaa/Aa/A	$27,052,481	58.9 %	$27,909,879	61.4 %
Baa	17,265,590	37.6 %	16,048,610	35.3 %
Total investment grade	44,318,071	96.5 %	43,958,489	96.7 %
Ba	1,191,772	2.6 %	1,035,676	2.3 %
B	139,313	0.3 %	130,857	0.3 %
Caa	122,717	0.3 %	134,586	0.3 %
Ca and lower	151,854	0.3 %	190,422	0.4 %
Total below investment grade	1,605,656	3.5 %	1,491,541	3.3 %
	$45,923,727	100.0 %	$45,450,030	100.0 %

The NAIC's Securities Valuation Office ("SVO") is responsible for the day-to-day credit quality assessment and the valuation of fixed maturity securities owned by state regulated insurance companies. The purpose of such assessment and valuation is for determining regulatory capital requirements and regulatory reporting. Insurance companies report ownership to the SVO when such securities are eligible for regulatory filings. The SVO conducts credit analysis on these securities for the purpose of assigning an NAIC designation and/or unit price. Typically, if a security has been rated by a NRSRO, the SVO utilizes that rating and assigns a NAIC designation based upon the following system:

NAIC Designation	NRSRO Equivalent Rating
1	Aaa/Aa/A

2	Baa
3	Ba
4	B
5	Caa
6	Ca and lower

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For most of the bonds held in our portfolio the NAIC designation matches the NRSRO equivalent rating. However, for certain loan-backed and structured securities, as defined by the NAIC, the NAIC rating is not always equivalent to the NRSRO rating presented in the previous table. The NAIC has adopted revised rating methodologies for certain loan-backed and structured securities comprised of non-agency residential mortgage backed securities ("RMBS") and commercial mortgage backed securities ("CMBS"). The NAIC's objective with the revised rating methodologies for these structured securities is to increase the accuracy in assessing expected losses and use the improved assessment to determine a more appropriate capital requirement for such structured securities. The revised methodologies reduce regulatory reliance on rating agencies and allow for greater regulatory input into the assumptions used to estimate expected losses from structured securities.

The use of this process by the SVO may result in certain non-agency RMBS and CMBS being assigned an NAIC designation that is higher than the equivalent NRSRO rating. The NAIC designations for non-agency RMBS and CMBS are based on security level expected losses as modeled by an independent third party (engaged by the NAIC) and the statutory carrying value of the security, including any purchase discounts or impairment charges previously recognized. Evaluation of non-agency RMBS and CMBS held by insurers using the NAIC rating methodologies is performed on an annual basis.

As stated previously, our fixed maturity security portfolio is managed to minimize risks such as defaults or impairments while earning a sufficient and stable return on our investments. Our strategy has been to invest primarily in investment grade fixed maturity securities. Investment grade is NAIC 1 and 2 securities and Baa3/BBB- and better securities on the NRSRO scale. This strategy meets the objective of minimizing risk while also managing asset capital charges on a regulatory capital basis.

A summary of our fixed maturity securities by NAIC designation is as follows:

	December 31, 2018				December 31, 2017			
NAIC Designation	Amortized Cost	Fair Value	Carrying Amount	Percentage of Total Carrying Amount	Amortized Cost	Fair Value	Carrying Amount	Percentage of Total Carrying Amount
	(Dollars in thousands)				(Dollars in thousands)			
1	$26,588,352	$26,921,843	$26,921,843	58.6 %	$26,669,427	$28,274,379	$28,274,379	62.2 %
2	17,901,161	17,528,072	17,528,072	38.2 %	15,198,551	15,869,219	15,869,219	34.9 %
3	1,396,650	1,269,242	1,269,242	2.8 %	1,161,737	1,157,420	1,158,001	2.5 %
4	173,987	137,991	137,991	0.3 %	134,838	117,542	117,542	0.3 %
5	23,836	19,453	19,453	— %	17,015	20,927	20,927	0.1 %
6	47,204	47,126	47,126	0.1 %	12,232	9,962	9,962	— %
	$46,131,190	$45,923,727	$45,923,727	100.0 %	$43,193,800	$45,449,449	$45,450,030	100.0 %

The amortized cost and fair value of fixed maturity securities at December 31, 2018, by contractual maturity are presented in Note 3 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7.

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Unrealized Losses

The amortized cost and fair value of fixed maturity securities that were in an unrealized loss position were as follows:

	Number of Securities	Amortized Cost	Unrealized Losses	Fair Value
	(Dollars in thousands)			
December 31, 2018				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	4	$8,650	$(322)	$8,328
United States Government sponsored agencies	23	1,066,544	(83,034)	983,510
United States municipalities, states and territories	136	518,758	(15,658)	503,100
Foreign government obligations	6	114,529	(4,159)	110,370
Corporate securities:				
Finance, insurance and real estate	286	3,551,237	(164,727)	3,386,510
Manufacturing, construction and mining	231	2,515,204	(119,607)	2,395,597
Utilities and related sectors	273	3,032,710	(127,957)	2,904,753
Wholesale/retail trade	103	1,308,962	(77,554)	1,231,408
Services, media and other	529	6,040,083	(348,884)	5,691,199
Residential mortgage backed securities	33	172,427	(4,125)	168,302
Commercial mortgage backed securities	487	4,367,221	(134,826)	4,232,395
Other asset backed securities	604	4,615,477	(270,234)	4,345,243
	2,715	$27,311,802	$(1,351,087)	$25,960,715
December 31, 2017				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	4	$8,443	$(147)	$8,296
United States Government sponsored agencies	18	1,035,489	(31,730)	1,003,759
United States municipalities, states and territories	48	176,831	(3,596)	173,235
Foreign government obligations	2	64,313	(2,025)	62,288
Corporate securities:				
Finance, insurance and real estate	92	1,090,077	(33,178)	1,056,899
Manufacturing, construction and mining	55	468,505	(14,324)	454,181
Utilities and related sectors	63	657,599	(13,000)	644,599
Wholesale/retail trade	31	344,196	(12,620)	331,576
Services, media and other	165	1,693,343	(72,565)	1,620,778
Residential mortgage backed securities	20	75,159	(2,471)	72,688
Commercial mortgage backed securities	310	2,473,034	(69,840)	2,403,194
Other asset backed securities	146	996,531	(13,405)	983,126
	954	$9,083,520	$(268,901)	$8,814,619
Fixed maturity securities, held for investment:				
Corporate security:				
Insurance	1	$77,041	$(581)	$76,460

The increase in unrealized losses from December 31, 2017 to 2018 was primarily due to an increase in interest rates in addition to price deterioration due to wider credit spreads during the year ended December 31, 2018. The 10-year U.S. Treasury yield rates at December 31, 2018 and 2017 were 2.69% and 2.40%, respectively. The 30-year U.S. Treasury yields at December 31, 2018 and 2017 were 3.02% and 2.74%, respectively.

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

NAIC Designation	Carrying Value of Securities with Gross Unrealized Losses	Percent of Total	Gross Unrealized Losses	Percent of Total
	(Dollars in thousands)			
December 31, 2018				
1	$13,302,253	51.2 %	$(552,455)	40.9 %
2	11,301,715	43.5 %	(622,053)	46.0 %
3	1,170,941	4.5 %	(129,441)	9.6 %
4	127,222	0.5 %	(40,927)	3.0 %
5	19,453	0.1 %	(4,383)	0.3 %
6	39,131	0.2 %	(1,828)	0.2 %
	$25,960,715	100.0 %	$(1,351,087)	100.0 %
December 31, 2017				
1	$5,433,608	61.1 %	$(158,991)	59.0 %
2	2,809,981	31.6 %	(64,369)	23.9 %
3	540,320	6.1 %	(23,166)	8.6 %
4	94,004	1.1 %	(17,972)	6.7 %
5	11,130	0.1 %	(1,460)	0.5 %
6	2,617	— %	(3,524)	1.3 %
	$8,891,660	100.0 %	$(269,482)	100.0 %

Our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 2,715 and 955 securities, respectively) have been in a continuous unrealized loss position at December 31, 2018 and 2017, along with a description of the factors causing the unrealized losses is presented in Note 3 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7.

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
December 31, 2018				
Fixed maturity securities:				
Investment grade:				
Less than six months	770	$6,986,778	$6,777,338	$(209,440)
Six months or more and less than twelve months	1,184	12,208,435	11,692,145	(516,290)
Twelve months or greater	606	6,639,807	6,186,550	(453,257)
Total investment grade	2,560	25,835,020	24,656,033	(1,178,987)
Below investment grade:				
Less than six months	59	578,858	533,979	(44,879)
Six months or more and less than twelve months	44	371,075	338,056	(33,019)
Twelve months or greater	52	526,849	432,647	(94,202)
Total below investment grade	155	1,476,782	1,304,682	(172,100)
	2,715	$27,311,802	$25,960,715	$(1,351,087)
December 31, 2017				
Fixed maturity securities				
Investment grade:				
Less than six months	409	$3,550,774	$3,520,164	$(30,610)
Six months or more and less than twelve months	27	257,924	249,690	(8,234)
Twelve months or greater	430	4,668,838	4,486,239	(182,599)
Total investment grade	866	8,477,536	8,256,093	(221,443)
Below investment grade:				
Less than six months	32	201,885	194,821	(7,064)
Six months or more and less than twelve months	12	36,595	34,619	(1,976)
Twelve months or greater	45	444,545	405,546	(38,999)
Total below investment grade	89	683,025	634,986	(48,039)
	955	$9,160,561	$8,891,079	$(269,482)

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
December 31, 2018				
Investment grade:				
Less than six months	5	$103,637	$78,378	$(25,259)
Six months or more and less than twelve months	1	20,189	15,225	(4,964)
Twelve months or greater	—	—	—	—
Total investment grade	6	123,826	93,603	(30,223)
Below investment grade:				
Less than six months	13	146,474	108,465	(38,009)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	3	45,594	26,665	(18,929)
Total below investment grade	16	192,068	135,130	(56,938)
	22	$315,894	$228,733	$(87,161)
December 31, 2017				
Investment grade:				
Less than six months	3	$8,597	$6,931	$(1,666)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	—	—	—	—
Total investment grade	3	8,597	6,931	(1,666)
Below investment grade:				
Less than six months	1	11,021	8,275	(2,746)
Six months or more and less than twelve months	1	3,523	2,674	(849)
Twelve months or greater	4	55,647	37,591	(18,056)
Total below investment grade	6	70,191	48,540	(21,651)
	9	$78,788	$55,471	$(23,317)

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

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
December 31, 2018				
Due in one year or less	$31,590	$30,780	$—	$—
Due after one year through five years	2,596,616	2,534,891	—	—
Due after five years through ten years	7,196,565	6,907,961	—	—
Due after ten years through twenty years	3,247,923	3,056,474	—	—
Due after twenty years	5,083,983	4,684,669	—	—
	18,156,677	17,214,775	—	—
Residential mortgage backed securities	172,427	168,302	—	—
Commercial mortgage backed securities	4,367,221	4,232,395	—	—
Other asset backed securities	4,615,477	4,345,243	—	—
	$27,311,802	$25,960,715	$—	$—
December 31, 2017				
Due in one year or less	$—	$—	$—	$—
Due after one year through five years	463,667	454,062	—	—
Due after five years through ten years	1,996,166	1,945,474	—	—
Due after ten years through twenty years	1,937,009	1,881,162	—	—
Due after twenty years	1,141,954	1,074,913	77,041	76,460
	5,538,796	5,355,611	77,041	76,460
Residential mortgage backed securities	75,159	72,688	—	—
Commercial mortgage backed securities	2,473,034	2,403,194	—	—
Other asset backed securities	996,531	983,126	—	—
	$9,083,520	$8,814,619	$77,041	$76,460

International Exposure

We hold fixed maturity securities with international exposure. As of December 31, 2018, 24% of the carrying value of our fixed maturity securities was comprised of corporate debt securities of issuers based outside of the United States and debt securities of foreign governments. All of our fixed maturity securities with international exposure are denominated in U.S. dollars. Our investment professionals analyze each holding for credit risk by economic and other factors of each country and industry. The following table presents our international exposure in our fixed maturity portfolio by country or region:

	December 31, 2018		
	Amortized Cost	Carrying Amount/ Fair Value	Percent of Total Carrying Amount
	(Dollars in thousands)		
GIIPS (1)	$249,818	$246,303	0.5 %
Asia/Pacific	460,239	464,240	1.0 %
Non-GIIPS Europe	3,030,213	3,007,307	6.6 %
Latin America	285,509	287,639	0.6 %
Non-U.S. North America	1,351,033	1,349,443	2.9 %

Australia & New Zealand	946,658	919,847	2.0	%
Other	5,195,192	4,935,145	10.8	%
	$11,518,662	$11,209,924	24.4	%

(1) Greece, Ireland, Italy, Portugal and Spain ("GIIPS"). All of our exposure in GIIPS are corporate securities with issuers domiciled in these countries. None of our foreign government obligations were held in any of these countries.

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All of the securities presented in the table above are investment grade (NAIC designation of either 1 or 2), except for the following:

	December 31, 2018	
	Amortized Cost	Carrying Amount/ Fair Value
	(Dollars in thousands)	
GIIPS	$19,524	$18,101
Asia/Pacific	11,000	9,814
Non-GIIPS Europe	140,289	132,826
Latin America	67,944	66,011
Non-U.S. North America	50,941	46,880
Other	419,602	373,533
	$709,300	$647,165

Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment, we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 20% or greater change in market price relative to its amortized cost and/or a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our residential and commercial mortgage backed securities as we monitor all of our residential and commercial mortgage backed securities on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At December 31, 2018, the amortized cost and fair value of securities on the watch list (all fixed maturity securities) are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
		(Dollars in thousands)				
Below investment grade						
Corporate securities:						
Consumer discretionary	5	$52,470	$(10,457)	$42,013	5 - 47	0 - 10
Energy	8	76,005	(18,321)	57,684	2 - 52	0 - 43
Industrials	1	562	—	562	—	—
Materials	1	3,990	1,417	5,407	—	—
Utilities	5	59,753	(6,008)	53,745	3 - 15	0 - 2
Other asset backed securities:						
Financials	2	1,693	326	2,019	—	—
	22	$194,473	$(33,043)	$161,430		

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We have determined that the unrealized losses of the securities on the watch list are temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before recovery of their amortized cost. Our analysis of these securities and their credit performance at December 31, 2018 is as follows:
Corporate securities:
Consumer discretionary: The decline in the value of certain of these securities is primarily due to weak operating performance and sales trends. The decrease in sales for certain of these securities related to a domestic based toy manufacturer is attributable to the liquidation of a major toy retailer during the fourth quarter of 2017. While the issuer has seen a decrease in operating performance, it has implemented a plan to reduce costs and stabilize its revenue and is in the early phase of executing on that plan. We have determined that these securities were not other than temporarily impaired due to our evaluation of the operating performance and the creditworthiness of the issuer and the fact that all required payments have been made. The decline in operating performance and sales trends of another of these securities related to a domestic company operating retail chain stores is a result of market deterioration being experienced in many companies within the retail market. We recognized an other than temporary impairment on this issuer during 2018 due to our evaluation of the operating performance and the credit worthiness of the issuer. In addition, we included a Brazilian food company whose operating trends have come under pressure due to export challenges, domestic poultry price weakness and a domestic trucking strike. As one of the world's largest food companies, we believe the company remains a viable entity even though operating metrics have declined. We have determined that these securities were not other than temporarily impaired due to our evaluation of their operating performance, asset base and creditworthiness of the borrower.
Energy, Industrials and Materials: The decline in the value of these securities relates to continued operational pressure due to past declines in certain commodity prices specific to their businesses. The decline in these commodity prices creates financial challenges as the companies had to realign operations to accommodate the new environment. These issuers will be stressed greater than the average company due to their price sensitivity and the specific position they hold in the supply chain. While values have declined, improving commodity prices should continue to provide better financial performance for these companies. We recognized an other than temporary impairment on two of these issuers during 2018 due to our evaluation of the operating performance and the credit worthiness of each issuer. While the remaining issuers have seen their financial and profitability profile weakened, we have determined that the remaining securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of the issuer.
Utilities: The decline in the value of these securities relates to pending litigation and bankruptcy concerns of the issuer. We have impaired one of these securities, which was issued at a premium, to reflect the risk that the issuer may call the bonds as a result of pending litigation and bankruptcy and limit payback to stated par values. The remaining securities were issued at discounts and we have determined that the issuer remains solvent and appears to have sufficient capital levels to address litigation concerns.
Other asset backed securities:
Financials: The decline in value of one of the asset backed securities is due to poor performance in the underlying pool of student loans. The investment is backed by a guarantee from the for-profit education services provider. This service provider filed for bankruptcy creating concerns around the security. We recognized an other than temporary impairment on this issuer during 2018 due to concerns over pending litigation and our evaluation of the operating performance and the credit worthiness. The decline in value of the other asset backed security is related directly to the decline in oil prices and the financial stability of its operator. The issuer has direct exposure to the oil market as its primary business is deep water drilling. As oil prices have remained low, the operator of the deep water vessel has experienced financial pressure on its balance sheet and similar vessel sales have been at softer valuations. We recognized other than temporary impairments on this security during 2018 and 2017.
Other Than Temporary Impairments
We have a policy and process to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments. During the years ended December 31, 2018, 2017 and 2016, we recognized other than temporary impairment on corporate securities, residential mortgage backed securities, commercial mortgage backed securities and other asset backed securities, all of

which are available for sale fixed maturity securities. In addition, in all periods presented we recognized credit losses on residential mortgage backed securities, and on one other asset backed security in 2018 and 2016 that resulted in a reclassification of OTTI loss from accumulated other comprehensive income to net income.

In 2018, we recognized $12 million OTTI loss in operations due to our intent to sell certain securities as part of our opportunistic replacement of lower yielding securities with higher yielding securities which is further discussed in Management's Discussion and Analysis - Executive Summary. We recognized a $5.5 million OTTI loss in operations on a corporate security in the utilities sector due to concerns over pending litigation. We recognized a $3.6 million OTTI loss in operations on an other asset backed security as potential sales activity related to the asset backing our security led us to conclude the asset is worth less than our previous estimate. We recognized a $2.7 million OTTI loss in operations on a corporate security related to an issuer operating retail chain stores due to deteriorating operating performance and sales trends. We recognized a $3.6 million OTTI loss in operations on an issuer in the commodities sector due to deteriorating operating performance resulting in part of from operational pressure related to past declines in certain commodity prices specific to its businesses.

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In 2017, we recognized a $2.5 million OTTI loss in operations due to our concern regarding a corporate security issued by a Latin America engineering and construction company as developments in 2017 led us to the conclusion that we will not be able to recover our amortized cost basis. We recognized an OTTI of $0.3 million on a residential mortgage backed security that had not been previously impaired and we recognized additional credit losses on previously impaired residential mortgage backed securities during 2017 as several factors led us to believe the full recovery of amortized cost is not expected on the residential mortgage backed securities. Also in 2017, we recognized an additional impairment of $0.3 million on an asset backed security as sales of similar assets during 2017 led us to conclude that the asset backing our security was worth less than our previous estimates.

In 2016, we recognized a $3.9 million OTTI loss in operations due to our concern regarding a corporate security issued by a Brazilian telecommunications company as developments in 2016 led us to the conclusion that we will not be able to fully recover our amortized cost basis due to liquidity concerns. A $3.0 million OTTI loss was recognized in operations due to our concern regarding a corporate security issued by a Brazilian metals and mining company as developments during 2016 led us to the conclusion that we will not be able to fully recover our amortized cost basis. We recognized a $9.2 million OTTI loss in operations on a corporate security and an other asset backed security as a result of the parent of both entities announcement that it is committed to exiting the power generation business and could potentially enter the facilities into bankruptcy. In 2016, we recognized an additional impairment of $3.5 million on an other asset backed security due to the asset supporting the cash flows being taken out of production which was first impaired during 2015. The OTTI that we recognized in 2016 on commercial mortgage backed securities were due to our intent to sell the securities, which were in an unrealized loss position at the reporting date of the period in which the decision to sell these securities was made.

Several factors led us to believe that full recovery of amortized cost is not expected on the securities for which we recognized credit losses and reclassified OTTI from accumulated other comprehensive income (loss) to net income. A discussion of these factors, our policy and process to identify securities that could potentially have impairment that is other than temporary and a summary of OTTI is presented in Note 3 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7.

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, net of loan loss allowances and deferred prepayment fees. At December 31, 2018 and 2017, the largest principal amount outstanding for any single mortgage loan was $23.8 million and $21.2 million, respectively, and the average loan size was $3.8 million and $3.5 million, respectively. In addition, the average loan to value ratio for the overall portfolio was 53.6% at both December 31, 2018 and 2017, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value is indicative of our conservative underwriting policies and practices for making commercial mortgage loans and may not be indicative of collateral values at the current reporting date. Our current practice is to only obtain market value appraisals of the underlying collateral at the inception of the loan unless we identify indicators of impairment in our ongoing analysis of the portfolio, in which case, we either calculate a value of the collateral using a capitalization method or obtain a third party appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type in Note 4 of our audited consolidated financial statements of this Form 10-K, which is incorporated by reference in this Item 7.

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At December 31, 2018, we had commitments to fund commercial mortgage loans totaling $148.0 million, with interest rates ranging from 4.50% to 7.40%. During 2018 and 2017, due to historically low interest rates, the commercial mortgage loan industry has been very competitive. This competition has resulted in a number of borrowers refinancing with other lenders. For the year ended December 31, 2018, we received $178.2 million in cash for loans being paid in full compared to $230.4 million for the year ended December 31, 2017. Some of the loans being paid off have either reached their maturity or are nearing maturity; however, some borrowers are paying the prepayment fee and refinancing at a lower rate.

See Note 4 to our audited consolidated financial statements, incorporated by reference, for a presentation of our specific and general loan loss allowances, impaired loans, foreclosure activity and troubled debt restructure analysis. We have a process by which we evaluate the credit quality of each of our commercial mortgage loans. This process utilizes each loan's debt service coverage ratio as a primary metric. A summary of our portfolio by debt service coverage ratio (based on most recent information collected) follows:

	December 31, 2018			December 31, 2017		
	Principal Outstanding	Percent of Total Principal Outstanding		Principal Outstanding	Percent of Total Principal Outstanding	
	(Dollars in thousands)			(Dollars in thousands)		
Debt Service Coverage Ratio:						
Greater than or equal to 1.5	$2,121,785	71.9	%	$1,826,596	68.3	%
Greater than or equal to 1.2 and less than 1.5	645,470	21.8	%	638,299	23.9	%
Greater than or equal to 1.0 and less than 1.2	127,083	4.3	%	148,881	5.6	%
Less than 1.0	58,126	2.0	%	60,539	2.2	%
	$2,952,464	100.0	%	$2,674,315	100.0	%

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All of our mortgage loans (based on principal outstanding) that have a debt service coverage ratio of less than 1.0 are performing under the original contractual loan terms at December 31, 2018.

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

	December 31,	
	2018	2017
	(Dollars in thousands)	
Impaired mortgage loans with an allowance	$1,253	$5,445
Impaired mortgage loans with no related allowance	—	1,436
Allowance for probable loan losses	(229)	(1,418)
Net carrying value of impaired mortgage loans	$1,024	$5,463

At December 31, 2018, we had no commercial mortgage loans that were delinquent (60 days or more past due at the reporting date) in their principal and interest payments.

Derivative Instruments

Our derivative instruments primarily consist of call options purchased to provide the income needed to fund the annual index credits on our fixed index annuity products. The fair value of the call options is based upon the amount of cash that would be required to settle the call options obtained from the counterparties adjusted for the nonperformance risk of the counterparty. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options.

None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the consolidated statements of operations. A presentation of our derivative instruments along with a discussion of the business strategy involved with our derivatives is included in Note 5 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7.

Liabilities

Our liability for policy benefit reserves increased to $57.6 billion at December 31, 2018 compared to $56.1 billion at December 31, 2017, primarily due to net cash flows from annuity deposits and funds returned to policyholders and interest and index credits credited to policyholders during 2018. The increase in policy benefit reserves resulting from these items was partially mitigated by a decrease in the fair value of our fixed index annuity embedded derivatives during 2018. Substantially all of our annuity products have a surrender charge feature designed to reduce the risk of early withdrawal or surrender of the policies and to compensate us for our costs if policies are withdrawn early. Our lifetime income benefit rider also reduces the risk of early withdrawal or surrender of the policies as it provides an additional liquidity option to policyholders as the policyholder can elect to receive guaranteed payments for life from their contract without requiring them to annuitize their contract value and the rider is not transferable to other contracts. Notwithstanding these policy features, the withdrawal rates of policyholder funds may be affected by changes in interest rates and other factors.

See Note 9 to our audited consolidated financial statements in this Form 10-K, which is incorporated by reference in this Item 7 for discussion of our notes and loan payable and borrowings under repurchase agreements.

See Note 10 to our audited consolidated financial statements for additional information concerning our subordinated debentures payable to, and the preferred securities issued by, our subsidiary trusts.

Liquidity and Capital Resources

Liquidity for Insurance Operations

Our insurance subsidiaries' primary sources of cash flow are annuity deposits, investment income, and proceeds from the sale, maturity and calls of investments. The primary uses of funds are investment purchases, payments to policyholders in connection with surrenders and withdrawals, policy acquisition costs and other operating expenses.

Liquidity requirements are met primarily by funds provided from operations. Our life subsidiaries generally receive adequate cash flow from annuity deposits and investment income to meet their obligations. Annuity liabilities are generally long-term in nature. However, a primary liquidity concern is the risk of an extraordinary level of early policyholder withdrawals. We include provisions within our annuity policies, such as surrender charges and bonus vesting, which help limit and discourage early withdrawals. Our lifetime income benefit rider also limits the risk of early withdrawals as it provides an additional liquidity option to policyholders as the policyholder can elect to receive guaranteed payments for life from their contract without requiring them to annuitize their contract value and the rider is not transferable to other contracts. At December 31, 2018, approximately 93% of our annuity liabilities were subject to penalty upon surrender, with a weighted average remaining surrender charge period of 7.5 years and a weighted average surrender charge percentage of 12.1%.

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were $1.2 billion for the year ended December 31, 2018 compared to $1.3 billion for the year ended December 31, 2017 with the decrease attributable to a $341.4 million (after coinsurance) increase in funds returned to policyholders, which was partially offset by a $202.9 million increase in net annuity deposits after coinsurance. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed maturity securities and fixed rate commercial mortgage loans.

Liquidity of Parent Company

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. We need liquidity primarily to service our debt (senior notes and subordinated debentures issued to subsidiary trusts), pay operating expenses and pay dividends to stockholders. Our assets consist primarily of the capital stock and surplus notes of our subsidiaries. Accordingly, our future cash flows depend upon the availability of dividends, surplus note interest payments and other statutorily permissible payments from our subsidiaries, such as payments under our investment advisory agreements and tax allocation agreement with our subsidiaries. These sources provide adequate cash flow for us to meet our current and reasonably foreseeable future obligations and we expect they will be adequate to fund our parent company cash flow requirements in 2019.

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

Currently, American Equity Life may pay dividends or make other distributions without the prior approval of the Iowa Insurance Commissioner, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory capital and surplus at the preceding December 31. For 2019, up to $325.2 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Commissioner. In addition, dividends and surplus note payments may be made only out of statutory earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities in the life subsidiary's state of domicile. American Equity Life had $1.9 billion of statutory earned surplus at December 31, 2018.

The maximum distribution permitted by law or contract is not necessarily indicative of an insurer's actual ability to pay such distributions, which may be constrained by business and regulatory considerations, such as the impact of such distributions on surplus, which could affect the insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends or make other distributions. Further, state insurance laws and regulations require that the statutory surplus of our life subsidiaries following any dividend or distribution must be reasonable in relation to their outstanding liabilities and adequate for their financial needs. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from rating agencies. Both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries. As of December 31, 2018, we estimate American Equity Life has sufficient statutory capital and surplus, combined with capital available to the holding company, to maintain this rating objective. However, this capital may not be sufficient if significant future losses are incurred or a rating agency modifies its rating criteria and access to additional capital could be limited.

The transfer of funds by American Equity Life is also restricted by a covenant in our line of credit agreement which requires American Equity Life to maintain a minimum risk-based capital ratio of 275% and a minimum level of statutory surplus equal to the sum of 1) 80% of statutory surplus at June 30, 2016, 2) 50% of the statutory net income for each fiscal quarter ending after June 30, 2016, and 3) 50% of all capital contributed to American Equity Life after June 30, 2016. American Equity Life's risk-based capital ratio was 360% at December 31, 2018. Under this agreement, we are also required to maintain a maximum ratio of adjusted debt to total adjusted capital of 0.35.

Cash and cash equivalents of the parent holding company at December 31, 2018, were $68.9 million. In addition, as discussed in Note 9 to our audited consolidated financial statements, we have a $150 million revolving line of credit agreement, with no borrowings outstanding at December 31, 2018. This revolving line of credit terminates on September 30, 2021, and borrowings are available for general corporate purposes of the parent company and its subsidiaries. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution. The terms of any offering would be established at the time of the offering, subject to market conditions.
Statutory accounting practices prescribed or permitted for our life subsidiaries differ in many respects from those governing the preparation of financial statements under GAAP. Accordingly, statutory operating results and statutory capital and surplus may differ substantially from amounts reported in the GAAP basis financial statements for comparable items. Information as to statutory capital and surplus and statutory net income for our life subsidiaries as of December 31, 2018 and 2017 and for the years ended December 31, 2018, 2017 and 2016 is included in Note 12 to our audited consolidated financial statements.

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In the normal course of business, we enter into financing transactions, lease agreements, or other commitments. These commitments may obligate us to certain cash flows during future periods. The following table summarizes such obligations as of December 31, 2018.

	Payments Due by Period				
	Total	Less Than 1 year	1–3 Years	4–5 Years	After 5 Years
	(Dollars in thousands)				
Annuity and single premium universal life products (1)	$51,269,156	$3,427,764	$10,105,250	$6,159,800	$31,576,342
Notes and loan payable, including interest payments (2)	713,734	25,462	50,772	50,000	587,500
Subordinated debentures, including interest payments (3)	574,235	15,535	31,071	31,071	496,558
Amounts due under repurchase agreements	109,298	109,298	—	—	—
Operating leases	13,389	1,986	3,878	3,161	4,364
Mortgage loan funding and other investments	203,980	176,234	27,746	—	—
Total	$52,883,792	$3,756,279	$10,218,717	$6,244,032	$32,664,764

(1) Amounts shown in this table are projected payments through the year 2038 which we are contractually obligated to pay to our annuity policyholders. The payments are derived from actuarial models which assume a level interest rate scenario and incorporate assumptions regarding mortality and persistency, when applicable. These assumptions are based on our historical experience.

(2) Period that principal amounts are due is determined by the earliest of the call/put date or the maturity date of each note payable.

(3) Amount shown is net of equity investments in the capital trusts due to the contractual right of offset upon repayment of the notes.

Inflation

Inflation does not have a significant effect on our consolidated balance sheet. We have minimal investments in property, equipment or inventories. To the extent that interest rates may change to reflect inflation or inflation expectations, there would be an effect on our balance sheet and operations. It is not possible to calculate the effect such changes in interest rates, if any, have had on our operating results.

Critical Accounting Policies

The increasing complexity of the business environment and applicable authoritative accounting guidance require us to closely monitor our accounting policies. We have identified six critical accounting policies that are complex and require significant judgment. The following summary of our critical accounting policies is intended to enhance your ability to assess our financial condition and results of operations and the potential volatility due to changes in estimates.

Valuation of Investments

Our fixed maturity securities classified as available for sale are reported at fair value. Unrealized gains and losses, if any, on these securities are included directly in stockholders' equity as a component of accumulated other comprehensive income (loss), net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements. Unrealized gains and losses represent the difference between the amortized cost or cost basis and the fair value of these investments. We use significant judgment within the process used to determine fair value of these investments.

GAAP defines fair value as 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. We categorize our investments 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.

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We categorize investments 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.

The following table presents the fair value of fixed maturity and equity securities, available for sale, by pricing source and hierarchy level as of December 31, 2018 and 2017, respectively:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	(Dollars in thousands)			
December 31, 2018				
Priced via third party pricing services	$5,907	$45,268,935	$ —	$45,274,842
Priced via independent broker quotations	—	20,367	—	20,367
Priced via other methods	—	635,955	—	635,955
	$5,907	$45,925,257	$ —	$45,931,164
% of Total	— %	100.0 %	— %	100.0 %
December 31, 2017				
Priced via third party pricing services	$290,645	$45,150,229	$ —	$45,440,874
Priced via independent broker quotations	—	34,750	—	34,750
Priced via other methods	—	189,794	—	189,794
	$290,645	$45,374,773	$ —	$45,665,418
% of Total	0.6 %	99.4 %	— %	100.0 %

Management's assessment of all available data when determining fair value of our investments is necessary to appropriately apply fair value accounting.

We utilize independent pricing services in estimating the fair values of investment securities. 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.

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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 quotes or prices from additional parties as needed. In addition, for our callable United States Government sponsored agencies we obtain multiple broker quotes and take the average of the broker prices received. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, comparison of the prices to a secondary pricing source, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of December 31, 2018 and 2017.

Evaluation of Other Than Temporary Impairments and Allowance for Loan Loss

The evaluation of investments for other than temporary impairments involves significant judgment and estimates by management. 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 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 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:

- 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;
- consideration of rating agency actions; and
- changes in estimated cash flows of mortgage and asset backed securities.

We determine whether other than temporary impairment losses should be recognized for debt securities by assessing all facts and circumstances surrounding each security. Where the decline in fair 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.

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

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

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

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

We evaluate our mortgage loan portfolio for the establishment of a loan loss allowance 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 on a quantitative and qualitative basis. 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.

We rate each of the mortgage loans in our portfolio based on factors such as historical operating performance, loan to value ratio and economic outlook, among others. We calculate a loss factor to apply to each rating based on historical losses we have recognized in our mortgage loan portfolio. We apply the loss factors to the total principal outstanding within each rating category to determine an appropriate estimate of the general loan loss allowance. We also assess the portfolio quantitatively and apply a loss rate to all loans without a specific allowance based on management's assessment of economic conditions, and we apply an additional amount of loss allowance to a group of loans that we have identified as having higher risk of loss.

Policy Liabilities for Fixed Index Annuities

We offer a variety of fixed index annuities with crediting strategies linked to the S&P 500 Index and other equity and bond market indices. We purchase call options on the applicable indices as an investment to provide the income needed to fund the annual index credits on the index products. See Financial Condition—Derivative Instruments. Certain derivative instruments embedded in the fixed index annuity contracts are recognized in the consolidated balance sheet at their fair values and changes in fair value are recognized immediately in our consolidated statements of operations in accordance with accounting standards for derivative instruments and hedging activities.

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Accounting for derivatives prescribes that the contractual obligations for future annual index credits are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. Policy liabilities for fixed index annuities are equal to the sum of the "host" (or guaranteed) component and the embedded derivative component for each fixed index annuity policy. The host value is established at inception of the contract and accreted over the policy's life at a constant rate of interest. We estimate the fair value of the embedded derivative component 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 credits 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 amounts reported in the consolidated statements of operations as "Interest sensitive and index product benefits" represent amounts credited to policy liabilities pursuant to accounting by insurance companies for certain long-duration contracts which include index credits through the most recent policy anniversary. The amounts reported in the consolidated statements of operations as "Changes in fair value of embedded derivatives" equal the change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date.

In general, the change in the fair value of the embedded derivatives will not correspond to the change in fair value of the purchased call options because the purchased call options are generally one year options while the options valued in the embedded derivatives represent the rights of the contract holder to receive index credits over the entire period the fixed index annuities are expected to be in force, which typically exceeds 10 years.

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at December 31, 2018 were to increase by 100 basis points, our reserves for fixed index annuities would decrease by $504.5 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of $423.5 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as an increase in amortization of deferred policy acquisition costs and deferred sales inducements. A decrease by 100 basis points in the discount rate used to discount the excess projected contract values would increase the fair value of the embedded derivatives by $559.9 million recorded through operations as an increase in the change in fair value of embedded derivatives and there would be a corresponding increase of $291.8 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.

Liability for Lifetime Income Benefit Riders

The liability for lifetime income benefit riders is based on estimates of the present value of benefit payments expected to be paid in excess of projected policy values recognizing the excess over the expected lives of the underlying policies based on the actual and present value of expected assessments including spreads and product charges and fees. The inputs used in the calculation of the liability for lifetime income benefit riders include actual policy values, actual income account values, actual payout factors, actual roll-up rates and our best estimate assumptions for future policy growth, future policy decrements, the ages at which policyholders are expected to elect to begin to receive lifetime income benefit payments, the percentage of policyholders who elect to receive lifetime income benefit payments and the type of income benefit payments selected upon election. The assumptions are reviewed quarterly and revisions to the assumptions are made based on historical results and our best estimates of future experience. The liability for lifetime income benefit riders is included in policy benefit reserves in the consolidated balance sheets and the change in the liability is included in interest sensitive and index product benefits in the consolidated statements of operations. See Results of Operations for the Three Years Ended December 31, 2018 in this Item 7 for a discussion and presentation of the actual effects of assumption revisions.

A key assumption in the calculation of the liability for lifetime income benefit riders is the percentage of policyholders who elect to receive lifetime income benefit payments. If the percentage of policyholders who elect to receive lifetime income benefit payments under our fee based rider was increased by 10% at December 31, 2018, our liability for lifetime income benefit riders would increase by $102 million recorded through operations as an increase in interest sensitive and index product benefits. A decrease by 10% in the percentage of policyholders who elect to receive lifetime income benefit payments under our fee based rider would decrease our liability for lifetime income benefit riders by $101 million recorded through operations as a decrease in interest sensitive and index product benefits.

Deferred Policy Acquisition Costs and Deferred Sales Inducements

Costs relating to the successful production of new business are not expensed when incurred but instead are capitalized as deferred policy acquisition costs or deferred sales inducements. Only costs which are expected to be recovered from future policy revenues and gross profits may be deferred.

Deferred policy acquisition costs and deferred sales inducements are subject to loss recognition testing on a quarterly basis or when an event occurs that may warrant loss recognition. Deferred policy acquisition costs consist principally of commissions and certain costs of policy issuance. Deferred sales inducements consist of premium and interest bonuses credited to policyholder account balances.