VORNADO OPERATING CO
Form 10-K
March 03, 2004

EXHIBIT INDEX ON PAGE 61

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended DECEMBER 31, 2003

or

[ ] 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 001-14525

VORNADO OPERATING COMPANY
(Exact name of registrant as specified in its charter)

DELAWARE	22-3569068
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
210 ROUTE 4 EAST, PARAMUS, NEW JERSEY	07652
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (201) 587-7721

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: NONE

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 [ ]

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. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). YES [ ] NO [X]

The aggregate market value of the voting and non-voting common shares held by non-affiliates of the registrant (i.e., by persons other than officers and directors of Vornado Operating Company) as of June 30, 2003 was $2,387,665.

As of February 1, 2004, there were 4,068,924 shares of the registrant's common stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

PART III: Portions of the Proxy Statement for Annual Meeting of Stockholders to be held on May 27, 2004.

TABLE OF CONTENTS

PART I...

ITEM 1. Business...

ITEM 2. Properties...

ITEM 3. Legal Proceedings..

ITEM 4. Submission of Matters to a Vote of Security Holders....................................

Executive Officers of the Registrant...

PART II..

ITEM 5. Market for Registrant's Common Equity and Related Stockholder Matters..................

ITEM 6. Selected Financial Data..

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk............................

ITEM 8. Financial Statements and Supplementary Data..

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

ITEM 9A. Controls and Procedures...

PART III...

ITEM 10. Directors and Executive Officers of the Registrant (1)................................

ITEM 11. Executive Compensation (1)..

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockhold Matters (1)..

ITEM 13. Certain Relationships and Related Transactions (1)....................................

ITEM 14. Principal Accountant Fees and Services (1)..

PART IV..

ITEM 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K......................

SIGNATURES...

(1)These items are omitted in part or in whole because the registrant will file a definitive Proxy Statement pursuant to Regulation 14A under the Securities Exchange Act of 1934 involving the election of directors with the Securities and Exchange Commission not later than 120 days after December 31, 2003, which is incorporated by reference herein. See "Executive Officers of the Registrant" for information relating to executive officers of the registrant.

Certain statements contained herein constitute forward-looking statements as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are not guarantees of performance. The Company's future results, financial condition and business may differ materially from those expressed in these forward-looking statements. You can find many of these statements by looking for words such as "believes," "expects," "anticipates," "intends," "plans" or similar expressions in this Annual Report on Form 10-K. These forward-looking statements are subject to numerous assumptions, risks and uncertainties. Many of the factors that will determine these items are beyond the Company's ability to control or predict. Factors that might cause such a material difference include, but are not limited to: (a) the substantial doubt

about the Company's ability to continue as a going concern and its limited financial resources; (b) restrictions on the Company's business and future opportunities; (c) dependence upon Vornado Realty Trust; (d) the substantial influence of the Company's controlling stockholders and conflicts of interest; (e) the bankruptcy of the Company's joint venture partner in AmeriCold Logistics, Crescent Operating, Inc.; (f) risks associated with potential investments and the ability to manage those investments; (g) competition; (h) dependence on key personnel; (i) potential anti-takeover effects of the Company's charter documents and Stockholder Protection Rights Plan and applicable law; (j) dependence on distributions from subsidiaries; (k) potential costs of compliance with environmental laws; (l) changes in the general economic climate; and (m) government regulations.

For these forward-looking statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K or the date of any document incorporated by reference. All subsequent written and oral forward-looking statements attributable to the Company or any person acting on the Company's behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this paragraph. The Company does not undertake any obligation to release publicly any revisions to the forward-looking statements to reflect events or circumstances after the date of this Annual Report on Form 10-K.

PART I.

ITEM 1. BUSINESS

GENERAL

On October 16, 1998, Vornado Realty L.P. (the "Operating Partnership"), a subsidiary of Vornado Realty Trust ("Vornado"), made a distribution of one share of common stock of Vornado Operating Company, a Delaware corporation (the "Company"), for each 20 units of limited partnership interest of the Operating Partnership (including the units owned by Vornado) held of record as of the close of business on October 9, 1998, and Vornado, in turn, made a distribution of the common stock it received to the holders of its common shares of beneficial interest.

The Company was incorporated on October 30, 1997 as a wholly owned subsidiary of Vornado. In order to maintain its status as a real estate investment trust ("REIT") for federal income tax purposes, Vornado is required to focus principally on investments in real estate assets. Accordingly, Vornado is prevented from owning certain assets and conducting certain activities that would be inconsistent with its status as a REIT. The Company was formed to own assets that Vornado could not itself own and conduct activities that Vornado could not itself conduct. The Company is intended to function principally as an operating company, in contrast to Vornado's principal focus on investments in real estate assets. The Company is able to do so because it is taxable as a regular "C" corporation rather than as a REIT.

The Company operates businesses conducted at properties it leases from Vornado or entities partially owned by Vornado, as contemplated by the agreement, dated as of October 16, 1998, between the Company and Vornado (the "Vornado Agreement"), referred to below. The Company expects to rely on Vornado to identify business opportunities for the Company and currently expects that those opportunities will relate in some manner to Vornado and its real estate investments rather than to unrelated businesses.

The principal executive offices of the Company are located at 210 Route 4 East, Paramus, New Jersey 07652, and its telephone number at that location is (201) 587-7721.

ABILITY TO CONTINUE AS A GOING CONCERN

Substantial doubt exists as to the Company's ability to continue as a going concern and its ability to discharge its liabilities in the normal course of business. The Company has incurred losses since its inception and, in the aggregate, its investments have not generated sufficient cash flow to pay all of the Company's expenses. The Company estimates that it has adequate borrowing capacity under its credit facility with Vornado to meet its cash needs until December 31, 2004. However, the principal, interest and fees outstanding under the line of credit come due on such date. The Company currently has no external sources of financing except this facility.

The Company's other potential source of cash is its investment in AmeriCold Logistics. However, AmeriCold Logistics has also reported losses since inception and, at December 31, 2003, the Company's 60% share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to its landlord, the Vornado REIT/Crescent REIT Partnership (the "Landlord"). AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado or the ability to continue as a going concern.

VORNADO AGREEMENT AND CHARTER PURPOSE CLAUSES

Pursuant to the Vornado Agreement, among other things, (i) Vornado will, under certain circumstances, offer the Company an opportunity to become the lessee of certain real property owned now or in the future by Vornado (under mutually satisfactory lease terms) and (ii) the Company will not make any real estate investment or other REIT-Qualified Investment unless it first offers Vornado the opportunity to make such investment and Vornado has rejected that opportunity.

More specifically, the Vornado Agreement requires, subject to certain terms, that Vornado provide the Company with an opportunity (a "Tenant Opportunity") to become the lessee of any real property owned now or in the future by Vornado if Vornado determines, in its sole discretion, that, consistent with Vornado's status as a REIT, it is required to enter into a master lease arrangement with respect to such property and that the Company is qualified

to act as lessee thereof. In general, a master lease arrangement is an arrangement pursuant to which an entire property or project (or a group of related properties or projects) is leased to a single lessee. Under the Vornado Agreement, the Company and Vornado will negotiate with each other on an exclusive basis for 30 days regarding the terms and conditions of the lease in respect of each Tenant Opportunity. If a mutually satisfactory agreement cannot be reached within the 30-day period, Vornado may for a period of one year thereafter enter into a binding agreement with respect to such Tenant Opportunity with any third party on terms no more favorable to the third party

than the terms last offered to the Company. If Vornado does not enter into a binding agreement with respect to such Tenant Opportunity within such one-year period, Vornado must again offer the Tenant Opportunity to the Company in accordance with the procedures specified above prior to offering such Tenant Opportunity to any other party.

In addition, the Vornado Agreement prohibits the Company from making (i) any investment in real estate (including the provision of services related to real estate, real estate mortgages, real estate derivatives or entities that invest in the foregoing) or (ii) any other REIT-Qualified Investment, unless it has provided written notice to Vornado of the material terms and conditions of the investment opportunity and Vornado has determined not to pursue such investment either by providing written notice to the Company rejecting the opportunity within ten days from the date of receipt of notice of the opportunity or by allowing such ten-day period to lapse. As used herein, "REIT-Qualified Investment" means an investment from which at least 95% of the gross income would qualify under the 95% gross income test set forth in Section 856(c)(2) of the Internal Revenue Code of 1986, as amended (the "Code") (or could be structured to so qualify), and the ownership of which would not cause Vornado to violate the asset limitations set forth in Section 856(c)(4) of the Code (or could be structured not to cause Vornado to violate the Section 856(c)(4) limitations); provided, however, that "REIT-Qualified Investment" does not include an investment in government securities, cash or cash items (as defined for purposes of Section 856(c)(4) of the Code), money market funds, certificates of deposit, commercial paper having a maturity of not more than 90 days, bankers' acceptances or the property transferred to the Company by the Operating Partnership. The Vornado Agreement also requires the Company to assist Vornado in structuring and consummating any such investment which Vornado elects to pursue, on terms determined by Vornado. In addition, the Company has agreed to notify Vornado of, and make available to Vornado, investment opportunities developed by the Company or of which the Company becomes aware but is unable or unwilling to pursue.

Under the Vornado Agreement, Vornado provides the Company with certain administrative, corporate, accounting, financial, insurance, legal, tax, data processing, human resources and operational services. Also, Vornado makes available to the Company, at Vornado's offices, space for the Company's principal corporate office. For these services, the Company compensates Vornado in an amount determined in good faith by Vornado as the amount an unaffiliated third party would charge the Company for comparable services and reimburses Vornado for certain costs incurred and paid to third parties on behalf of the Company. For such services, the Company incurred $330,000, $330,000 and $371,000 in the years ended December 31, 2003, 2002 and 2001, respectively.

Vornado and the Company each have the right to terminate the Vornado Agreement if the other party is in material default of the Vornado Agreement or upon 90 days written notice to the other party at any time after December 31, 2003. In addition, Vornado has the right to terminate the Vornado Agreement upon a change in control of the Company.

The Company's restated certificate of incorporation (the "Charter") specifies that one of its corporate purposes is to perform under the Vornado Agreement and, for so long as the Vornado Agreement remains in effect, prohibits the Company from making any real estate investment or other REIT-Qualified Investment without first offering the opportunity to Vornado in the manner specified in the Vornado Agreement.

VORNADO OPERATING L.P. AND INTERSTATE PROPERTIES

The Company holds its assets and conducts its business through Vornado Operating L.P., a Delaware limited partnership ("Company L.P."). The Company is the sole general partner of and, as of December 31, 2003, owned a 90.1%

partnership interest in Company L.P. All references to the "Company" refer to Vornado Operating Company and its subsidiaries, including Company L.P.

Interstate Properties, a New Jersey general partnership ("Interstate"), and its three partners -- Steven Roth (Chairman of the Board and Chief Executive Officer of Vornado and the Company), David Mandelbaum (a trustee of Vornado) and Russell B. Wight, Jr. (a trustee of Vornado and a director of the Company) -- beneficially owned, in the aggregate, a 9.9% limited partnership interest in Company L.P. and 7.9% of the common stock of the Company as of December 31, 2003. Interstate has the right to have its limited partnership interest in Company L.P. redeemed by Company L.P. either for (i) cash in an amount equal to the fair market value, at the time of redemption,

of 447,017 shares of common stock or (ii) 447,017 shares of common stock, in each case as selected by the Company and subject to customary anti-dilution adjustments.

TEMPERATURE CONTROLLED LOGISTICS BUSINESS ("AMERICOLD LOGISTICS")

(Data in this section with respect to AmeriCold Logistics represents 100% of AmeriCold Logistics, in which the Company holds a 60% interest, unless otherwise specified)

In October 1997, a partnership (the "Vornado REIT/Crescent REIT Partnership" or the "Landlord") in which Vornado has a 60% interest and Crescent Real Estate Equities Company ("Crescent") has a 40% interest acquired each of AmeriCold Corporation and URS Logistics, Inc. In June and July 1998, the Vornado REIT/Crescent REIT Partnership acquired the assets of Freezer Services, Inc. and the Carmar Group.

On March 11, 1999, the Company and Crescent Operating, Inc. ("COPI") formed the "Vornado Crescent Logistics Operating Partnership" (which does business under the name "AmeriCold Logistics") to purchase all of the non-real estate assets of the Vornado REIT/Crescent REIT Partnership for $48,723,000, of which the Company's 60% share was $29,234,000. The purchase price was proposed by the Landlord. The Boards of Directors of both the Company and COPI approved the transaction after concluding that the price was the fair market value at the time of the transaction. To fund its share of the purchase price, the Company utilized $4,647,000 of cash and borrowed $18,587,000 under its Revolving Credit Agreement with Vornado. The Company paid the balance of $6,000,000 on March 7, 2000.

Subject to confirmation of a plan of reorganization under Chapter 11 of the United States Bankruptcy Code, COPI is expected to transfer its interest in AmeriCold Logistics to an entity to be owned by the shareholders of Crescent. The shareholders of COPI approved the plan of reorganization on March 6, 2003. It is uncertain whether this plan will be confirmed and what effect, if any, this plan and the proposed change in ownership will have on the operation and management of AmeriCold Logistics.

AmeriCold Logistics, headquartered in Atlanta, Georgia, has approximately 5,800 employees and operates 102 temperature controlled warehouse facilities nationwide with an aggregate of approximately 546 million cubic feet of refrigerated, frozen and dry storage space. Of the 102 warehouses, AmeriCold Logistics leases 87 temperature controlled warehouses with an aggregate of approximately 441 million cubic feet of space from the Landlord, and manages 15 additional warehouses containing approximately 105 million cubic feet of space. AmeriCold Logistics provides the food industry with refrigerated warehousing and transportation management services. Refrigerated warehouses are comprised of

production, distribution and public facilities. Production facilities typically serve one or a small number of customers, generally food processors, which are located nearby. These customers store large quantities of processed or partially processed products in the facilities until they are shipped to the next stage of production or distribution. Distribution facilities primarily warehouse a wide variety of customers' finished products until future shipment to end-users. Each distribution facility generally services the surrounding regional market. Public facilities generally serve the needs of local and regional customers under short-term agreements. Food manufacturers and processors use these facilities to store capacity overflow from their production facilities or warehouses. AmeriCold Logistics' transportation management services include freight routing, dispatching, freight rate negotiation, backhaul coordination, freight bill auditing, network flow management, order consolidation and distribution channel assessment. AmeriCold Logistics' temperature controlled logistics expertise and access to both frozen food warehouses and distribution channels enable its customers to respond quickly and efficiently to time-sensitive orders from distributors and retailers.

AmeriCold Logistics' customers consist primarily of national, regional and local food manufacturers, distributors, retailers and service organizations. A breakdown of AmeriCold Logistics' largest customers follows:

	Percentage of 2003 Revenue
H.J. Heinz & Co.	15%
ConAgra Foods, Inc.	13
Philip Morris Companies, Inc.	8
Sara Lee Corp.	5
General Mills, Inc.	4
Tyson Foods, Inc.	4
Schwan Corporation	4
McCain Foods, Inc.	4
J.R. Simplot Co.	2
Nippon Suisan	2
Other	39
Total	100%

AmeriCold Logistics faces national, regional and local competition. Breadth of service, warehouse locations, customer mix, warehouse size, service performance and price are major competitive factors.

Management of AmeriCold Logistics

On February 23, 2004, AmeriCold Logistics announced that Alec Covington resigned as President and Chief Executive Officer, effective March 31, 2004, to take an opportunity in an unrelated industry. A search to identify a successor is under way. In the interim, Mike O'Connell, who has been with AmeriCold Logistics for over ten years, has been promoted to be in charge of all operations and, until a successor is in place, will report to Anthony Cossentino, Chief Financial Officer.

Anthony Cossentino became the Chief Financial Officer of AmeriCold

Logistics in September 2003. Mr. Cossentino was formerly the President and Chief Executive Officer of Jazz Photo Corp., a privately-held designer, importer and distributor of photographic equipment. Prior thereto, from January 1995 to May 2001, he was the Chief Financial Officer of CS Integrated LLC, a provider of logistics services with over 100 temperature controlled warehouses throughout the United States and Europe and a wholly-owned subsidiary of ProLogis. Mr. Cossentino, a certified public accountant, replaced Jonathan C. Daiker, who resigned from the position of Chief Financial Officer effective June 2003.

AmeriCold Logistics' Leases with the Landlord

AmeriCold Logistics entered into leases with the Landlord covering 87 of the warehouses used in this business. The leases, which commenced in March 1999, as amended, generally have 15-year terms with two five-year renewal options and provide for the payment of fixed base rent and percentage rent based on revenue from customers. The leases provide for fixed base rents of approximately $136,000,000 in 2000, $137,000,000 per annum from 2001 through 2003, $140,000,000 per annum from 2004 through 2008, $145,000,000 per annum for 2009, $142,000,000 per annum for 2010, and $139,000,000 per annum from 2011 through February 2014. Percentage rent for each lease is based on a specified percentage of revenues in excess of a specified base amount. The aggregate base revenue amount under five of the six leases is approximately $350,000,000, and the weighted average percentage rate is approximately 36% through 2003, approximately 38% from 2004 through 2008 and approximately 40% from 2009 through February 2014. The aggregate base revenue amount under the sixth lease is approximately $32,000,000 through 2001, and approximately $26,000,000 from 2002 through February 2014, and the percentage rate is 24% through 2001, 37.5% from 2002 through 2006, 40% from 2007 through 2011 and 41% from 2012 through February 2014. The fixed base rent for each of the two five-year renewal options is equal, generally, to the greater of the fair market rent at that time and the fixed base rent for the immediately preceding lease year plus 5%.

On February 22, 2001, AmeriCold Logistics' leases with the Landlord were restructured to, among other things, (i) reduce 2001 contractual rent to $146,000,000, (ii) reduce 2002 contractual rent to $150,000,000 (plus additional contingent rent in certain circumstances), (iii) increase the Landlord's share of annual maintenance capital expenditures by $4,500,000 to $9,500,000 effective January 1, 2000 and (iv) extend the deferred rent period to December 31, 2003 from March 11, 2002.

AmeriCold Logistics is required to pay for all costs arising from the operation, maintenance and repair of the properties, including all real estate taxes and assessments, utility charges, permit fees and insurance premiums, as well as property capital expenditures in excess of $9,500,000 annually.

AmeriCold Logistics has the right to defer the payment of 15% of annual fixed base rent and all percentage rent until December 31, 2004 to the extent that available cash, as defined in the leases, is insufficient to pay such rent. Pursuant thereto, AmeriCold Logistics' deferred rent liability at December 31, 2003, net of the waived rent discussed below, is as follows:

(amounts in thousands)	Total (1)
Deferred during 2003	$ 41,811
Deferred during 2002	32,248
Aggregate deferral at December 31, 2001	8,335
	$ 82,394

(1) The Company does not guarantee AmeriCold Logistics' deferred rent liability.

In the three months ended December 31, 2001, AmeriCold Logistics reversed $25,469,000 of the rent expense recorded in 2001. This resulted from the Landlord waiving its rights to collect this portion of the rent. Further, the Landlord waived $14,343,000 of the rent expense recorded by AmeriCold Logistics in 2000; AmeriCold Logistics recorded this amount as income in the three months ended December 31, 2001. The aggregate amount waived by the Landlord of $39,812,000 (of which the Company's share is $23,887,000) represents a portion of the rent due under the leases, which AmeriCold Logistics deferred in such years.

On January 23, 2002, four of the leases with the Landlord were combined into one lease. This did not affect total contractual rent due under the combined leases.

On March 2, 2004, AmeriCold Logistics and the Landlord extended the deferred rent period in AmeriCold Logistics' leases with the Landlord to December 31, 2005 from December 31, 2004. The parties previously extended the deferred rent period to December 31, 2004 from December 31, 2003 on March 7, 2003.

Severance and Relocation Costs

In the year ended December 31, 2001, AmeriCold Logistics recorded a charge of $8,895,000 (of which the Company's share is $5,337,000) comprised of (i) severance and relocation costs associated with a management restructuring and (ii) expenses arising from the consolidation of a portion of the corporate office in Portland, Oregon into AmeriCold Logistics' Atlanta, Georgia headquarters. Severance related charges were for the termination of 199 employees, located primarily in the Atlanta and Portland offices. In 2002, AmeriCold Logistics reduced the charge by $949,000 (of which the Company's share is $569,000). AmeriCold Logistics' liability for severance at December 31, 2003 was $497,000; the remaining 50 of the 199 original employees are expected to be terminated in 2004.

Dispositions

On December 31, 2002, Vornado and Crescent formed a new joint venture (the "Quarry Company") in which Vornado holds a 44% interest and Crescent holds a 56% interest. This new joint venture acquired AmeriCold Logistics' Carthage, Missouri and Kansas City, Kansas limestone quarries for $20,000,000, the appraised value. The purchase price consisted of $8,929,000 in cash and the cancellation of $11,071,000 of notes owed by AmeriCold Logistics to Crescent. AmeriCold Logistics recognized a gain of $2,225,000 (of which the Company's share is $1,335,000). AmeriCold Logistics used $8,800,000 of the cash proceeds to repay a portion of its loans from the Company. The Company recognized a gain on the repayment from AmeriCold Logistics of $8,608,000 as the loans were previously reduced by equity in losses of AmeriCold Logistics. Additionally, AmeriCold Logistics entered into a management agreement with the Quarry Company to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as operator of the quarries. The agreement is for a term of one year and automatically renews for additional one-year periods unless terminated by either party. The Company used the $8,800,000 repayment from AmeriCold Logistics and $700,000 of its cash to repay $7,685,000 of principal and $1,815,000 of interest and commitment fees under the Revolving Credit Agreement with Vornado.

On December 31, 2002, AmeriCold Logistics sold, without recourse, accounts receivable of $5,720,000 to the Quarry Company for $5,600,000 in cash. AmeriCold Logistics recognized a loss of $120,000 on the sale (of which the Company's share is $72,000).

On March 28, 2003, AmeriCold Logistics sold, without recourse, accounts receivable of $6,640,000 to the Quarry Company for $6,500,000 in cash. AmeriCold Logistics recognized a loss of $140,000 on the sale.

On January 20, 2004, AmeriCold Logistics sold, without recourse, accounts receivable of $6,120,000 to the Quarry Company for $6,000,000 in cash. AmeriCold Logistics recognized a loss of $120,000 on the sale. AmeriCold Logistics also agreed to act as agent to collect the accounts receivable. The Company does not believe that any significant servicing asset or liability exists.

Cash Resources

At December 31, 2002, the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of comprehensive losses of AmeriCold Logistics. AmeriCold Logistics has reported losses since its inception and, at December 31, 2003, the Company's share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to the Landlord. On March 2, 2004, AmeriCold Logistics and the Landlord extended the deferred rent period to December 31, 2005 from December 31, 2004. Based on its right to defer rent, the management of AmeriCold Logistics anticipates it will have sufficient cash flows to operate at least through December 31, 2004. AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to

AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado due December 31, 2004.

Terms of the Vornado Crescent Logistics Operating Partnership

Vornado is the day-to-day liaison to the management of AmeriCold Logistics. AmeriCold Logistics pays Vornado an annual fee of $487,000, which is based on the temperature controlled logistics operating assets acquired by AmeriCold Logistics on March 11, 1999. This fee increases by an amount equal to 1% of the cost of new acquisitions, including transaction costs. AmeriCold Logistics provides financial statement preparation, tax and similar services to the Vornado REIT/Crescent REIT Partnership. For such services, AmeriCold Logistics has received fees of $276,000, $273,000 and $268,000 in 2003, 2002 and 2001, respectively.

The Company must obtain COPI's approval for specified matters involving AmeriCold Logistics, including approval of the annual budget, requiring specified capital contributions, entering into specified new leases or amending existing leases, selling or acquiring specified assets and any sale, liquidation or merger of AmeriCold Logistics. If the partners fail to reach an agreement on certain matters during the period through October 30, 2007, the Company may set a price at which it commits to either buy COPI's investment, or sell its own, and COPI will decide whether to buy or sell at that price. If the partners fail

to reach agreement on such matters after October 30, 2007, either party may set a price at which it commits to either buy the other party's investment, or sell its own, and the other party will decide whether to buy or sell at that price.

Neither partner may transfer its rights or interest in the partnership without the consent of the other partner. The partnership will continue for a term through October 30, 2027, except as the partners may otherwise agree.

EMPLOYEES

At December 31, 2003, the Company had no employees. The Company expects that, when it acquires specific assets or business operations, the subsidiaries of the Company making such acquisitions will have their own employees. AmeriCold Logistics, in which the Company has a 60% interest, has approximately 5,800 employees.

AVAILABLE INFORMATION

Copies of the Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as well as filings on Forms 3, 4 and 5 regarding officers, directors or 10% beneficial owners of the Company, filed or furnished pursuant to Section 13(a), 15(d) or 16(a) of the Securities Exchange Act of 1934, are available free of charge through the Company's website (www.vornadoopco.com) as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission. The Company also has made available, on the website, copies of the Company's Audit Committee charter and "Code of Ethics for Senior Financial Officers." In the event of any changes to these items, changed copies will be made available on the website.

RISK FACTORS

Set forth below are the risks and certain factors that may adversely affect the Company's business and operations. This section contains forward-looking statements. Refer to the qualifications and limitations on forward-looking statements on page 2.

ABILITY TO CONTINUE AS A GOING CONCERN AND LIMITED FINANCIAL RESOURCES

Substantial doubt exists as to the Company's ability to continue as a going concern and its ability to discharge its liabilities in the normal course of business. The Company has incurred losses since its inception and, in the aggregate, its investments have not generated sufficient cash flow to pay all of the Company's expenses. The Company estimates that it has adequate borrowing capacity under its credit facility with Vornado to meet its cash needs until December 31, 2004. However, the principal, interest and fees outstanding under the line of credit come due on such date. The Company currently has no external sources of financing except this facility.

The Company's other potential source of cash is its investment in AmeriCold Logistics. However, AmeriCold Logistics has also reported losses since inception and, at December 31, 2003, the Company's 60% share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to the Landlord, the Vornado REIT/Crescent REIT Partnership.

-8-

AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and

there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado or the ability to continue as a going concern.

RESTRICTIONS ON THE COMPANY'S BUSINESS AND FUTURE OPPORTUNITIES

The Vornado Agreement and the Charter prohibit the Company from making any real estate investment or other REIT-Qualified Investment unless it first offers Vornado the opportunity to make such investment and Vornado has rejected that opportunity. See "Item 1. Business -- Vornado Agreement and Charter Purpose Clauses." Because of the provisions of the Vornado Agreement and the Charter, the nature of the Company's business and the opportunities it may pursue are significantly restricted.

DEPENDENCE UPON VORNADO

The Company expects to rely on Vornado to identify business opportunities for the Company, and the Company currently expects that those opportunities will relate in some manner to Vornado and its real estate investments rather than to unrelated businesses. There can be no assurance that Vornado will identify opportunities for the Company or that any opportunities that Vornado identifies will be within the Company's financial, operational or managerial parameters. Vornado is required under the Vornado Agreement to provide the Company with an opportunity to become the lessee of real property acquired by Vornado only if Vornado determines in its sole discretion that, consistent with Vornado's status as a REIT, it is required to enter into a master lease arrangement with respect to such property and that the Company is qualified to act as lessee thereof. Moreover, the Company is entitled to enter into such a master lease arrangement with Vornado only if the Company and Vornado are able to agree on mutually satisfactory lease terms.

If in the future Vornado should cease to qualify as a REIT and thereafter acquire a property, Vornado would have the right under the Vornado Agreement to lease the property to any person or entity pursuant to any type of lease (including a master lease arrangement) or to operate the property itself, in either case without offering the Company an opportunity to become a lessee thereof. The Company, however, would remain subject to all of the limitations on its operations contained in the Charter and the Vornado Agreement. Accordingly, if Vornado should cease to qualify as a REIT, it could have a material adverse effect on the Company.

If in the future, Vornado should sell any property which is leased to the Company, it is possible that the new owner might refuse to renew the lease upon the expiration of its term.

SUBSTANTIAL INFLUENCE OF CONTROLLING STOCKHOLDERS AND CONFLICTS OF INTEREST

As of December 31, 2003, Interstate and its three partners -- Steven Roth (Chairman of the Board and Chief Executive Officer of Vornado and the Company), David Mandelbaum (a trustee of Vornado) and Russell B. Wight, Jr. (a trustee of Vornado and a director of the Company) -- beneficially owned, in the aggregate, 11.7% of the outstanding Vornado common shares of beneficial interest (excluding shares issuable on conversion of units of the Operating Partnership for this purpose) and beneficially owned, in the aggregate, a 9.9% limited partnership interest in Company L.P. and 7.9% of the common stock of the Company. Because of the foregoing, Messrs. Roth, Mandelbaum and Wight and Interstate (collectively, the "Interstate Parties") have substantial influence over the Company and Vornado and on the outcome of any matters submitted to the Company's stockholders or Vornado's shareholders for approval.

Four of the members of the Company's Board of Directors (including Mr. Roth and Michael D. Fascitelli) are members of Vornado's Board of Trustees, and certain members of senior management of the Company hold corresponding positions with Vornado. Members of the Company's Board and senior management may have different percentage equity interests in the Company and in Vornado. Moreover, the Interstate Parties engage in a wide variety of activities in the real estate business. Thus, members of the Board and senior management of the Company and Vornado and the Interstate Parties may be presented with conflicts of interest with respect to certain matters affecting the Company, such as determinations of which of such entities or persons, if any, may take advantage of potential business opportunities, decisions concerning the business focus of such entities (including decisions concerning the types of properties and geographic locations in which such entities make investments), potential competition between business activities conducted, or sought to be conducted, by such entities or persons (including competition for properties and tenants), possible corporate transactions (such as acquisitions) and other strategic decisions affecting the future of such parties.

BANKRUPTCY OF THE COMPANY'S JOINT VENTURE PARTNER, CRESCENT OPERATING, INC.

Subject to confirmation of a plan of reorganization under Chapter 11 of the United States Bankruptcy Code, COPI is expected to transfer its interest in AmeriCold Logistics to an entity to be owned by the shareholders of Crescent. The shareholders of COPI approved the plan of reorganization on March 6, 2003. It is uncertain whether this plan will be confirmed and what effect, if any, this plan and the proposed change in ownership will have on the operation and management of AmeriCold Logistics.

RISKS ASSOCIATED WITH POTENTIAL INVESTMENTS AND ABILITY TO MANAGE THOSE INVESTMENTS AND COMPETITION

Although the Company currently expects that the opportunities it pursues will relate in some manner to Vornado and its real estate investments rather than to unrelated businesses, it is possible that they will not. In addition, whether or not such opportunities relate in some manner to Vornado and its real estate investments, the businesses in which it engages may require a wide range of skills and qualifications, and there is no assurance that the Company's management or employees will have, or that the Company will be able to hire and retain employees with, such skills and qualifications. There also is no assurance that the opportunities the Company pursues will be integrated, perform as expected or contribute significant revenues or profits to the Company, and there is a risk that the Company may realize substantial losses with respect thereto. The industries in which the Company will compete may be subject to government regulation and restrictions, some of which may be significant and burdensome. The businesses with which it will compete may be better capitalized or have other features that will make it difficult for the Company to compete effectively.

ABSENCE OF DIVIDENDS ON COMMON STOCK

The Company intends to use its available funds to cover cash flow deficits and, therefore, does not anticipate the payment of any cash dividends on its common stock in the foreseeable future. Payment of dividends on the common stock is prohibited under the Revolving Credit Agreement until all amounts outstanding thereunder have been paid in full and the commitment thereunder is terminated.

The Company may also be unable to pay dividends under Delaware law. Under the Delaware General Corporation Law, a corporation may pay dividends only

out of its surplus or, when there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. The Company has a stockholders' deficit, has not had any net profits since its commencement of operations and may never have profits.

DEPENDENCE ON KEY PERSONNEL

The Company is dependent on the efforts of Steven Roth, the Chairman of the Board and Chief Executive Officer of the Company, and Michael D. Fascitelli, the President of the Company. While the Company believes that it could find replacements for these key personnel, the loss of their services could have an adverse effect on the operations of the Company.

POTENTIAL ANTI-TAKEOVER EFFECTS OF CHARTER DOCUMENTS, STOCKHOLDER PROTECTION RIGHTS PLAN AND APPLICABLE LAW

The Charter, the Company's bylaws and Stockholder Protection Rights Plan, and applicable sections of the Delaware General Corporation Law contain provisions that may make the acquisition of control of the Company more difficult without the approval of the Company's Board.

DEPENDENCE ON DISTRIBUTIONS FROM SUBSIDIARIES

Substantially all of the Company's assets consist of its partnership interests in Company L.P., of which the Company is the sole general partner. Substantially all of Company L.P.'s properties and assets are held through subsidiaries. Any right of the Company to participate in any distribution of the assets of any indirect subsidiary of the Company upon the liquidation, reorganization or insolvency of such subsidiary (and any consequent right of the Company's security holders to participate in those assets) will be subject to the claims of the creditors (including AmeriCold Logistics' deferred rent obligation to the Landlord) and preferred holders of equity, if any, of Company L.P. and such subsidiary, except to the extent the Company has a recognized claim against such subsidiary as a creditor of such subsidiary. In addition, in the event that claims of the Company as a creditor of a subsidiary are recognized, such claims would be subordinate to any security interest in the assets of such subsidiary and any indebtedness of such subsidiary senior to that held by the Company.

POTENTIAL COSTS OF COMPLIANCE WITH ENVIRONMENTAL LAWS

Under various federal and state laws, a current or previous owner or operator of real estate (including the Company as lessee of real estate) may be required to investigate and cleanup certain hazardous or toxic substances released at a property, and may be held liable to a governmental entity or to third parties for property damage or personal injuries and for investigation and cleanup costs incurred by those parties because of the contamination. Such laws often impose liability without regard to whether the owner or operator knew of the release of such hazardous substances or caused the release. The presence of contamination or the failure to remediate contamination may adversely affect the owner's ability to sell or lease real estate or to borrow using the real estate as collateral or the operator's ability to sell or finance the operations. Other laws and regulations govern indoor and outdoor air quality, including those that can require abatement or removal of asbestos-containing materials in the event of damage, demolition, renovations or remodeling. The laws also govern emissions of and exposure to asbestos fibers in the air. Air emissions and wastewater discharges and the operation and removal of certain underground storage tanks are also regulated by federal and state laws. The maintenance and removal of lead paint and certain electrical equipment containing polychlorinated biphenyls

are also regulated by federal and state laws. In connection with the ownership, operation and management of its properties, including the properties it leases from Vornado or manages for others, the Company could be held liable for the costs of remedial action, or other compliance expenditures, with respect to such regulated substances or tanks and related claims for personal injury, property damage or fines. Further, properties that AmeriCold Logistics leases or manages are subject to a variety of environmental laws and regulations in each of the jurisdictions in which it operates governing, among other things, soil and groundwater contamination, the use, handling and disposal of hazardous substances, air emissions, wastewater discharges, and employee health and safety.

ITEM 2. PROPERTIES

Under the Vornado Agreement, Vornado makes available to the Company, at Vornado's offices, space for the Company's principal corporate offices, for which the Company compensates Vornado in an amount determined in good faith by Vornado as the amount an unaffiliated third party would charge the Company for comparable space. The Company believes that such facilities will be adequate to meet its expected requirements for the coming year.

ITEM 3. LEGAL PROCEEDINGS

The Company is from time to time involved in legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the outcome of such matters will not have a material effect on the Company's financial condition, results of operations or cash flows.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 31, 2003.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following is a list of the names, ages, principal occupations and positions of the executive officers of the Company and the position held by such officers during the past five years. Officers are appointed by and serve at the discretion of the Board of Directors.

Steven Roth, age 62, has been Chairman of the Board and Chief Executive Officer of the Company since incorporation. Mr. Roth has been Chairman of the Board and Chief Executive Officer of Vornado Realty Trust ("Vornado") since May 1989 and Chairman of the Executive Committee of the Board of Vornado since April 1980. Since 1968, he has been a general partner and more recently, the Managing General Partner of Interstate Properties. In March 1995, he became Chief Executive Officer of Alexander's, Inc. ("Alexander's"). Mr. Roth is also a director of Alexander's and Capital Trust, Inc.

Michael D. Fascitelli, age 47, has been President and a director of the Company since incorporation. Mr. Fascitelli has been President and a trustee of Vornado, and a director of Alexander's, since December 1996. He has been President of Alexander's since August 2000. From December 1992 to December 1996, Mr. Fascitelli was a partner at Goldman Sachs & Co. in charge of its real estate practice.

Joseph Macnow, age 58, has been Executive Vice President and Chief Financial Officer of the Company since June 2002. Prior thereto, he was

Executive Vice President - Finance and Administration of the Company since incorporation. Mr. Macnow has been Executive Vice President - Finance and Administration of Vornado since January 1998 and its Chief Financial Officer since March 2001. From 1985 to January 1998, he was Vice President and Chief Financial Officer of Vornado. Mr. Macnow has been Executive Vice President and Chief Financial Officer of Alexander's since June 2002. Prior thereto, he was Executive Vice President - Finance and Administration of Alexander's since March 2001. From August 1995 to March 2001, he was Vice President and Chief Financial Officer of Alexander's.

Neither Mr. Roth, Mr. Fascitelli nor any other member of management is committed to spending a particular amount of time on the Company's affairs, nor do any of them devote their full time to the Company. Mr. Roth, Mr. Fascitelli and the other members of management devote such time and efforts as they deem reasonably necessary to conduct the operations of the Company while continuing to devote a material amount of their time and efforts to the management and properties of Vornado, Alexander's and other businesses.

-12-

PART II.

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The American Stock Exchange suspended trading in the Company's common stock as of the close of business on July 11, 2003. Effective July 14, 2003, the Company's common stock began trading over the counter under its newly assigned ticker symbol, VOOC. On July 24, 2003, the Securities and Exchange Commission issued an order to approve the removal of the Company's common stock from listing on the American Stock Exchange. Effective July 25, 2003, the Company's common stock was eligible for trading on the OTC Bulletin Board. Trading of the Company's common stock through market makers may involve decreased liquidity and risks not present when common stock is traded on a securities exchange. The transfer agent and registrar for the common stock is Wachovia Bank, N.A.

Set forth below are the high and low sales prices (prior to July 12, 2003) and the high and low bid quotations (July 12, 2003 and thereafter) for the common stock for each quarterly period in the years ended December 31, 2003 and 2002. The over-the-counter market quotations reflect inter-dealer prices, without retail markup, markdown or commission, and may not necessarily represent actual transactions. These over-the-counter quotations are publicly available on the website, www.nasdaq.com.

	Year Ended December 31, 2003		Year Ended December 31, 2002	
Quarter	High	Low	High	Low
First..................	$ 0.58	$ 0.20	$ 1.24	$ 0.35
Second.................	0.90	0.13	2.15	0.70
Third..................	0.60(1)	0.05(1)	0.85	0.40
Fourth.................	0.70	0.34	0.70	0.22

(1) The high and low prior to July 12, 2003 are $0.60 and $0.46, respectively; thereafter, the high and low are $0.55 and $0.05, respectively.

The approximate number of record holders of the common stock of the

Company at February 29, 2004 was 900.

No cash dividends have been declared or paid in respect of the common stock. Payment of any dividends on the common stock is prohibited under the Revolving Credit Agreement with Vornado Realty Trust until all amounts outstanding thereunder are paid in full and the commitment thereunder is terminated. Additionally, the Company intends to use its available funds to cover cash flow deficits and, therefore, does not anticipate the payment of any cash dividends on the common stock for the foreseeable future. The declaration of dividends is subject to the discretion of the Board, subject to applicable law. Under the Delaware General Corporation Law, a corporation may pay dividends only out of its surplus or, when there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. The Company has a stockholders' deficit, has not had any net profits since its commencement of operations and may never have profits.

Information relating to compensation plans under which equity securities of the Company are authorized for issuance is set forth under Part III, Item 12 of this Form 10-K and such information is incorporated herein by reference.

-13-

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected financial and operating data. This data should be read in conjunction with the consolidated financial statements and notes thereto and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K. This data may not be comparable to, or indicative of, future operating results.

	Year Ended December 31		
	2003	2002	2001
REVENUES			
Interest income	$ 3,523	$ 2,346	$ 7,293
EXPENSES			
General and administrative	1,118,134	1,053,241	1,896,822
Organization costs	--	--	--
	1,118,134	1,053,241	1,896,822
	(1,114,611)	(1,050,895)	(1,889,529)
Interest and debt expense to Vornado Realty Trust	(1,559,899)	(1,998,550)	(2,422,337)
Income (loss) from AmeriCold Logistics (1)(2)(3)(4)	1,889,960	(7,301,784)	(2,331,105)
Loss from marketable securities	--	--	(777,630)
Loss from Transportal Network	--	--	--
Gain on sale of investment in Charles E. Smith Commercial Realty L.P.	--	--	--
Loss before minority interest	(784,550)	(10,351,229)	(7,420,601)
Minority interest(5)	--	--	--

NET LOSS	$ (784,550)	$(10,351,229)	$ (7,420,601)	$
Net loss per share - basic and diluted	$ (0.19)	$ (2.54)	$ (1.82)	$
Balance sheet data:				
Total assets	$ 1,356,628	$ 649,587	$ 19,110,923	$
Note, interest, and fees payable to Vornado Realty Trust	25,394,254	23,834,355	31,434,682	
Stockholders' (deficit) equity	(24,217,550)	(23,433,000)	(12,899,024)	

(1) The Company did not record $21,779,000 its 60% share of AmeriCold Logistics' net loss of $36,298,000 for the year ended December 31, 2003, as the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of comprehensive losses of AmeriCold Logistics at December 31, 2002. The income from AmeriCold Logistics for the year ended December 31, 2003 represents interest and the recovery from repayments of loans previously reduced by equity in losses.

(2) The year ended December 31, 2002 includes the Company's $1,335,000 share of AmeriCold Logistics' $2,225,000 gain on its sale of its Carthage, Missouri and Kansas City, Kansas limestone quarries and a recovery of $8,608,000 from the $8,800,000 repayment of loans to AmeriCold Logistics previously reduced by equity in losses.

(3) The year ended December 31, 2001 includes the Company's $23,887,000 share of $39,812,000 of deferred rent waived by AmeriCold Logistics' Landlord, as defined below, and the Company's $5,337,000 share of AmeriCold Logistics' charge of $8,895,000 for severance and relocation costs.

(4) On March 11, 1999, the Company and Crescent Operating, Inc. formed the "Vornado Crescent Logistics Operating Partnership" (which does business under the name "AmeriCold Logistics") to purchase all of the non-real estate assets of the Vornado REIT/Crescent REIT Partnership (the "Landlord"). AmeriCold Logistics leases 87 temperature controlled warehouses from the Landlord, which continues to own the real estate. The Company's results of operations reflect 60% of the losses of AmeriCold Logistics from March 11, 1999 until December 31, 2002 (see footnote (1) above).

(5) During the year ended December 31, 2000, the minority interest was fully absorbed by losses.

No cash dividends have been declared or paid in respect of the Company's common stock, par value $0.01 per share.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Management's Discussion and Analysis of Financial Condition and Results of Operations considers the Company's consolidated financial statements for the years ended December 31, 2003, 2002 and 2001.

ABILITY TO CONTINUE AS A GOING CONCERN

Substantial doubt exists as to the Company's ability to continue as a

going concern and its ability to discharge its liabilities in the normal course of business. The Company has incurred losses since its inception and, in the aggregate, its investments have not generated sufficient cash flow to pay all of the Company's expenses. The Company estimates that it has adequate borrowing capacity under its credit facility with Vornado Realty Trust ("Vornado") to meet its cash needs until December 31, 2004. However, the principal, interest and fees outstanding under the line of credit come due on such date. The Company currently has no external sources of financing except this facility.

The Company's other potential source of cash is its investment in AmeriCold Logistics. However, AmeriCold Logistics has also reported losses since inception and, at December 31, 2003, the Company's 60% share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to its landlord, the Vornado REIT/Crescent REIT Partnership (the "Landlord"). AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado or the ability to continue as a going concern.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Set forth below is a summary of the accounting policies that management believes are critical to the preparation of the consolidated financial statements. The summary should be read in conjunction with the more complete discussion of the Company's significant accounting policies included in Note 3 to the consolidated financial statements in this Annual Report on Form 10-K.

Investments in and Advances to AmeriCold Logistics

The Company's 60% interest in AmeriCold Logistics is currently accounted for under the equity method of accounting as Crescent Operating, Inc. ("COPI"), the Company's partner in AmeriCold Logistics, has substantive participating rights. The investments in and advances to AmeriCold Logistics are recorded initially at cost and subsequently adjusted for the Company's share of comprehensive income or loss and cash distributions or principal repayments from AmeriCold Logistics. The interest earned on the advances to AmeriCold Logistics is recorded as a component of income or loss from AmeriCold Logistics. The Company does not record comprehensive losses in excess of the cost of its investments in and advances to AmeriCold Logistics, as the Company is not liable for the obligations of, or otherwise committed to provide additional financial support to, AmeriCold Logistics. The Company did not record its 60% share of AmeriCold Logistics' net loss for the year ended December 31, 2003 as the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of comprehensive losses of AmeriCold Logistics at December 31, 2002. In addition, the Company's share of other comprehensive losses of AmeriCold Logistics not recorded at December 31, 2003 was $6,882,000. The Company will record its share of future comprehensive income from AmeriCold Logistics only for the portion of such income that exceeds its share of comprehensive losses not previously recorded. The Company's method of accounting for AmeriCold Logistics will change in the fourth quarter of 2004 (see "Recently

Issued Accounting Standards" below). The Company's exposure to losses from AmeriCold Logistics is limited to its investments in and advances to AmeriCold Logistics.

Recently Issued Accounting Standards

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51. FIN No. 46 required the consolidation of an entity by an enterprise if (i) that enterprise, known as a "primary beneficiary," has an interest that will absorb a majority of the entity's expected losses if they occur, receive a majority of the entity's expected residual returns if they occur, or both and (ii) the entity is a variable interest entity. An entity is a variable interest entity if (a) the total equity investment at risk in the entity is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties or (b) the equity investors do not have the characteristics of a controlling financial interest in the entity. The initial determination of whether an entity is a variable interest entity shall be made as of the date at which an enterprise became involved with the entity and reconsidered as of the date that one of three triggering events described in FIN No. 46 occurs.

The Company previously disclosed that its investments in AmeriCold Logistics met the criteria for consolidation under FIN No. 46 and it would consolidate AmeriCold Logistics beginning July 1, 2003 by restating its prior period consolidated financial statements. However, in October 2003, FASB issued FASB Staff Position No. FIN 46-6, Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities. This position allowed public entities to defer the date for implementing FIN No. 46, except certain required disclosures, until the end of the first interim or annual period ending after December 15, 2003 if certain conditions apply. The Company concluded that AmeriCold Logistics qualified for deferral and elected to implement FIN No. 46 on December 31, 2003. However, on December 24, 2003, FASB issued a revision to FIN No. 46 to, among other things, clarify some of the provisions of FIN No. 46. The revision allows a public entity which is a small business issuer, as defined in Regulation S-B, that has not previously applied FIN No. 46 to implement the revision no later than the end of the first interim or annual period ending after December 15, 2004. The Company meets the criteria of the small business issuer definition and has elected to implement the revision on December 31, 2004. The Company is evaluating its implementation alternatives (i.e., restatement of its previously issued consolidated financial statements or a cumulative effect adjustment). Had AmeriCold Logistics been consolidated as of December 31, 2003, the Company's accumulated deficit and accumulated other comprehensive loss would have increased to $99,955,000 and $15,363,000, respectively.

RESULTS OF OPERATIONS

Years Ended December 31, 2003 and 2002

The Company had a net loss of $785,000 for the year ended December 31, 2003, compared to a net loss of $10,351,000 for the prior year, a decrease of $9,566,000. The Company did not record $21,779,000, its 60% share of AmeriCold Logistics' net loss of $36,298,000 for the year ended December 31, 2003, as the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of the comprehensive losses of AmeriCold Logistics at December 31, 2002. In the year ended December 31, 2002, the Company recorded its share of AmeriCold Logistics' net loss of $29,766,000, or $17,980,000. Additionally, the Company recognized $896,000 and $8,608,000 as income in the

respective periods. These amounts represent repayments from AmeriCold Logistics of its loans from the Company that were previously reduced by equity in losses of AmeriCold Logistics.

General and administrative expenses were $1,118,000 for the year ended December 31, 2003, compared to $1,053,000 for the prior year, an increase of $65,000. The increase resulted primarily from higher insurance costs and professional fees.

Interest and debt expense to Vornado was $1,560,000 for the year ended December 31, 2003, compared to $1,999,000 for the prior year, a decrease of $439,000. The decrease resulted from interest calculated at lower LIBOR rates on a lower average outstanding balance due to the December 2002 $7,685,000 principal payment made following the quarry sale, as discussed below.

The following represents the components of the Company's income (loss) from AmeriCold Logistics:

(amounts in thousands)	For The Year Ended December 31, 2003	2002
Equity in loss	$ --	$ (17,980)
Interest on loans	994	2,070
Recovery from repayments of loans previously reduced by equity in losses	896	8,608
	$ 1,890	$ (7,302)

The Company did not record $21,779,000, its 60% share of AmeriCold Logistics' net loss of $36,298,000 for the year ended December 31, 2003, as the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of the comprehensive losses of AmeriCold Logistics at December 31, 2002 and as the Company is not liable for the obligations of, or otherwise committed to provide additional financial support to, AmeriCold Logistics. In the year ended December 31, 2002, the Company recorded its share of AmeriCold Logistics' net loss of $29,766,000, or $17,980,000. The decreases in interest earned on the Company's loans to AmeriCold Logistics were attributable to lower average loans outstanding in the current year. The $896,000 and $8,608,000 recognized as income in the respective periods represent repayments from AmeriCold Logistics of its loans from the Company that were previously reduced by equity in losses of AmeriCold Logistics.

On December 31, 2002, Vornado and Crescent Real Estate Equities Company ("Crescent") formed a new joint venture (the "Quarry Company") in which Vornado holds a 44% interest and Crescent holds a 56% interest. This new joint venture acquired AmeriCold Logistics' Carthage, Missouri and Kansas City, Kansas limestone quarries for $20,000,000, the appraised value. The purchase price consisted of $8,929,000 in cash and the cancellation of $11,071,000 of notes owed by AmeriCold Logistics to Crescent. AmeriCold Logistics recognized a gain of $2,225,000 (of which the Company's share is $1,335,000). AmeriCold Logistics used $8,800,000 of the cash proceeds to repay a portion of its loans from the Company. The Company recognized a gain on the repayment from AmeriCold Logistics of $8,608,000 as the loans were previously reduced by equity in losses of AmeriCold Logistics. Additionally, AmeriCold Logistics entered into a management

agreement with the joint venture to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as operator of the quarries. The agreement is for a term of one year and automatically renews for additional one-year periods unless terminated by either party. The Company used the $8,800,000 repayment from AmeriCold Logistics and $700,000 of its cash to repay $7,685,000 of principal and $1,815,000 of interest and commitment fees under its Revolving Credit Agreement with Vornado.

To keep the Company's stockholders knowledgeable about the Company's sole investment, a discussion of AmeriCold Logistics' results of operations is included below. The amounts discussed below in "AmeriCold Logistics' Results of Operations for the Years Ended December 31, 2003 and 2002" exclude the interest income of $994,000 and $2,070,000 and gains of $896,000 and $8,608,000 recorded by the Company in the years ended December 31, 2003 and 2002, respectively.

AmeriCold Logistics' Results of Operations for the Years Ended December 31, 2003 and 2002

The following is a discussion of the results of operations of AmeriCold Logistics, the Company's investee in the temperature controlled logistics business. See "Item 1. Business - Temperature Controlled Logistics Business (`AmeriCold Logistics')" for a discussion of the business. The data below represents 100% of this business, in which the Company holds a 60% interest. For the purpose of the discussion below, "Leased Operations" refer to operations at warehouses leased by AmeriCold Logistics and "Other Operations" refer to (i) warehouses managed by AmeriCold Logistics for the accounts of customers ("Managed Warehouses"), (ii) Transportation Management Services, which includes freight routing, dispatching, freight rate negotiation, backhaul coordination, and distribution channel assessments, and (iii) Quarry Operations. In December 2002, AmeriCold Logistics sold its quarries to a joint venture owned 44% by Vornado and 56% by Crescent, the owners of the Landlord. Additionally, AmeriCold Logistics agreed to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as the operator.

Certain prior year amounts in this discussion were reclassified to conform to the current year presentation.

Revenues were $653,746,000 for the year ended December 31, 2003, compared to $646,332,000 for the prior year, an increase of $7,414,000. Revenues from Leased Operations were $433,704,000 for the year ended December 31, 2003, compared to $439,532,000 for the prior year, a decrease of $5,828,000. Revenues from Other Operations were $220,042,000 for the year ended December 31, 2003, compared to $206,800,000 for the prior year, an increase of $13,242,000.

The decrease in revenue from Leased Operations for the year was largely the result of lower storage and accessorial revenues, partially offset by increased handling revenues. The increase in revenue from Other Operations was chiefly attributable to (i) new Managed Warehouse contracts and (ii) increased volume from existing Managed Warehouse and Transportation Management customers, partially offset by (iii) the effect of the December 2002 quarry sale noted above.

The gross margin for Leased Operations was $159,909,000, or 36.9%, for the year ended December 31, 2003, compared to $159,302,000, or 36.2%, for the prior year, an increase of $607,000. The increase in gross margin was primarily the result of cost containment measures.

Operating income from Other Operations was $15,499,000 for the year ended December 31, 2003, compared to $11,437,000 for the prior year, an increase of $4,062,000. This increase resulted primarily from the new Managed Warehouse contracts noted above and more favorable rates with transportation carriers, partially offset by the effect of the December 2002 quarry sale.

Rent expense was $165,266,000 for the year ended December 31, 2003, compared to $153,759,000 for the prior year, an increase of $11,507,000. This increase resulted from higher percentage rent in the current year as the lease amendment with the Landlord that reduced percentage rent for the 2002 lease year expired.

General and administrative expenses were $34,937,000 for the year ended December 31, 2003, compared to $35,625,000 for the prior year, a decrease of $688,000. This decrease resulted largely from cost containment measures, partially offset by higher payroll expenses.

Depreciation and amortization expense was $9,751,000 for the year ended December 31, 2003, compared to $10,701,000 for the prior year, a decrease of $950,000. This decrease was mainly attributable to the December 2002 quarry sale.

Interest expense was $3,507,000 for the year ended December 31, 2003, compared to $5,089,000 for the prior year, a decrease of $1,582,000. This decrease resulted from lower average borrowings outstanding in the current year, partially offset by the interest on higher average deferred rent balances in the current year.

Other income, net, was $1,755,000 for the year ended December 31, 2003, compared to $1,495,000 for the prior year, an increase of $260,000. This increase was mainly due to improved results from a joint venture partially offset by lower interest rates on cash balances.

Years Ended December 31, 2002 and 2001

The Company had a net loss of $10,351,000 for the year ended December 31, 2002, compared to a net loss of $7,421,000 for the prior year, an increase of $2,930,000.

General and administrative expenses were $1,053,000 for the year ended December 31, 2002, compared to $1,897,000 for the prior year, a decrease of $844,000. The decrease resulted from (i) lower payroll costs relating to the resignation of the Company's former Chief Operating Officer effective June 15, 2001 and (ii) a decrease in franchise taxes due to the decline in the book value of the Company's investments in and advances to AmeriCold Logistics.

Interest and debt expense to Vornado was $1,999,000 for the year ended December 31, 2002, compared to $2,422,000 for the prior year, a decrease of $423,000. The decrease resulted primarily from interest calculated at lower LIBOR rates under the Revolving Credit Agreement with Vornado.

The Company's loss from AmeriCold Logistics was $7,302,000 for the year ended December 31, 2002, compared to a loss of $2,331,000 for the prior year, an increase of $4,971,000. Included in these losses is interest income for the years ended December 31, 2002 and 2001 of $2,070,000 and $1,082,000, respectively. This interest was earned on the Company's loans to AmeriCold Logistics. This increase was attributable to higher average loans outstanding in the current year.

On December 31, 2002, Vornado and Crescent formed the Quarry Company in which Vornado holds a 44% interest and Crescent holds a 56% interest. This new

joint venture acquired AmeriCold Logistics' Carthage, Missouri and Kansas City, Kansas limestone quarries for $20,000,000, the appraised value. The purchase price consisted of $8,929,000 in cash and the cancellation of $11,071,000 of notes owed by AmeriCold Logistics to Crescent. AmeriCold Logistics recognized a gain of $2,225,000 (of which the Company's share is $1,335,000). AmeriCold Logistics used $8,800,000 of the cash proceeds to repay a portion of its loans from the Company. The Company recognized a gain on the repayment from AmeriCold Logistics of $8,608,000 as the loans were previously reduced by equity in losses of AmeriCold Logistics. Additionally, AmeriCold Logistics entered into a management agreement with the joint venture to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as operator of the quarries. The agreement is for a term of one year and automatically renews for additional one-year periods unless terminated by either party. The Company used the

$8,800,000 repayment from AmeriCold Logistics and $700,000 of its cash to repay $7,685,000 of principal and $1,815,000 of interest and commitment fees under its Revolving Credit Agreement with Vornado.

In the three months ended December 31, 2001, AmeriCold Logistics reversed $25,469,000 of the rent expense recorded in 2001. This resulted from the Landlord waiving its rights to collect this portion of the rent. Further, the Landlord waived $14,343,000 of the rent expense recorded by AmeriCold Logistics in 2000; AmeriCold Logistics recorded this amount as income in the three months ended December 31, 2001. The aggregate amount waived by the Landlord of $39,812,000 (of which the Company's share is $23,887,000) represents a portion of the rent due under the leases, which AmeriCold Logistics deferred in such years.

In the year ended December 31, 2001, AmeriCold Logistics recorded a charge of $8,895,000 (of which the Company's share is $5,337,000) comprised of (i) severance and relocation costs associated with a management restructuring and (ii) expenses arising from the consolidation of a portion of the corporate office in Portland, Oregon into AmeriCold Logistics' Atlanta, Georgia headquarters. Severance related charges were for the termination of 199 employees, located primarily in the Atlanta and Portland offices. In 2002, AmeriCold Logistics reduced the charge by $949,000 (of which the Company's share is $569,000).

The amounts discussed below in "AmeriCold Logistics' Results of Operations for the Years Ended December 31, 2002 and 2001" exclude the interest income and the $8,608,000 gain recorded by the Company. AmeriCold Logistics' net losses were $29,766,000 and $5,688,000 for the years ended December 31, 2002 and 2001 (of which the Company's share is $17,980,000 and $3,413,000, respectively).

AmeriCold Logistics' Results of Operations for the Years Ended December 31, 2002 and 2001

The following is a discussion of the results of operations of AmeriCold Logistics, the Company's investee in the temperature controlled logistics business. See "Item 1. Business - Temperature Controlled Logistics Business (`AmeriCold Logistics')" for a discussion of the business. The data below represents 100% of this business, in which the Company holds a 60% interest. For the purpose of the discussion below, "Leased Operations" refer to operations at warehouses leased by AmeriCold Logistics and "Other Operations" refer to (i) warehouses managed by AmeriCold Logistics for the accounts of customers ("Managed Warehouses"), (ii) Transportation Management Services, which includes freight routing, dispatching, freight rate negotiation, backhaul coordination, and distribution channel assessments, and (iii) Quarry Operations. In December

2002, AmeriCold Logistics sold its quarries to a joint venture owned 44% by Vornado and 56% by Crescent, the owners of the Landlord. Additionally, AmeriCold Logistics agreed to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as the operator.

Certain prior year amounts in this discussion were reclassified to conform to the current year presentation.

Revenues were $646,332,000 for the year ended December 31, 2002, compared to $647,259,000 for the prior year, a decrease of $927,000. Revenues from Leased Operations were $439,532,000 for the year ended December 31, 2002, compared to $441,772,000 for the prior year, a decrease of $2,240,000. Revenues from Other Operations were $206,800,000 for the year ended December 31, 2002, compared to $205,487,000 for the prior year, an increase of $1,313,000.

The decrease in revenue from Leased Operations for the year is primarily the result of a rate restructuring with a significant customer and temporary plant shutdowns, partially offset by higher occupancy rates. The increase in revenue from Other Operations is largely attributable to new warehouse management contracts, partially offset by the discontinuation of Transportation Management Services business with lower margin customers.

The gross margin for Leased Operations was $159,302,000, or 36.2%, for the year ended December 31, 2002, compared to $160,145,000, or 36.3%, for the prior year, a decrease of $843,000. The decrease in gross margin is primarily the result of increased insurance, workers' compensation and labor costs, partially offset by a pension curtailment gain in 2002.

Operating income from Other Operations was $11,437,000 for the year ended December 31, 2002, compared to $11,897,000 for the prior year, a decrease of $460,000. This decrease is largely attributable to a reduction in output at the Quarry Operations partially offset by improved margins on Transportation Management Services and new warehouse management contracts.

Rent expense was $153,759,000 for the year ended December 31, 2002, compared to $130,807,000 for the prior year, an increase of $22,952,000. The increase resulted primarily from the waiver of 2001 rent of

$25,469,000 by the Landlord in the three months ended December 31, 2001, as discussed above, partially offset by a decline in contingent rent which varies based on revenue in the applicable periods. Further, in the three months ended December 31, 2001, AmeriCold Logistics recorded income resulting from the waiver by the Landlord of rent deferred in 2000 of $14,343,000, also as discussed above.

General and administrative expenses were $35,625,000 for the year ended December 31, 2002, compared to $37,137,000 for the prior year, a decrease of $1,512,000. This decrease resulted primarily from lower professional fees, partially offset by higher payroll expenses.

Reserves established for restructuring were $8,895,000 for the year ended December 31, 2001. This reflects senior management changes and the consolidation of a portion of the corporate office in Portland, Oregon into AmeriCold Logistics' Atlanta, Georgia headquarters, as

discussed above. Severance related charges were for the termination of 199 employees, located primarily in the Atlanta and Portland offices. In 2002, AmeriCold Logistics reduced the charge by $949,000.

Depreciation and amortization expense was $10,701,000 for the year ended December 31, 2002, compared to $11,477,000 for the prior year, a decrease of $776,000. This decrease was primarily due to a change in estimate in 2001 for depletion at one of AmeriCold Logistics' former quarries partially offset by depreciation on additional equipment purchased in 2002 and an adjustment in the first quarter of 2002 of the useful lives of certain assets.

Gain on the sale of AmeriCold Logistics' Carthage, Missouri and Kansas City, Kansas limestone quarries was $2,225,000 for the year ended December 31, 2002, as discussed above.

Interest expense was $5,089,000 for the year ended December 31, 2002, compared to $4,702,000 for the prior year, an increase of $387,000. This increase was largely the result of higher average borrowings outstanding in the current year.

Other income, net, was $1,495,000 for the year ended December 31, 2002, compared to $945,000 for the prior year, an increase of $550,000. This increase was primarily the result of a 2001 write off of receivables from Transportal Network, which ceased operations in 2000.

The Company recognized a loss from marketable securities of $778,000 in 2001, due to an "other than temporary decline" in the fair value of marketable securities classified as available for sale.

LIQUIDITY AND CAPITAL RESOURCES

Substantial doubt exists as to the Company's ability to continue as a going concern and its ability to discharge its liabilities in the normal course of business. The Company has incurred losses since its inception and, in the aggregate, its investments have not generated sufficient cash flow to pay all of the Company's expenses. The Company estimates that it has adequate borrowing capacity under its credit facility with Vornado to meet its cash needs until December 31, 2004. However, the principal, interest and fees outstanding under the line of credit come due on such date. The Company currently has no external sources of financing except this facility.

The Company's other potential source of cash is its investment in AmeriCold Logistics. However, AmeriCold Logistics has also reported losses since inception and, at December 31, 2003, the Company's 60% share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to its Landlord, the Vornado REIT/Crescent REIT Partnership. AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado or the ability to continue as a going concern.

The Company has a $75,000,000 unsecured Revolving Credit Agreement with Vornado which expires on December 31, 2004. Borrowings under this facility bear interest at LIBOR plus 3% (4.12% at December 31, 2003). The Company pays Vornado a commitment fee equal to 1% per annum on the average daily unused portion of the facility pursuant thereto; for the years ended December 31, 2003, 2002 and 2001, the Company recorded commitment fees under the facility of $505,000,

$432,000 and $485,000, respectively. Amounts may be borrowed under the Revolving Credit Agreement, repaid and reborrowed from time to time on a revolving basis (so long as the principal amount outstanding at any time does not exceed $75,000,000). Principal payments are not required under

the Revolving Credit Agreement during its term. The Revolving Credit Agreement prohibits the Company from incurring indebtedness to third parties (other than certain purchase money debt and certain other exceptions) and prohibits the Company from paying any dividends. The Company currently has no external sources of financing except this facility. At December 31, 2003, $1,591,000 of interest and commitment fees were unpaid, which reduces the availability under the Revolving Credit Agreement to $49,606,000. See the preceding two paragraphs regarding the substantial doubt as to the Company's ability to continue as a going concern and discharge this liability in the normal course of business.

During 2001 and 2000, the Company made three secured loans totaling $11,940,000 to AmeriCold Logistics. The first two loans, totaling $6,840,000, were secured by a mortgage on AmeriCold Logistics' quarries. These loans bore interest at 12% and required monthly payments of interest until maturity on March 31, 2002. The third loan was $5,100,000 and is secured by property, plant and equipment. This loan bears interest at 14% and requires monthly payments of principal and interest of $99,000 until maturity on December 31, 2002. On March 11, 2002, all three of these loans were amended to extend the maturity date to December 31, 2004. On December 31, 2002, AmeriCold Logistics used $8,800,000 of the cash proceeds from the sale of its quarries, as discussed under "Results of Operations," to repay the two loans secured by the quarries and a portion of the loan secured by property, plant and equipment. At December 31, 2003, $1,474,000 remains outstanding under the property, plant and equipment loan.

The Company's $6,000,000 contribution to AmeriCold Logistics on March 7, 2000 was unmatched by COPI. Accordingly, the $4,000,000 contribution receivable shown in partners' capital of the Vornado Crescent Logistics Operating Partnership's financial statements was cancelled at December 31, 2001. On March 11, 2002, the Company's $6,000,000 became a special equity contribution that has priority over the original equity amounts and accrues a return of 12% compounded annually. On November 5, 2002, the Company's $6,000,000 special equity contribution was converted into a loan collateralized by certain trade receivables of AmeriCold Logistics. The conversion was effective March 11, 2002. The loan bears interest of 12% and requires monthly interest payments until maturity on December 31, 2004.

AmeriCold Logistics' deferred rent liability at December 31, 2003, net of the waived rent discussed below, is as follows:

(amounts in thousands)	Total (1)
Deferred during 2003	$ 41,811
Deferred during 2002	32,248
Aggregate deferral at December 31, 2001	8,335
	$ 82,394

(1) The Company does not guarantee AmeriCold Logistics' deferred rent liability.

In the three months ended December 31, 2001, AmeriCold Logistics reversed $25,469,000 of the rent expense recorded in 2001. This resulted from the Landlord waiving its rights to collect this portion of the rent. Further, the Landlord waived $14,343,000 of the rent expense recorded by AmeriCold Logistics in 2000; AmeriCold Logistics recorded this amount as income in the three months ended December 31, 2001. The aggregate amount waived by the Landlord of $39,812,000 (of which the Company's share is $23,887,000) represents a portion of the rent due under the leases, which AmeriCold Logistics deferred in such years.

On January 23, 2002, four of the leases with the Landlord were combined into one lease. This did not affect total contractual rent due under the combined leases.

On March 2, 2004, AmeriCold Logistics and the Landlord extended the deferred rent period in AmeriCold Logistics' leases with the Landlord to December 31, 2005 from December 31, 2004. The parties previously extended the deferred rent period to December 31, 2004 from December 31, 2003 on March 7, 2003.

In the year ended December 31, 2001, AmeriCold Logistics recorded a charge of $8,895,000 (of which the Company's share is $5,337,000) comprised of (i) severance and relocation costs associated with a management restructuring and (ii) expenses arising from the consolidation of a portion of the corporate office in Portland, Oregon into AmeriCold Logistics' Atlanta, Georgia headquarters. Severance related charges were for the termination of 199 employees, located primarily in the Atlanta and Portland offices. In 2002, AmeriCold Logistics reduced the charge by $949,000 (of which the Company's share is $569,000). AmeriCold Logistics' liability for severance at December 31, 2003 was $497,000; the remaining 50 of the 199 original employees are expected to be terminated in 2004.

-21-

On December 31, 2002, Vornado and Crescent formed a new joint venture, the Quarry Company, in which Vornado holds a 44% interest and Crescent holds a 56% interest. This new joint venture acquired AmeriCold Logistics' Carthage, Missouri and Kansas City, Kansas limestone quarries for $20,000,000, the appraised value. The purchase price consisted of $8,929,000 in cash and the cancellation of $11,071,000 of notes owed by AmeriCold Logistics to Crescent. AmeriCold Logistics recognized a gain of $2,225,000 (of which the Company's share is $1,335,000). AmeriCold Logistics used $8,800,000 of the cash proceeds to repay a portion of its loans from the Company. The Company recognized a gain on the repayment from AmeriCold Logistics of $8,608,000 as the loans were previously reduced by equity in losses of AmeriCold Logistics. Additionally, AmeriCold Logistics entered into a management agreement with the Quarry Company to manage and operate the quarries for an annual management fee of approximately $200,000 plus all direct expenses incurred as operator of the quarries. The agreement is for a term of one year and automatically renews for additional one-year periods unless terminated by either party. The Company used the $8,800,000 repayment from AmeriCold Logistics and $700,000 of its cash to repay $7,685,000 of principal and $1,815,000 of interest and commitment fees under the Revolving Credit Agreement with Vornado.

On December 31, 2002, AmeriCold Logistics sold, without recourse, accounts receivable of $5,720,000 to the Quarry Company for $5,600,000 in cash. AmeriCold Logistics recognized a loss of $120,000 on the sale (of which the Company's share is $72,000).

On March 28, 2003, AmeriCold Logistics sold, without recourse, accounts receivable of $6,640,000 to the Quarry Company for $6,500,000 in cash. AmeriCold

Logistics recognized a loss of $140,000 on the sale.

On January 20, 2004, AmeriCold Logistics sold, without recourse, accounts receivable of $6,120,000 to the Quarry Company for $6,000,000 in cash. AmeriCold Logistics recognized a loss of $120,000 on the sale. AmeriCold Logistics also agreed to act as agent to collect the accounts receivable. The Company does not believe that any significant servicing asset or liability exists.

The American Stock Exchange suspended trading in the Company's common stock as of the close of business on July 11, 2003. Effective July 14, 2003, the Company's common stock began trading over the counter under its newly assigned ticker symbol, VOOC. On July 24, 2003, the Securities and Exchange Commission issued an order to approve the removal of the Company's common stock from listing on the American Stock Exchange. Effective July 25, 2003, the Company's common stock was eligible for trading on the OTC Bulletin Board. Trading of the Company's common stock through market makers may involve decreased liquidity and risks not present when common stock is traded on a securities exchange.

At December 31, 2002, the Company's investments in and advances to AmeriCold Logistics were fully absorbed by the Company's share of comprehensive losses of AmeriCold Logistics. AmeriCold Logistics has reported losses since its inception and, at December 31, 2003, the Company's share of AmeriCold Logistics' partners' deficit was $45,643,000, which includes $49,436,000 of deferred rent (rent recognized as expense but not paid in cash) to the Landlord. On March 2, 2004, AmeriCold Logistics and the Landlord extended the deferred rent period to December 31, 2005 from December 31, 2004. Based on its right to defer rent, management of AmeriCold Logistics anticipates it will have sufficient cash flows to operate at least through December 31, 2004. AmeriCold Logistics anticipates that in 2004, the Landlord will restructure the leases to provide additional cash flow to AmeriCold Logistics. Notwithstanding the foregoing, the Landlord is under no obligation to restructure the leases and there can be no assurance that it will do so. In the absence of the anticipated lease restructuring or other options, AmeriCold Logistics will not have the ability to distribute funds to the Company and in turn, the Company will not have resources sufficient to repay its $25,394,000 loan from Vornado due December 31, 2004.

Contractual Obligations

At December 31, 2003, the Company had the following contractual obligations:

(amounts in thousands)	Total	Less than One Year	One to Two Years	Three to Five Years
Long-term debt obligations.............	$ 25,394	$ 25,394	$ --	$ --
Other liabilities......................	180	180	--	--
Total..................................	$ 25,574	$ 25,574	$ --	$ --

Cash Flows for the Year Ended December 31, 2003

Net cash used in operating activities of $123,000 was comprised of (i)

a net loss of $785,000 and (ii) the non-cash and non-operating income from AmeriCold Logistics of $896,000, offset by (iii) the net change in operating assets and liabilities of $1,558,000.

Cash provided by investing activities of $896,000 resulted from repayments of loans to AmeriCold Logistics.

There were no cash flows from financing activities.

Cash Flows for the Year Ended December 31, 2002

Net cash used in operating activities of $1,380,000 was comprised of (i) a net loss of $10,351,000 and (ii) the net change in operating assets and liabilities of $401,000, offset by (iii) a non-cash loss from AmeriCold Logistics of $9,372,000.

Cash provided by investing activities of $9,330,000 resulted from repayments of loans to AmeriCold Logistics.

Net cash used in financing activities of $7,620,000 resulted primarily from repayments under the Company's Revolving Credit Agreement with Vornado.

Cash Flows for the Year Ended December 31, 2001

Net cash used in operating activities of $2,934,000 is comprised of (i) a net loss of $7,421,000, partially offset by (ii) the net change in operating assets and liabilities of $296,000 and (iii) adjustments for non-cash and non-operating items of $4,191,000. The adjustments for non-cash and non-operating items are comprised of (a) a loss from AmeriCold Logistics of $3,413,000 and (b) a loss from marketable securities of $778,000.

Net cash used in investing activities of $9,282,000 is comprised of (i) advances to AmeriCold Logistics of $8,940,000 and (ii) payments of $582,000 to cease the operations of Transportal Network, partially offset by (iii) repayments of loans to AmeriCold Logistics of $240,000.

Cash provided by financing activities of $11,642,000 resulted from borrowings under the Company's Revolving Credit Agreement with Vornado.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At December 31, 2003 and 2002, respectively, the Company had $25,394,000 and $23,834,000 of variable rate debt outstanding, entered into for non-trading purposes, bearing interest at LIBOR plus 3% (4.12% at December 31, 2003). A one percent increase for one year in the base used to determine the interest rate of the variable rate debt outstanding at December 31, 2003 would result in a $254,000 increase in the Company's interest and debt expense ($0.06 per basic share).

The fair values of the note payable to Vornado at December 31, 2003 and 2002 are approximately $19,700,000 and $19,600,000, respectively. These fair values were estimated by discounting the future cash flows using current market rates available to the Company. Such fair value estimates are not necessarily indicative of the amount that would be paid upon liquidation of the Company's note payable.

The variable interest rate on the Revolving Credit Agreement is reset periodically. At reset, the Company can fix the interest rate, at its discretion, for a period of one, two, three, or six months. The Company attempts to select interest rate periods that it believes will minimize interest and debt expense. There can be no assurance that the Company will select interest rate periods that will minimize its expense.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO FINANCIAL STATEMENTS

Independent Auditors' Report...
Consolidated Balance Sheets at December 31, 2003 and 2002....................................
Consolidated Statements of Operations for the Years Ended December 31, 2003, 2002 and 2001.......
Consolidated Statements of Stockholders' Deficit for the Years Ended December 31, 2003, 2002 and
Consolidated Statements of Cash Flows for the Years Ended December 31, 2003, 2002 and 2001.......
Notes to Consolidated Financial Statements...

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

(b) Internal Control over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting during the fourth quarter of the Company's fiscal year ended December 31, 2003 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

INDEPENDENT AUDITORS' REPORT

Stockholders and Board of Directors
Vornado Operating Company
Paramus, New Jersey

We have audited the accompanying consolidated balance sheets of Vornado Operating Company as of December 31, 2003 and 2002 and the related consolidated statements of operations, stockholders' deficit and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial

statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Vornado Operating Company at December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company's inability to repay its $25,394,000 loan when it comes due on December 31, 2004 raises substantial doubt about its ability to continue as a going concern. Management's plans concerning this matter are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

DELOITTE & TOUCHE LLP

Parsippany, New Jersey
March 2, 2004

-25-

VORNADO OPERATING COMPANY
CONSOLIDATED BALANCE SHEETS

ASSETS	
Cash and cash equivalents, including U.S. government obligations under repurchase agreements of $650,000 and $200,000, respectively	$
Investments in and advances to AmeriCold Logistics	
Interest receivable from AmeriCold Logistics	
Prepaid expenses and other assets	
Total assets	$
LIABILITIES AND STOCKHOLDERS' DEFICIT	
Note, interest, and fees payable to Vornado Realty Trust	$
Due to Vornado Realty Trust	
Accounts payable and accrued expenses	
Total liabilities	
Minority interest	

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' DEFICIT

Common stock: par value $0.01 per share; authorized, 40,000,000 shares; issued and outstanding, 4,068,924 shares	
Additional paid-in capital	
Accumulated deficit	
	--
Accumulated other comprehensive loss	
	--
Total stockholders' deficit	
	--
Total liabilities and stockholders' deficit	$
	==

See notes to consolidated financial statements.

VORNADO OPERATING COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS

	YEAR ENDED DECEMB	
	2003	2002
REVENUES		
Interest income	$ 3,523	$ 2,34
EXPENSES		
General and administrative (including fees to Vornado Realty Trust of $330,000, $330,000 and $371,000)	1,118,134	1,053,24
	(1,114,611)	(1,050,89
Interest and debt expense to Vornado Realty Trust	(1,559,899)	(1,998,55
Income (loss) from AmeriCold Logistics	1,889,960	(7,301,78
Loss from marketable securities	--	-
Loss before minority interest	(784,550)	(10,351,22
Minority interest	--	-
NET LOSS	$ (784,550)	$ (10,351,22
Net loss per share -- basic and diluted	$ (0.19)	$ (2.5

See notes to consolidated financial statements.

VORNADO OPERATING COMPANY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	ACCUMULATED OTHER COMPREHENSIVE LOSS
BALANCE, JANUARY 1, 2001	$ 40,689	$ 22,462,555	$(25,828,267)	$ (720,126)
Recognition of loss from marketable securities previously included in comprehensive loss	--	--	--	720,126
Proportionate share of other comprehensive loss of AmeriCold Logistics	--	--	--	(2,153,400)
Net loss	--	--	(7,420,601)	--
BALANCE, DECEMBER 31, 2001	40,689	22,462,555	(33,248,868)	(2,153,400)
Proportionate share of other comprehensive loss of AmeriCold Logistics	--	--	--	(182,747)
Net loss	--	--	(10,351,229)	--
BALANCE, DECEMBER 31, 2002	40,689	22,462,555	(43,600,097)	(2,336,147)
Net loss	--	--	(784,550)	--
BALANCE, DECEMBER 31, 2003	$ 40,689	$ 22,462,555	$(44,384,647)	$ (2,336,147)

See notes to consolidated financial statements.

-28-

VORNADO OPERATING COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,	
	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (784,550)	$(10,351,229)

Adjustments to reconcile net loss to net cash used in operating activities:		
Equity in loss of AmeriCold Logistics	--	17,979,985
Recovery from repayment of loans to AmeriCold Logistics previously reduced by equity in losses	(896,435)	(8,607,869)
Loss from marketable securities	--	--
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	49,232	(101,055)
Interest and fees payable on note from Vornado Realty Trust	1,559,899	19,600
Interest receivable from AmeriCold Logistics	17,230	7,495
Accounts payable and accrued expenses	(69,274)	(315,979)
Due to Vornado Realty Trust	966	(11,054)
Net cash used in operating activities	(122,932)	(1,380,106)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investments in and advances to AmeriCold Logistics ..	--	--
Repayment of loans to AmeriCold Logistics	896,435	9,330,066
Investment in Transportal Network	--	--

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Interest expense on notes payable4,940 3,370 14,264 11,288
Interest expense on subordinated debentures3,805 3,841 11,206 12,078
Interest expense on amounts due under repurchase agreements— 100 — 344
Amortization of deferred policy acquisition costs45,795 (2,972) 73,980 44,938
Other operating costs and expenses16,213 13,961 48,900 45,305
Total benefits and expenses352,043 347,981 749,824 760,341
Income (loss) before income taxes31,439 (5,067) 51,389 43,814
Income tax expense (benefit)10,925 (2,089) 17,494 11,305
Net income (loss)$20,514 $(2,978) $33,895 $32,509

Earnings (loss) per common share$0.35 $(0.05) $0.58 $0.59
Earnings (loss) per common share - assuming dilution$0.33 $(0.05) $0.56 $0.57

See accompanying notes to unaudited consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital	Unallocated Common Stock Held by ESOP	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2009	$56,203	$422,225	$(5,679)	$(30,456)	$312,330	$754,623
Other comprehensive income:						
Net income for period	—	—	—	—	33,895	33,895
Change in net unrealized investment gains/losses	—	—	—	234,529	—	234,529
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	(2,302)	—	(2,302)
Other comprehensive income	—	—	—	—	—	266,122
Conversion of $60 of subordinated debentures	7	49	—	—	—	56
Acquisition of 6,300 shares of common stock	(6)	(44)	—	—	—	(50)
Allocation of 44,641 shares of common stock by ESOP, including excess income tax benefits	—	(31)	484	—	—	453
Share-based compensation, including excess income tax benefits	—	6,800	—	—	—	6,800
Issuance of 488,725 shares of common stock under compensation plans, including excess income tax benefits	489	2,296	—	—	—	2,785
Issuance of warrants	—	15,600	—	—	—	15,600
Balance at September 30, 2010	$56,693	$446,895	$(5,195)	$201,771	$346,225	$1,046,389
Balance at December 31, 2008	$50,739	$376,782	$(6,336)	$(147,376)	$223,035	$496,844
Cumulative effect of noncredit OTTI, net	—	—	—	(20,094)	25,240	5,146
Other comprehensive income:						
Net income for the period	—	—	—	—	32,509	32,509
Change in net unrealized investment gains/losses	—	—	—	251,689	—	251,689
Noncredit component of OTTI losses, available for sale securities, net	—	—	—	(70,208)	—	(70,208)
Other comprehensive income	—	—	—	—	—	213,990
Issuance of treasury stock	5	50	—	—	(18)	37
Acquisition of 12,362 shares of common stock	(12)	(40)	—	—	—	(52)

Allocation of 37,667 shares of common stock by ESOP, including excess income tax benefits	—	(114)	406	—	—	292
Share-based compensation, including excess income tax benefits	—	2,814	—	—	—	2,814
Issuance of 5,000,000 shares of common stock in exchange for notes payable	5,000	26,226	—	—	—	31,226
Issuance of 132,300 shares of common stock	132	855	—	—	—	987
Issuance of 339,015 shares of common stock under compensation plans, including excess income tax benefits	339	(339)	—	—	—	—
Balance at September 30, 2009	$56,203	$406,234	$(5,930)	$14,011	$280,766	$751,284

See accompanying notes to unaudited consolidated financial statements.

4

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

	Nine Months Ended September 30, 2010	2009
Operating activities		
Net income	$33,895	$32,509
Adjustments to reconcile net income to net cash provided by operating activities:		
Interest sensitive and index product benefits	584,842	207,028
Amortization of deferred sales inducements	21,516	17,814
Annuity product charges	(52,673)	(47,501)
Change in fair value of embedded derivatives	(11,513)	414,636
Increase in traditional life and accident and health insurance reserves	20,777	6,331
Policy acquisition costs deferred	(260,837)	(244,164)
Amortization of deferred policy acquisition costs	73,980	44,938
Provision for depreciation and other amortization	7,391	4,323
Amortization of discounts and premiums on investments	(188,044)	(160,338)
Realized gains on investments and net OTTI losses recognized	(14,233)	53,069
Change in fair value of derivatives	30,876	(109,563)
Deferred income taxes	(100,804)	(114,669)
Loss (gain) on extinguishment of debt	292	(3,098)
Share-based compensation	6,624	3,183
Change in accrued investment income	(34,854)	(39,409)
Change in income taxes recoverable/payable	95,924	11,498
Change in other assets	(10,061)	(4,111)
Change in other policy funds and contract claims	64,545	(515)
Change in collateral held for derivatives	(157,791)	228,068
Change in other liabilities	25,439	(38,855)
Other	421	(2,010)
Net cash provided by operating activities	135,712	259,164
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	3,084,551	2,236,834
Fixed maturity securities - held for investment	1,585,267	1,918,418
Equity securities - available for sale	31,665	11,778
Mortgage loans on real estate	111,305	87,898
Derivative instruments	406,563	6,534
Acquisition of investments:		
Fixed maturity securities - available for sale	(5,620,989)	(5,987,086)
Fixed maturity securities - held for investment	(215,870)	—
Equity securities - available for sale	(10,125)	—
Mortgage loans on real estate	(203,606)	(149,624)
Derivative instruments	(241,962)	(189,424)
Short-term investments	(599,746)	—
Other investments	(533)	(28)

Purchases of property, furniture and equipment	(5,342)	(1,001)
Net cash used in investing activities	(1,678,822)	(2,065,701)

5

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

	Nine Months Ended September 30,	
	2010	2009
Financing activities		
Receipts credited to annuity policyholder account balances	$3,114,235	$2,777,615
Coinsurance deposits	(248,488)	(371,897)
Return of annuity policyholder account balances	(1,189,388)	(1,038,657)
Financing fees incurred and deferred	(6,742)	(320)
Proceeds from notes payable	200,000	75,000
Repayments of notes payable	(156,641)	(3,082)
Purchase of call spread - 2015 Notes Hedges	(37,000)	—
Increase in amounts due under repurchase agreements	—	410,254
Acquisition of common stock	(50)	(34)
Excess tax benefits realized from share-based compensation plans	256	63
Proceeds from issuance of common stock	2,723	987
Proceeds from issuance of warrants	15,600	—
Change in checks in excess of cash balance	(14,878)	(8,404)
Other	—	12
Net cash provided by financing activities	1,679,627	1,841,537
Increase in cash and cash equivalents	136,517	35,000
Cash and cash equivalents at beginning of period	528,002	214,862
Cash and cash equivalents at end of period	$664,519	$249,862
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$17,101	$19,669
Income taxes	121,488	117,850
Income tax refunds received	100,000	—
Non-cash operating activity:		
Deferral of sales inducements	244,979	229,739
Non-cash investing activity:		
Real estate acquired in satisfaction of mortgage loans	7,408	8,949
Non-cash financing activities:		
Stock issued in extinguishment of debt	—	31,250
Conversion of subordinated debentures	56	—

See accompanying notes to unaudited consolidated financial statements.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2010
(Unaudited)

1. Significant Accounting Policies
Consolidation and Basis of Presentation

The accompanying consolidated financial statements of American Equity Investment Life Holding Company (“we”, “us” or “our”) have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited consolidated financial statements. Operating results for the three and nine month periods ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. All significant intercompany accounts and transactions have been eliminated. The preparation of financial statements requires the use of management estimates. For further information related to a description of areas of judgment and estimates and other information necessary to understand our financial position and results of operations, refer to the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2009.

We recorded an immaterial correction for the accounting for single premium immediate annuities during the third quarter 2010 which increased net income by $0.5 million. Reclassifications have been made to prior period financial statements to conform to the current period presentation.

Adopted Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity is now required to disclose separately the amounts of significant transfers in to and out of Level 1 and Level 2 fair value measurement categories and describe the reasons for the transfers. Clarification on existing disclosure requirements is also provided in this update relating to the level of disaggregation of information as to determining appropriate classes of assets and liabilities as well as disclosure requirements regarding valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. This standard was effective for us on January 1, 2010, and has not had a material impact on our consolidated financial statements.

In June 2009, the FASB amended accounting standards for transfers and servicing of financial assets and extinguishments of liabilities. The new standard removes the concept of a qualifying special-purpose entity ("QSPE") from existing standards and removes the exception of QSPE's from consolidation requirements. Additionally, more stringent conditions for reporting a transfer of a portion of a financial asset as a sale were created, derecognition criteria was clarified, the initial measurement of retained interests was revised, the guaranteed mortgage securitization recharacterization provisions were removed and disclosure requirements were added. This standard was effective for us on January 1, 2010 and had no effect on our consolidated financial statements upon adoption.

In June 2009, the FASB issued an amendment to the accounting standards for consolidation of variable interest entities. The new standard replaces the quantitative-based risks and rewards calculation of existing standards for determining which enterprise, if any, has a controlling financial interest in a variable interest entity with a primarily qualitative approach focused on identifying which enterprise has the power to direct the activities of a variable interest entity ("VIE") that most significantly impacts the entity's economic performance and (1) the obligation to absorb

losses of the entity or (2) the right to receive benefits from the entity. This standard was effective for us on January 1, 2010, and had no effect on our consolidated financial statements upon adoption. Through our funds withheld coinsurance agreement with an unauthorized life reinsurer we have been named as beneficiary of the trust that holds the funds withheld. We have determined that this trust is a VIE. We also have determined that the reinsurer is the primary beneficiary of this VIE due to the fact that all earnings of the trust inure to the reinsurer, and the reinsurer directs the operations of the trust subject to an investment policy. Therefore, we have not consolidated the trust prior to or after the adoption of this amendment to the accounting standards for consolidation of VIE's.

New Accounting Pronouncements

In January 2010, the FASB issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity will be required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. This guidance will be effective on January 1, 2011, and we do not expect the adoption to have a material impact on our consolidated financial statements.

In July 2010, the FASB issued an accounting standards update that expands disclosures and provide users more transparency about allowances for credit losses and the credit quality of the financing receivables of an entity. This guidance requires additional disclosures about an entity's financing receivables, such as credit quality indicators, aging of past due financing receivables, and significant purchases and sales of financing receivables. In addition, disclosures must be disaggregated by portfolio segment or class based on how an entity develops its allowance for credit losses and how it manages its credit exposure. Most of the disclosure requirements are effective for the fourth quarter of 2010 with certain additional disclosures required for the first quarter of 2011. We are currently evaluating the impact of this guidance on our consolidated financial statements.

In October 2010, as a result of a consensus of the FASB Emerging Issues Task Force, the FASB issued an accounting standards update that modifies the definition of the types of costs incurred that can be capitalized in the acquisition of new and renewal insurance contracts. This guidance defines the costs that qualify for deferral as incremental direct costs that result directly from and are essential to successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. In addition, it lists certain costs as deferrable as those that are directly related to underwriting, policy issuance and processing, medical and inspection, and sales force contract selling as deferrable, as well as the portion of an employee's total compensation related directly to time spent performing those activities for actual acquired contracts and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. This amendment to current GAAP should be applied prospectively and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with retrospective application permitted. We are currently evaluating the impact of the guidance on our consolidated financial statements.

2. Fair Values of Financial Instruments

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

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

Level 1 - Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.

Level 2 - Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.

Level 3 - Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant would use in determining fair value.

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security. Transfers between Level 1 and Level 2 were not material for the nine months ended September 30, 2010.

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. We generally obtain one value from our primary external pricing service. In situations where a price is not available from this service, we may obtain further quotes or prices from additional parties as needed.

The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. 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.

In addition, we obtain prices from a broker for our callable United States Government sponsored agencies. 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.

Fair value of call options are determined by obtaining prices from our counterparties who use market standard valuation methodologies. Market inputs include market volatility and risk free interest rates and are used in income valuation techniques in arriving at a fair value for each option contract.

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

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

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

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

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

Equity securities: The fair values of equity securities are based on quoted market prices. If quoted market prices are not available, the third parties use observable or unobservable inputs and other factors relating to instruments or securities with similar characteristics to determine fair value.

Mortgage loans on real estate: The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using current competitive market interest rates currently being offered for similar loans which are not fair value exit prices.

Derivative instruments: The fair values of derivative instruments are based upon the amount of cash that we will receive to settle each derivative instrument on the reporting date. These amounts are obtained from each of the counterparties using industry accepted valuation models and are adjusted for the nonperformance risk of each counterparty net of any collateral held. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options purchased to fund our fixed index annuity policy liabilities.

Short-term investments: The fair values of short-term investments are based on quoted market prices.

Other investments: Other investments is comprised of policy loans, rental real estate and real estate held for sale. We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived. The fair value of our real estate owned was determined either by obtaining a third party appraisal of the property or by estimating the potential annual net operating income from each commercial rental property, which we discount by a current market capitalization rate.

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

2015 notes hedges: The fair value of these call options is determined by applying market observable data such as our common stock price, its dividend yield and its volatility, as well as the time to expiration of the call options to determine a fair value of the buy side of these options.

Policy benefit reserves and coinsurance deposits: The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value). The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. We are not required to and have not estimated the fair value of the liabilities under contracts that involve significant mortality or morbidity risks, as these liabilities fall within the definition of insurance contracts that are exceptions from financial instruments that require disclosures of fair value.

Notes payable: The fair value of the convertible senior notes is based upon quoted market prices. Fair values of other notes payable are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

Subordinated debentures: Fair values for subordinated debentures are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

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

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

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

	September 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$14,648,448	$14,648,448	$10,704,131	$10,704,131
Held for investment	289,953	260,727	1,635,083	1,601,864
Equity securities, available for sale	82,172	82,172	93,086	93,086
Mortgage loans on real estate	2,528,459	2,580,440	2,449,778	2,409,197
Derivative instruments	283,920	283,920	479,272	479,272
Short-term investments	599,961	599,961	—	—
Other investments	19,810	19,810	12,760	12,760
Cash and cash equivalents	664,519	664,519	528,002	528,002
Coinsurance deposits	2,566,228	2,284,316	2,237,740	1,934,996
2015 notes hedges	38,483	38,483	—	—
Liabilities				
Policy benefit reserves	21,958,455	18,431,020	19,195,870	16,152,088
Notes payable	327,740	393,032	316,468	340,673

Subordinated debentures	268,397	166,029	268,347	186,215
2015 notes embedded derivatives	38,483	38,483	—	—
Interest rate swaps	2,531	2,531	1,891	1,891

Our assets and liabilities which are measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Dollars in thousands)			
September 30, 2010				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$3,698	$3,698	$—	$—
United States Government sponsored agencies	4,152,112	—	4,152,112	—
United States municipalities, states and territories	1,261,070	—	1,261,070	—
Corporate securities	6,502,727	73,648	6,429,079	—
Residential mortgage backed securities	2,728,841	—	2,726,142	2,699
Equity securities, available for sale: finance, insurance and real estate	82,172	60,831	21,341	—
Derivative instruments	283,920	—	283,920	—
Cash and cash equivalents	664,519	664,519	—	—
Short-term investments	599,961	599,961	—	—
2015 notes hedges	38,483	—	38,483	—
	$16,317,503	$1,402,657	$14,912,147	$2,699
Liabilities				
Interest rate swaps	$2,531	$—	$2,531	$—
2015 notes embedded derivatives	38,483	—	38,483	—
Fixed index annuities - embedded derivatives	1,706,262	—	—	1,706,262
	$1,747,276	$—	$41,014	$1,706,262
December 31, 2009				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$3,310	$2,545	$765	$—
United States Government sponsored agencies	3,998,537	—	3,998,537	—
United States municipalities, states and territories	355,634	—	355,634	—
Corporate securities	3,857,549	70,363	3,773,078	14,108
Residential mortgage backed securities	2,489,101	—	2,486,290	2,811
Equity securities, available for sale: finance, insurance and real estate	93,086	83,672	8,415	999
Derivative instruments	479,272	—	479,272	—
Cash and cash equivalents	528,002	528,002	—	—
	$11,804,491	$684,582	$11,101,991	$17,918
Liabilities				
Interest rate swaps	$1,891	$—	$1,891	$—
Fixed index annuities - embedded derivatives	1,375,866	—	—	1,375,866
	$1,377,757	$—	$1,891	$1,375,866

During the three months ended September 30, 2010, we transferred four corporate securities with a fair value of $12.5 million from Level 2 to Level 1 as quoted prices in active markets as evidenced by actual trades of these securities occurred at the end of this period. Identical security trading had not been observable prior to this period for these four securities.

The following tables provide a reconciliation of the beginning and ending balances for our Level 3 assets and liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the three and nine months ended September 30, 2010 and 2009:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Available for sale securities				
Beginning balance	$8,910	$19,140	$17,918	$20,082
Purchases, issuances, and settlements	60	(52)	(15,060)	(126)
Transfers out of Level 3	(6,155)	—	(6,155)	—
Total gains (losses) (realized/unrealized):				
Included in other comprehensive income (loss)	(116)	1,628	8,226	1,586
Included in operations	—	(287)	(2,230)	(1,113)
Ending balance	$2,699	$20,429	$2,699	$20,429

The transfers out of Level 3 were corporate debt and equity securities in the home building sector that were issued as a result of a bankruptcy reorganization in late 2009. The operation that has resulted from this emergence from bankruptcy has become a stable business to which a third party broker has applied observable market data such as similar securities and credit spreads in determining fair value of these securities. Realized losses of $2.2 million for nine months ended September 30, 2010 are included in net realized gains on investments in the unaudited consolidated statements of operations compared to $0.3 million and $1.1 million for the three and nine months ended September 30, 2009.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Fixed index annuities - embedded derivatives				
Beginning balance	$1,482,429	$1,050,769	$1,375,866	$998,015
Reinsurance adjustment	—	(14,567)	—	(14,567)
Premiums less benefits	156,984	2,377	571,719	(2,464)
Change in unrealized gains, net	66,849	210,333	(241,323)	267,928
Ending balance	$1,706,262	$1,248,912	$1,706,262	$1,248,912

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

3. Investments

At September 30, 2010 and December 31, 2009, the amortized cost and fair value of fixed maturity securities and equity securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
September 30, 2010				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$3,235	$463	$—	$3,698
United States Government sponsored agencies	4,119,569	32,543	—	4,152,112
United States municipalities, states and territories	1,188,236	73,700	(866)	1,261,070
Corporate securities	5,911,946	617,853	(27,072)	6,502,727
Residential mortgage backed securities	2,795,666	82,133	(148,958)	2,728,841
	$14,018,652	$806,692	$(176,896)	$14,648,448
Held for investment:				
United States Government sponsored agencies	$214,202	$1,108	$—	$215,310
Corporate security	75,751	—	(30,334)	45,417
	$289,953	$1,108	$(30,334)	$260,727
Equity securities, available for sale:				
Finance, insurance, and real estate	$70,793	$12,111	$(732)	$82,172
December 31, 2009				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$3,101	$215	$(6)	$3,310
United States Government sponsored agencies	4,113,457	3,468	(118,388)	3,998,537
United States municipalities, states and territories	350,787	7,110	(2,263)	355,634
Corporate securities	3,709,446	233,023	(84,920)	3,857,549
Residential mortgage backed securities	2,735,889	59,584	(306,372)	2,489,101
	$10,912,680	$303,400	$(511,949)	$10,704,131
Held for investment:				
United States Government sponsored agencies	$1,559,434	$1,647	$(5,900)	$1,555,181
Corporate security	75,649	—	(28,966)	46,683
	$1,635,083	$1,647	$(34,866)	$1,601,864
Equity securities, available for sale:				
Finance, insurance, and real estate	$82,930	$13,425	$(3,269)	$93,086

During the nine months ended September 30, 2010 and 2009, we received $4.0 billion and $3.6 billion, respectively, in redemption proceeds primarily related to calls of our callable United States Government sponsored agency securities, of which $1.6 billion and $1.9 billion, respectively, were classified as held for investment. We reinvested the proceeds from these redemptions primarily in United States Government sponsored agencies, corporate securities, and United States municipalities, states, and territories classified as available for sale. In addition, we held approximately $600 million in short-term investments at September 30, 2010. At September 30, 2010, 40% of our

fixed income securities have call features and 14% ($2.0 billion) are subject to call redemption during the fourth quarter of 2010. Another 18% ($2.5 billion) will become subject to call redemption during the first three quarters of 2011.

13

The amortized cost and fair value of fixed maturity securities at September 30, 2010, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our residential mortgage backed securities provide for periodic payments throughout their lives and are shown below as a separate line.

	Available-for-sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$30,372	$30,721	$—	$—
Due after one year through five years	406,359	451,668	—	—
Due after five years through ten years	1,608,610	1,851,088	—	—
Due after ten years through twenty years	1,852,257	1,965,964	—	—
Due after twenty years	7,325,388	7,620,166	289,953	260,727
	11,222,986	11,919,607	289,953	260,727
Residential mortgage backed securities	2,795,666	2,728,841	—	—
	$14,018,652	$14,648,448	$289,953	$260,727

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

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Net unrealized gains (losses) on available for sale fixed maturity securities and equity securities	$641,185	$(198,393)
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(365,436)	116,870
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax (expense) benefit	(96,512)	28,533
Net unrealized gains (losses) reported as accumulated other comprehensive income (loss)	$201,771	$(30,456)

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade.” Based on the NAIC designations and fair values, 98% and 97% of our fixed maturity portfolio was rated investment grade at September 30, 2010 and December 31, 2009, respectively.

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

	September 30, 2010		December 31, 2009	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$10,482,067	$10,863,122	$9,495,015	$9,370,647
2	3,434,818	3,703,832	2,571,815	2,555,826
3	349,422	298,439	409,860	315,948

4	32,259	32,079	24,375	20,799
5	2,943	4,200	21,013	20,749
6	7,096	7,503	25,685	22,026
	$14,308,605	$14,909,175	$12,547,763	$12,305,995

14

A summary of our RMBS by collateral type and split by NAIC designation, as well as a separate summary of securities for which we have recognized OTTI and those which we have not yet recognized any OTTI is as follows:

Collateral Type	NAIC Designation	September 30, 2010 Principal Amount	Amortized Cost	Fair Value	December 31, 2009 Principal Amount	Amortized Cost	Fair Value
		(Dollars in thousands)					
OTTI has not been recognized							
Government agency	1	$67,103	$66,390	$73,631	$69,496	$68,715	$72,306
Prime	1	1,818,274	1,722,604	1,761,936	1,713,391	1,595,502	1,585,337
	2	26,291	24,730	24,499	127,951	127,210	106,395
	3	21,474	21,145	18,795	1,474	1,471	977
	4	10,627	10,195	10,347	—	—	—
Alt-A	1	55,282	54,732	52,375	93,963	87,071	70,749
	2	5,123	5,219	4,304	46,456	47,301	38,030
		$2,004,174	$1,905,015	$1,945,887	$2,052,731	$1,927,270	$1,873,794
OTTI has been recognized							
Prime	1	$226,865	$205,822	$180,883	$173,149	$156,108	$126,301
	2	195,252	185,801	159,643	223,473	212,221	156,522
	3	69,651	65,530	61,645	60,965	58,965	44,853
Alt-A	1	269,492	232,093	213,585	194,682	164,402	127,341
	2	160,021	137,310	117,387	111,673	96,700	75,557
	3	71,622	59,857	47,112	134,085	115,522	81,922
	6	4,899	4,238	2,699	5,394	4,701	2,811
		$997,802	$890,651	$782,954	$903,421	$808,619	$615,307
Total by collateral type							
Government agency		$67,103	$66,390	$73,631	$69,496	$68,715	$72,306
Prime		2,368,434	2,235,827	2,217,748	2,300,403	2,151,477	2,020,385
Alt-A		566,439	493,449	437,462	586,253	515,697	396,410
		$3,001,976	$2,795,666	$2,728,841	$2,956,152	$2,735,889	$2,489,101
Total by NAIC designation							
	1	$2,437,016	$2,281,641	$2,282,410	$2,244,681	$2,071,798	$1,982,034
	2	386,687	353,060	305,833	509,553	483,432	376,504
	3	162,747	146,532	127,552	196,524	175,958	127,752
	4	10,627	10,195	10,347	—	—	—
	6	4,899	4,238	2,699	5,394	4,701	2,811
		$3,001,976	$2,795,666	$2,728,841	$2,956,152	$2,735,889	$2,489,101

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 196 and 355 securities, respectively) have been in a continuous unrealized loss position, at September 30, 2010 and December 31, 2009:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
September 30, 2010						
Fixed maturity securities:						
Available for sale:						
United States municipalities, states and territories	$62,618	$(866)	$—	$—	$62,618	$(866)
Corporate securities:						
Finance, insurance and real estate	107,957	(2,927)	123,658	(12,480)	231,615	(15,407)
Manufacturing, construction and mining	70,801	(1,418)	44,229	(2,289)	115,030	(3,707)
Utilities and related sectors	119,726	(1,577)	14,395	(4,325)	134,121	(5,902)
Wholesale/retail trade	20,856	(134)	9,150	(1,331)	30,006	(1,465)
Services, media and other	71,324	(591)	—	—	71,324	(591)
Residential mortgage backed securities	166,817	(8,688)	1,141,297	(140,270)	1,308,114	(148,958)
	$620,099	$(16,201)	$1,332,729	$(160,695)	$1,952,828	$(176,896)
Held for investment:						
Corporate security:						
Finance, insurance and real estate	—	—	45,417	(30,334)	45,417	(30,334)
Equity securities, available for sale:						
Finance, insurance and real estate	$12,192	$(590)	$16,858	$(142)	$29,050	$(732)
December 31, 2009						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$332	$(6)	$—	$—	$332	$(6)
United States Government sponsored agencies	2,908,205	(118,388)	—	—	2,908,205	(118,388)
United States municipalities, states and territories	111,969	(2,263)	—	—	111,969	(2,263)
Corporate securities:						
Finance, insurance and real estate	154,093	(10,560)	239,211	(39,995)	393,304	(50,555)
Manufacturing, construction and mining	93,922	(2,032)	74,258	(8,430)	168,180	(10,462)
Utilities and related sectors	149,515	(5,046)	63,933	(8,110)	213,448	(13,156)
Wholesale/retail trade	35,629	(623)	39,547	(4,800)	75,176	(5,423)
Services, media and other	46,625	(512)	61,359	(4,812)	107,984	(5,324)
Residential mortgage backed securities	226,567	(22,781)	1,186,542	(283,591)	1,413,109	(306,372)
	$3,726,857	$(162,211)	$1,664,850	$(349,738)	$5,391,707	$(511,949)

Held for investment:						
United States Government sponsored agencies	$359,100	$(5,900)	$—	$—	$359,100	$(5,900)
Corporate security:						
Finance, insurance and real estate	—	—	46,683	(28,966)	46,683	(28,966)
	$359,100	$(5,900)	$46,683	$(28,966)	$405,783	$(34,866)
Equity securities, available for sale:						
Finance, insurance and real estate	$9,802	$(147)	$28,877	$(3,122)	$38,679	$(3,269)

The following is a description of the factors causing the temporary unrealized losses by investment category as of September 30, 2010:

United States municipalities, states and territories: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. These securities carry yields less than those available at September 30, 2010.

Corporate securities: The unrealized losses in these securities are due partially to the continuation of wider than historic credit spreads in certain sectors of the corporate bond market. While credit spreads narrowed, several sectors remain at spreads wider than pre-crisis levels, such as financial and select economic sensitive issuers. As the result of wider spreads, these issues carry yields less than those available in the market as of September 30, 2010.

Residential mortgage backed securities: At September 30, 2010, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $493.4 million and a fair value of $437.5 million. Despite recent improvements in the capital markets, the fair values of RMBS continue at prices below amortized cost. RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.

Equity securities: The unrealized loss on equity securities, which are primarily investment grade perpetual preferred stocks with exposure to REITS, investment banks and finance companies, are due to the ongoing concerns relating to capital, asset quality and earnings stability due to the financial crisis. All of the equity securities in an unrealized loss position for 12 months or more are investment grade perpetual preferred stocks that are absent credit deterioration. A continued difficult housing market has raised concerns in regard to earnings and dividend stability in many companies which directly affect the values of these securities.

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

Approximately 72% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2010 are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized gains (losses) on investments for the nine months ended September 30, 2010 and 2009 are as follows:

	Nine Months Ended September 30,	
	2010	2009
	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$3,993	$3,321
Investments carried at fair value:		
Fixed maturity securities, available for sale	$838,344	$465,818
Short-term investments	11	—
Equity securities, available for sale	1,223	35,169
	839,578	500,987
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	(482,306)	(300,148)
Deferred income tax valuation allowance	—	30,842
Deferred income tax asset	(125,045)	(70,294)
	(607,351)	(339,600)
Increase/decrease in net unrealized gains/losses on investments carried at fair value	$232,227	$161,387

Proceeds from sales of available for sale securities for the nine months ended September 30, 2010 and 2009 were $271.5 million and $290.2 million, respectively. Scheduled principal repayments, calls and tenders for available for sale securities for the nine months ended September 30, 2010 and 2009 were $2.7 billion and $1.9 billion, respectively. Calls of held for investment fixed maturity securities for the nine months ended September 30, 2010 and 2009 were $1.6 billion and $1.9 billion, respectively.

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Realized gains (losses) on investments, excluding net OTTI losses for the three and nine months ended September 30, 2010 and 2009 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$9,732	$10,334	$22,019	$16,461
Gross realized losses	—	(2,619)	(2,359)	(2,672)
	9,732	7,715	19,660	13,789
Equity securities:				
Gross realized gains	3,264	3,279	9,471	3,282
Gross realized losses	(71)	—	(71)	—
	3,193	3,279	9,400	3,282
Mortgage loans on real estate:				
Increase in allowance for credit losses	(1,043)	(5,484)	(6,212)	(6,484)
Other investments:				
Impairment losses	(584)	—	(584)	—
	$11,298	$5,510	$22,264	$10,587

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

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

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

We determine whether other than temporary impairment losses should be recognized for debt and equity securities by assessing all facts and circumstances surrounding the security. If our assessment of an equity security has resulted in a determination that its price will not recover to cost in a reasonable period of time or we intend to sell the security

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

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

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

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

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

The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the nine months ended September 30, 2010 and 2009 which are all senior level tranches within the structure of the securities:

		Discount Rate		Default Rate		Loss Severity	
Sector	Vintage	Min	Max	Min	Max	Min	Max
September 30, 2010							
Prime	2005	7.5 %	7.5 %	11 %	11 %	45 %	45 %
	2006	7.3 %	7.3 %	7 %	11 %	45 %	55 %
	2007	5.8 %	6.6 %	11 %	19 %	45 %	60 %
Alt-A	2005	6.2 %	7.4 %	12 %	27 %	45 %	50 %
	2007	7.0 %	7.0 %	44 %	45 %	57 %	60 %
September 30, 2009							
Prime	2005	7.7 %	7.7 %	7 %	7 %	50 %	50 %
	2006	6.5 %	9.2 %	8 %	14 %	35 %	55 %
	2007	5.8 %	7.9 %	8 %	31 %	35 %	50 %
Alt-A	2005	5.6 %	8.7 %	10 %	16 %	10 %	50 %
	2006	6.0 %	7.3 %	16 %	27 %	40 %	60 %
	2007	6.2 %	7.5 %	15 %	52 %	45 %	70 %

The determination of the credit loss component of a corporate bond (including redeemable preferred stocks) is based on the underlying financial performance of the issuer and their ability to meet their contractual obligations. Considerations in our evaluation include, but are not limited to, credit rating changes, financial statement and ratio analysis, changes in management, 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.

19

The following table summarizes other than temporary impairments for the three months and nine months ended September 30, 2010 and 2009, by asset type:

General Description	Number of Securities	Total OTTI Losses	Portion of OTTI Losses in Other Comprehensive Income	Net OTTI Losses in Operations
		(Dollars in thousands)		
Three months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	7	—	(1,830)	(1,830)
	9	(2,160)	(1,830)	(3,990)
Three months ended September 30, 2009				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(3,619)	$(2,257)	$(5,876)
Insurance	1	(211)	(696)	(907)
Residential mortgage backed securities	47	(78,712)	52,594	(26,118)
Equity securities, available for sale:				
Finance	1	(10,182)	—	(10,182)
Insurance	2	(1,492)	—	(1,492)
	52	$(94,216)	$49,641	$(44,575)
Nine months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	10	(14,187)	8,316	(5,871)
	12	$(16,347)	$8,316	$(8,031)
Nine months ended September 30, 2009				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	1	$(245)	$—	$(245)
Corporate securities:				
Finance	3	(8,388)	(1,521)	(9,909)
Insurance	2	(641)	(1,165)	(1,806)
Home building	3	(756)	(70)	(826)
Residential mortgage backed securities	49	(140,454)	110,768	(29,686)
Equity securities, available for sale:				
Finance	7	(18,292)	—	(18,292)
Insurance	2	(1,492)	—	(1,492)
Real estate	2	(1,400)	—	(1,400)
	69	$(171,668)	$108,012	$(63,656)

We recognized OTTI of $2.2 million on two corporate fixed maturity securities during the three and nine months ended September 30, 2010, because we changed from a position of holding these securities until price recovery to intending to sell them prior to price recovery.

20

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Cumulative credit loss at beginning of period	$(81,962)	$(43,554)	$(82,930)	$(34,229)
Credit losses on securities for which OTTI has not previously been recognized	(2,160)	(6,015)	(4,847)	(13,083)
Additional credit losses on securities for which OTTI has previously been recognized	(1,830)	(26,887)	(3,184)	(29,389)
Accumulated losses on securities that were disposed of during the period	1,855	5,210	6,864	5,455
Cumulative credit loss at end of period	$(84,097)	$(71,246)	$(84,097)	$(71,246)

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security for securities that are part of our investment portfolio at September 30, 2010 and December 31, 2009:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
September 30, 2010				
Corporate fixed maturity securities	$14,479	$(2,701)	$7,503	$19,281
Residential mortgage backed securities	890,651	(213,561)	105,865	782,955
Equity securities:				
Finance, insurance and real estate	24,380	—	9,289	33,669
	$929,510	$(216,262)	$122,657	$835,905
December 31, 2009				
Corporate fixed maturity securities	$25,603	$(9,488)	$7,763	$23,878
Residential mortgage backed securities	809,632	(205,245)	11,809	616,196
Equity securities:				
Finance, insurance and real estate	34,645	—	13,045	47,690
	$869,880	$(214,733)	$32,617	$687,764

4. Mortgage Loans on Real Estate

Our mortgage loan portfolio totaled $2.5 billion at September 30, 2010 and December 31, 2009, with commitments outstanding of $23.4 million at September 30, 2010. The portfolio consists of commercial mortgage loans collateralized by the related properties and diversified as to property type, location and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. The mortgage loan portfolio is summarized by geographic region and property type as follows:

	September 30, 2010			December 31, 2009		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Geographic distribution						
East	$580,822	22.9	%	$560,256	22.8	%
Middle Atlantic	164,084	6.5	%	168,246	6.9	%
Mountain	399,951	15.8	%	388,940	15.9	%
New England	43,165	1.7	%	44,541	1.8	%
Pacific	238,125	9.4	%	216,382	8.8	%
South Atlantic	498,266	19.6	%	464,077	18.9	%
West North Central	398,664	15.7	%	410,883	16.7	%
West South Central	212,594	8.4	%	201,719	8.2	%
	$2,535,671	100.0	%	$2,455,044	100.0	%
Loan loss allowance	(7,212	)		(5,266	)	
	2,528,459			2,449,778		
Property type distribution						
Office	$672,909	26.6	%	$664,701	27.1	%
Medical Office	157,852	6.2	%	145,390	5.9	%
Retail	563,801	22.2	%	564,023	23.0	%
Industrial/Warehouse	626,743	24.7	%	610,279	24.8	%
Hotel	151,834	6.0	%	155,594	6.4	%
Apartment	136,764	5.4	%	122,854	5.0	%
Mixed use/other	225,768	8.9	%	192,203	7.8	%
	$2,535,671	100.0	%	$2,455,044	100.0	%
Loan loss allowance	(7,212	)		(5,266	)	
	2,528,459			2,449,778		

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified. A mortgage loan is impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. In addition, we analyze the mortgage loan portfolio for the need of a general loan allowance for probable losses on all other loans. 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. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions. Based upon this process and analysis, we increased our general loan loss allowance by $0.6 million to $1.7 million during the third quarter of 2010. The $1.7 million general loan loss

allowance was recorded during the nine months ended September 30, 2010.

We increased the allowance for credit losses on mortgage loans by $1.0 million and $6.2 million during the three and nine months ended September 30, 2010, respectively, and $5.5 million and $6.5 million during the three and nine months ended September 30, 2009, respectively. During three months ended September 30, 2010, three mortgage loans were satisfied by taking ownership of the real estate serving as collateral on the loans. These loans had a total principal amount outstanding of $6.9 million, for which a specific loan loss allowance of $3.8 million was established and recognized during 2009. During the nine months ended September 30, 2010, five mortgage loans were satisfied by taking ownership of the real estate serving as collateral on the loans, which had a total principal amount outstanding of $11.7 million, for which specific loan loss allowances totaling $4.3 million were established and recognized during the nine months ended September 30, 2010.

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 and loans delinquent for more than 60 days at the reporting date).

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans with allowances	$22,206	$15,869
Mortgage loans with no allowance for losses	75,150	70,214
Allowance for probable loan losses	(7,212)	(5,266)
Net carrying value	$90,144	$80,817

5. Derivative Instruments

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

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

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Assets		
Derivative instruments		
Call options	$283,920	$479,272
Other assets		
2015 notes hedges	38,483	—
	$322,403	$479,272
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$1,706,262	$1,375,866
Other liabilities		
2015 notes embedded conversion derivatives	38,483	—
Interest rate swaps	2,531	1,891
	$1,747,276	$1,377,757

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Revenues				
Change in fair value of derivatives:				
Call options	$93,109	$123,121	$(31,720)	$110,019

2015 notes hedges (see note 7)	1,483	—	1,483	—
Interest rate swaps	(612)	(1,614)	(2,505)	(1,841)
	$93,980	$121,507	$(32,742)	$108,178
Benefits and expenses				
Change in fair value of embedded derivatives:				
2015 notes embedded conversion derivatives (see note 7)	$1,483	$—	$1,483	$—
Fixed index annuities	113,340	259,737	(12,996)	414,636
	114,823	259,737	(11,513)	414,636

23

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

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

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

		September 30, 2010		December 31, 2009	
Counterparty	Credit Rating	Notional Amount	Fair Value	Notional Amount	Fair Value
		(Dollars in thousands)			
Bank of America	A+	$168,425	$5,679	$796	$—
BNP Paribas	AA	1,003,936	35,416	1,647,627	101,888
Lehman	NR	—	—	1,437	—
Bank of New York	AA-	68,804	434	112,193	6,153
Credit Suisse	A+	1,974,164	41,346	2,711,027	163,321
Barclays	AA-	1,509,386	39,848	258,853	10,082
SunTrust	BBB+	123,722	3,888	427,572	27,735
Wells Fargo	AA	1,792,700	51,941	1,189,234	70,746
J.P. Morgan	AA-	2,918,631	87,563	1,648,394	99,347
UBS	A+	722,114	17,805	—	—
		$10,281,882	$283,920	$7,997,133	$479,272

As of September 30, 2010 and December 31, 2009, we held $188.7 million and $346.1 million, respectively, of cash and cash equivalents received from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $102.2 million and $149.5 million at September 30, 2010 and December 31, 2009, respectively.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. All options purchased from affiliates of Lehman had expired as of September 30, 2010. The amount of option proceeds due on expired options which had been purchased from Lehman that we did not receive payment on was $2.6 million for the third quarter 2009 and $12.0 million for the nine months ended September 30, 2009. No amount has been recognized for any recovery of these amounts that may result from our claim in Lehman's bankruptcy proceedings.

We have entered into interest rate swaps to manage interest rate risk associated with the floating rate component on certain of our subordinated debentures and amounts outstanding under our revolving line of credit. See notes 9 and 10 in our Annual Report on Form 10-K for the year ended December 31, 2009 for more information on our revolving line of credit and subordinated debentures. The terms of the interest rate swaps provide that we pay a fixed rate of interest and receive a floating rate of interest. We record the interest rate swaps at fair value and any net cash payments received or paid are included in the change in fair value of derivatives in the unaudited consolidated statements of operations.

Details regarding the interest rate swaps are as follows:

Maturity Date	Notional Amount	Receive Rate	Pay Rate	Counterparty	September 30, 2010 Fair Value	December 31, 2009 Fair Value
					(Dollars in thousands)	
September 15, 2010	—	*LIBOR (a)	5.19	Bank of America	—	(142)
April 7, 2011	20,000	*LIBOR (a)	5.23	Bank of America	(149)	(290)
October 15, 2011	15,000	**LIBOR	1.54	SunTrust	(462)	(144)
October 31, 2011	30,000	**LIBOR	1.51	SunTrust	(240)	(241)
October 31, 2011	30,000	**LIBOR	1.61	SunTrust	(500)	(301)
October 31, 2011	75,000	**LIBOR	1.77	SunTrust	(1,180)	(773)
	$170,000				$(2,531)	$(1,891)

* - three month London Interbank Offered Rate
** - one month London Interbank Offered Rate
(a) - subject to a floor of 4.25%

6. Income Taxes

In 2008, we recorded a valuation allowance of $34.5 million on deferred income tax assets related to capital loss carryforwards and other than temporary impairments on investment securities, as utilization of the income tax benefits from a portion of these items was not more likely than not due to the fact that we had insufficient future taxable income from capital gain sources. The valuation allowance decreased by $3.6 million in the nine months ended September 30, 2009 to $30.9 million as of September 30, 2009 primarily due to an increase in anticipated future taxable income from capital gain sources, offset in part by a smaller increase in the amount of other than temporary impairments that give rise to the deferred income tax asset for which a valuation allowance is necessary.

7. Notes Payable

In September 2010, we issued $200.0 million principal amount of 3.5% Convertible Senior Notes Due 2015 (the "2015 notes"). The 2015 notes have a stated interest rate of 3.5%, mature on September 15, 2015, and are intended to be settled in cash; however, we have the discretion to settle in shares of our common stock or a combination of cash and shares of our common stock. The indenture for the 2015 notes does not contain any financial covenants. Contractual interest payable on the 2015 notes began accruing in September 2010 and is payable semi-annually in arrears each March 15th and September 15th. The initial purchaser's transaction fees and expenses totaling $6.7 million were capitalized as deferred financing costs and will be amortized over the term of the 2015 notes using the effective interest method.

Upon occurrence of any of the conditions described below, holders may convert their 2015 notes at the applicable conversion rate at any time prior to June 15, 2015. On or after June 15, 2015 through the maturity date of September 15, 2015, holders may convert each of their 2015 notes at the applicable conversion rate regardless of the following conditions:

- during the 5 business day period after any 10 consecutive trading day period (the “measurement period”) in which the trading price per $1,000 principal amount of notes was less than 98% of the product of the last reported sale price of our common stock and the applicable conversion rate on such trading day;
- during any calendar quarter commencing after December 31, 2010, the Notes may be converted if the last reported price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30

consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the applicable conversion price on each applicable trading day. The "last reported sale price" means the closing sale price per share (or if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices) on that date as reported in composite transactions for the New York Stock Exchange; or

- upon the occurrence of specified corporate transactions.

The initial conversion rate for the 2015 notes is 80 shares of our common stock per $1,000 principal amount of 2015 notes, equivalent to a conversion price of approximately $12.50 per share of our common stock, with the amount due on conversion. Upon conversion, a holder will receive the sum of the daily settlement amounts, calculated on a proportionate basis for each day, during a specified observation period following the conversion date.

If a fundamental change occurs prior to maturity and our stock price is at least $10.00 per share at that time, the conversion rate will increase by an additional amount of up to 20 shares of our common stock per $1,000 principal amount of 2015 notes, which amount would be paid to each holder that elects to convert its 2015 notes at that time. A fundamental change is:

- Any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in which more than 50% of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration;

- Our stockholders approve any plan or proposal for liquidation or dissolution of us; or
- Our common stock (or other common stock underlying the notes) ceases to be listed or quoted on any of The New York Stock Exchange, The NASDAQ Global Select Market or The NASDAQ Global Market.

No fundamental change will have occurred if at least 90% of the consideration received or to be received by common stockholders, excluding cash payments for fractional shares and cash payments made pursuant to dissenters' appraisal rights in connection with such transaction(s), consists of shares of common stock or other certificates representing common equity interests that are listed or quoted on any of the The New York Stock Exchange, The NASDAQ Global Select Market or The NASDAQ Global Market (or any of their respective successors) or will be so listed or quoted when issued or exchanged in connection with such transaction(s), and as a result of this transaction(s) the notes become convertible into such consideration, excluding cash payments for fractional shares and cash payments made pursuant to dissenters' appraisal rights.

The conversion option of the 2015 notes (the "2015 notes embedded conversion derivative") is an embedded derivative that requires bifurcation from the 2015 notes and accounted for as a derivative liability, which is included in Other liabilities in our Consolidated Balance Sheets. The fair value of the 2015 notes embedded conversion derivative at the time of issuance of the 2015 notes was $37.0 million, and was recorded as the original debt discount for purposes of accounting for the debt component of the 2015 notes. This discount will be recognized as interest expense using the effective interest method over the term of the 2015 notes. The estimated fair value of the 2015 notes embedded conversion derivative was $38.5 million as of September 30, 2010.

Concurrently with the issuance of the 2015 notes, we entered into hedge transactions (the "2015 notes hedges") with various parties whereby we have the option to receive the cash equivalent of approximately 16.0 million shares of our common stock based upon a strike price of $12.50 per share, subject to certain conversion rate adjustments in the 2015 notes. These options expire on September 15, 2015 and must be settled in cash. The aggregate cost of the 2015 notes hedges was $37.0 million. The 2015 notes hedges are accounted for as derivative assets, and are included in Other assets in our Consolidated Balance Sheets. The estimated fair value of the 2015 notes hedges was $38.5 million as of September 30, 2010.

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

In separate transactions, we also sold warrants (the "2015 warrants") to two counterparties for the purchase of up to approximately 16.0 million shares of our common stock at a price of $16.00 per share. The warrants expire on various dates from December 2015 through March 2016 and are intended to be settled in net shares. The total number of shares of common stock deliverable under the 2015 warrants is, however, currently limited to 11.6 million shares. We received $15.6 million in cash proceeds from the sale of the 2015 warrants, which has been recorded as an increase in Stockholders' equity. Changes in the fair value of these warrants will not be recognized in our Consolidated Financial Statements as long as the instruments remain classified as equity. The warrants are included in diluted earnings per share to the extent the impact is dilutive.

In December 2004, we issued $260.0 million of contingent convertible senior notes due December 15, 2024 (the "2024 notes"), of which $22.9 million was assigned to the equity component (net of income tax of $16.1 million). In December 2009, we issued $115.8 million of contingent convertible senior notes due December 15, 2029 (the "2029 notes"), of which $15.6 million was assigned to the equity component (net of income tax of $11.0 million). $52.2 million of the December 2029 notes were issued for cash, and $63.6 million were issued in exchange of $63.6 million of the 2024 notes.

The liability and equity components of our convertible senior 2024 notes and 2029 notes included in notes payable are accounted for separately as a liability component and an equity component in the consolidated balance sheets. The liability component of our 2015 notes and the liability and equity components of our 2024 notes and 2029 notes are as follows:

	September 30, 2010			December 31, 2009	
	September 2015 Notes	December 2029 Notes	December 2024 Notes	December 2029 Notes	December 2024 Notes
	(Dollars in thousands)				
Notes payable:					
Principal amount of liability component	$200,000	$115,839	$74,494	$115,839	$81,152
Unamortized discount	(36,864)	(23,410)	(2,319)	(26,542)	(3,982)
Net carrying amount of liability component	$163,136	$92,429	$72,175	$89,297	$77,170
Additional paid-in capital:					
Carrying amount of equity component	N/A	$15,586	$22,637	$15,586	$22,637

The discount is being amortized over the expected life of the notes, which is December 6, 2011 for the 2024 notes, December 6, 2014 for the 2029 notes, and September 15, 2015 for the 2015 notes. The expected life of the 2024 notes and the 2029 notes are based on the dates at which we may redeem the notes or the holders may require us to repurchase the notes. The effective interest rates are 8.7%, 8.5% and 11.8% on the 2015 notes, 2024 notes and the 2029 notes, respectively. The interest cost recognized in operations for the 2024 notes, inclusive of the 5.25% coupon and amortization of the discount and debt issue costs, was $1.8 million and $4.7 million for the three and nine months ended September 30,

2010, respectively, and $2.9 million and $9.7 million for the same periods in 2009. The interest cost recognized in operations for the 2029 notes was $3.1 million and $8.0 million for the three and nine months ended September 30, 2010, respectively. The interest cost recognized in operations for the 2015 notes, inclusive of the 3.50% coupon and amortization of the discount and debt issue costs, was $0.3 million for the three and nine months ended September 30, 2010.

We are required to include the dilutive effect of the 2024 and 2029 notes in our diluted earnings per share calculation. Because these notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the fair value of our common stock at the end of the reporting period exceeds the conversion price per share of $14.24 for the 2024 notes and $9.69 for the 2029 notes. At September 30, 2010, the conversion premium of the 2029 notes was dilutive and the effect has been included in diluted earnings per share for the three and nine months ended September 30, 2010. The 2015 notes and related purchased options are also excluded from the dilutive effect in our diluted earnings per share calculation as they are currently to be settled only in cash. The 2015 warrants could have a dilutive effect on our earning per share to the extent that the price of our common stock exceeds the strike price of the 2015 warrants during the measurement period at their maturity.

In May 2010, we extinguished $6.7 million principal amount of the outstanding 2024 notes for $6.6 million in cash. The extinguished notes carried unamortized debt issue costs and unamortized debt discounts totaling $0.3 million. No value was assigned to reacquire of the equity component of the debt. A $0.3 million loss on extinguishment of debt was recorded for the amount that the cash payment exceeded the carrying of value the notes extinguished. In May 2009, we exchanged five million shares of our common stock for $37.2 million principal amount of the 2024 notes which resulted in a gain on extinguishment of debt of $3.1 million. The fair value of our common stock issued was $31.3 million and the 2024 notes extinguished in the common stock for debt exchange carried unamortized debt discount and debt issue costs totaling $2.8 million.

In 2006, we entered into a five year $150 million revolving line of credit agreement with eight banks. The applicable interest rate on this credit facility is LIBOR plus 0.80% or the greater of prime rate or federal funds rate plus 0.50%, as elected by us. As of December 31, 2009, we had fully drawn the $150 million from this revolving line of credit. In September 2010, we repaid $150 million of the outstanding amount with a portion of the net proceeds from the 2015 notes issued in September 2010.

8. Contingencies

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

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in two purported class action lawsuits alleging improper sales practices and similar claims as described below. It is often not possible to determine the ultimate outcome of pending legal proceedings or to provide reasonable ranges of potential losses with any degree of certainty. One of the lawsuits referred to below is in the initial trial stage while the other is in the pre-litigation and discovery stages and we do not have sufficient information to make an assessment of the plaintiffs' claims for liability or damages. The plaintiffs are seeking undefined amounts of damages or other relief, including punitive damages, which are difficult to quantify and cannot be estimated based on the information currently available. We do not believe that these lawsuits, including those discussed below, will have a material adverse effect

on our financial position, results of operations or cash flows. However, there can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

We are a defendant in two cases, including (i) Stephens v. American Equity Investment Life Insurance Company, et. al., in the San Luis Obispo Superior Court, San Francisco, California (complaint filed November 29, 2004) (the "SLO Case") and (ii) McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation, in the United States District Court for the Central District of California, Western Division (complaint filed September 7, 2005) (the "Los Angeles Case").

The plaintiffs in the SLO Case represent a class of individuals who are California residents and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. The named plaintiffs in this case are: Chalys M. Stephens and John P. Stephens. Plaintiffs seek injunctive relief and restitution on behalf of all class members under California Business & Professions Code section 17200 et seq.; compensatory damages for breach of contract and breach of fiduciary duty; other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq.; and punitive damages under common law causes of action for fraud and breach of the covenant of good faith and fair dealing. We are vigorously defending the underlying allegations and may seek to decertify the entire class after further discovery into the merits of the case and during the initial trial phase. Trial in this matter began November 1, 2010.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by

27

and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek recessionary and injunctive relief including restitution and disgorgement of profits on behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. We are vigorously defending against both class action status as well as the underlying claims.

9. Sale of Our Common Stock

On August 20, 2009, we entered into distribution agreements with Fox-Pitt Kelton Cochran Caronia Waller (USA) LLC (“FPK”) and Sandler O’Neill & Partners, L.P. ("Sandler O'Neill"). On December 3, 2009, Macquarie Capital (USA) Inc. ("Macquarie Capital") assumed all of FPK's rights and obligations under our distribution agreement with FPK. Under the distribution agreements, we can offer and sell shares of our common stock up to an aggregate offering price of $50 million. On August 4, 2010, we provided notice to Macquarie Capital and Sandler O'Neill that we were terminating the distribution agreements. From October 1, 2009 through August 4, 2010, we did not sell any shares of our common stock pursuant to these distribution agreements. From August 20, 2009 through September 30, 2009, we sold 132,300 shares of our common stock, resulting in gross proceeds to us of $1.1 million.

10. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands, except per share data)			
Numerator:				
Net income (loss) - numerator for earnings per common share	$20,514	$(2,978)	$33,895	$32,509
Interest on convertible subordinated debentures (net of income tax benefit)	258	259	776	777
Numerator for earnings (loss) per common share - assuming dilution	$20,772	$(2,719)	$34,671	$33,286
Denominator:				
Weighted average common shares outstanding (1)	58,563,757	58,029,697	58,422,324	55,462,097
Effect of dilutive securities:				
Convertible subordinated debentures	2,727,121	2,734,528	2,730,323	2,734,528
Convertible senior notes	729,783	—	729,783	—
Stock options and deferred compensation agreements	477,393	68,410	363,656	34,501
Denominator for earnings per common share - assuming dilution	$62,498,054	$60,832,635	$62,246,086	$58,231,126
Earnings (loss) per common share	$0.35	$(0.05)	$0.58	$0.59
Earnings (loss) per common share - assuming dilution	$0.33	$(0.05)	$0.56	$0.57

(1)

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

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

Period	Number of Shares	Range of Exercise Prices
Three months ended September 30, 2010	943,000	$10.65 - $14.34
Nine months ended September 30, 2010	2,222,929	$8.75 - $14.34
Three months ended September 30, 2009	1,769,489	$8.67 - $14.34
Nine months ended September 30, 2009	2,389,289	$6.96 - $14.34

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

Management's discussion and analysis reviews our unaudited consolidated financial position at September 30, 2010, and the unaudited consolidated results of operations for the three and nine month periods ended September 30, 2010 and 2009, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with our unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

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

For a detailed discussion of these and other factors that might affect our performance, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009, and Exhibit 99.2 of our Form 8-K filed on September 20, 2010.

Overview

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a lesser extent, we also sell life insurance policies. Under U.S. generally accepted accounting principles ("GAAP"), premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liabilities for policyholder account balances and not as expenses. Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender and other charges deducted from policyholder account balances, net realized gains on investments, excluding other than temporary impairment losses, and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are interest sensitive and index product benefits (primarily interest credited to account balances), changes in fair value of embedded derivatives, amortization of deferred policy acquisition costs and deferred sales inducements, other operating costs and expenses and income taxes.

Annuity deposits by product type collected during the three and nine months ended September 30, 2010 and 2009, were as follows:

Product Type	Three Months Ended September 30, 2010	2009	Nine Months Ended September 30, 2010	2009
	(Dollars in thousands)			
Fixed index annuities:				
Index strategies	$581,907	$434,233	$1,530,269	$1,163,375
Fixed strategy	387,066	482,034	1,091,296	1,462,926
	968,973	916,267	2,621,565	2,626,301
Fixed rate annuities:				
Single-year rate guaranteed	81,979	37,462	197,144	76,878
Multi-year rate guaranteed	169,641	26,255	295,526	74,436
	251,620	63,717	492,670	151,314
Total before coinsurance ceded	1,220,593	979,984	3,114,235	2,777,615
Coinsurance ceded	143,225	203,796	402,297	514,620
Net after coinsurance ceded	$1,077,368	$776,188	$2,711,938	$2,262,995

Annuity deposits before coinsurance ceded increased 25% during the third quarter of 2010 and 12% for the nine months ended September 30, 2010 compared to the same periods in 2009. We attribute these increases to several factors, including the highly competitive rates of our products, our continued strong relationships with our national marketing organizations and field force of licensed, independent insurance agents, the continued attractiveness of safe money products in volatile markets, lower interest rates on competing products such as bank certificates of deposit and product enhancements including a new generation of guaranteed income withdrawal benefit riders. In addition, we continue to benefit from the actions of several competitors who have been less aggressive in marketing their products than in prior periods. The extent to which this trend will continue is uncertain.

As reported in our 2009 filings, we undertook several actions in 2009 to manage our statutory capital position to facilitate growth. These actions included a restructuring of commission payments to agents, an amendment to a reinsurance agreement to expand such agreement to cover certain policy forms that were not in existence when the agreement was executed and the entry into two funds withheld coinsurance agreements to reinsure a portion of our 2009 sales. Under the 2009 coinsurance agreements, we ceded to the reinsurer 20% of annuity deposits received in 2009 and the first quarter of 2010 from our two top selling fixed index annuity products and 80% of the annuity deposits received after June 30, 2009 from a multi-year rate guaranteed fixed annuity product. The agreement to cede 80% of the annuity deposits from the multi-year rate guaranteed fixed annuity product is ongoing. Effective April 1, 2010, we are retaining 100% of our fixed index annuity deposits and are no longer ceding any portion of those annuity deposits to the reinsurer. We believe our existing statutory capital and surplus and the statutory surplus we expect to generate internally through statutory earnings will support a higher level of new business growth than in previous years. However, while we have the capital resources to accept more business than was sold in 2009, our capacity is not unlimited and sales growth must be matched with available resources to maintain desired financial strength ratings from credit rating agencies and in particular, A.M. Best Company. Should sales growth accelerate to levels that cannot be supported by internal capital generation, we would intend to obtain capital from external sources to facilitate such growth.

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:

	Nine Months Ended September 30,			
	2010		2009	
Average yield on invested assets	6.08	%	6.32	%
Cost of money:				
Aggregate	2.92	%	3.29	%
Cost of money for fixed index annuities	2.87	%	3.27	%
Average crediting rate for fixed rate annuities:				
Annually adjustable	3.26	%	3.26	%
Multi-year rate guaranteed	3.75	%	3.90	%
Investment spread:				
Aggregate	3.16	%	3.03	%
Fixed index annuities	3.21	%	3.05	%
Fixed rate annuities:				
Annually adjustable	2.82	%	3.06	%
Multi-year rate guaranteed	2.33	%	2.42	%

The cost of money for fixed index annuities and average crediting rates for fixed rate annuities are computed based upon policyholder account balances and do not include the impact of amortization of deferred sales inducements. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009. With respect to our fixed index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate strategy, expenses we incur to fund the annual index credits and where applicable, minimum guaranteed interest credited. Proceeds received upon expiration or early termination of call options purchased to fund annual index credits are recorded as part of the change in fair value of derivatives, and are largely offset by an expense for interest credited to annuity policyholder account balances. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities and Financial Condition - Derivative Instruments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

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

Results of Operations

Three and nine Months Ended September 30, 2010 and 2009

Net income (loss) increased to $20.5 million in the third quarter of 2010 and increased 4% to $33.9 million for the nine months ended September 30, 2010 compared to $(3.0) million and $32.5 million for the same periods in 2009.

Net income (loss) has been positively impacted by the growth in the volume of business in force and the investment spread earned on this business. Average annuity account values outstanding increased 18% in the third quarter of 2010 and 16% for the nine months ended September 30, 2010 compared to 14% and 13% the same periods in 2009. Our investment spread measured in dollars was $125.3 million and $367.9 million for the three and nine months ended September 30, 2010, respectively, compared to $111.9 million and $309.1 million for the same periods in 2009.

Our investment spread measured on a percentage basis was 3.09% in the third quarter of 2010 and 3.16% for the nine months ended September 30, 2010 compared to 3.13% and 3.03% for same periods in 2009. The increase in investment spread the three and nine months ended September 30, 2010 primarily resulted from a lower aggregate cost of money on our fixed index annuities, offset in part, by a smaller decline in the average yield on invested assets. The lower cost of money for fixed index annuities during 2010 was due to lower costs of options purchased to fund the annual index credits on fixed index annuities and lower rates for the fixed rate strategy in fixed index annuities. The decrease in the average yield on invested assets was primarily attributable to a lag in reinvestment of proceeds from bonds called for redemption during the first nine months of 2010 into new assets resulting in high levels of low yielding short-term investments and interest earning cash and cash equivalents. The decrease in the investment spread for the three months ended September 30, 2010 primarily resulted from a larger decrease in the average yield on invested assets compared to the decrease in the aggregate cost of money and was significantly impacted by the foregone investment income resulting from the excess liquidity generated by the significant volume of bonds called for redemption during 2010.

We periodically revise the key assumptions used in the calculation of amortization of deferred policy acquisition costs and deferred sales inducements retrospectively through an unlocking process when estimates of current or future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. The impact of unlocking during the three and nine months ended September 30, 2010 was a $0.3 million increase in the amortization of deferred sales inducements and a $1.4 million increase in amortization of deferred policy acquisition costs and included the impact of account balance true ups as of June 30, 2010 and adjustment to future period assumptions for interest margins, surrenders, lifetime income benefit rider utilization and reinsurance costs. There were no changes in our estimated future gross profits during the three and nine months ended September 30, 2009 that resulted in unlocking adjustments to the deferred policy acquisition costs and deferred sales inducements balances.

Adjusted operating income (a non-GAAP financial measure) decreased 2% to $27.6 million in the third quarter of 2010 and increased 13% to $82.6 million for the nine months ended September 30, 2010 compared to $28.2 million and $73.1 million for the same periods in 2009.

In addition to net income, we have consistently utilized operating income, a non-GAAP financial measure commonly used in the life insurance industry, as an economic measure to evaluate our financial performance. Operating income equals net income adjusted to eliminate the impact of net realized gains on investments, including net other than temporary impairment ("OTTI") losses recognized in operations and related deferred tax asset valuation allowance, (gain) loss on retirement of debt, fair value changes in derivatives and embedded derivatives, and the Lehman counterparty default on expired call options. Because these items fluctuate from year to year in a manner unrelated to core operations, we believe measures excluding their impact are useful in analyzing operating trends. We believe the combined presentation and evaluation of operating income together with net income, provides information that may enhance an investor's understanding of our underlying results and profitability.

Adjusted operating income is not a substitute for net income determined in accordance with GAAP. The adjustments made to derive adjusted operating income are important to understanding our overall results from operations and, if evaluated without proper context, adjusted 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 generate 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 adjusted operating income, it does not include the decrease in cash flows expected to be collected as a result of credit loss OTTI. Further, net income includes changes to net investment income as a result of OTTI, which are not directly related to our insurance operations, and does not adjust for any negative impact to cash flows that we may experience in future periods as a result of such changes in net investment income. Therefore, our management and board of directors also separately review net realized investment gains (losses) and analyses of our net investment income, including impacts related to OTTI write-downs, in connection with their review of our investment portfolio. In addition, our management and board of directors examine net income as part of their review of our overall financial results. The adjustments made to net income to arrive at operating income for the three months and nine months ended September 30, 2010 and 2009 are set forth in the table that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Operating Income	$27,562	$28,153	$82,553	$73,064
Reconciliation to net income:				
Net income (loss)	$20,514	$(2,978)	$33,895	$32,509

Net realized gains and net OTTI losses on investments, net of offsets	(1,950)	11,491	(4,308)	10,954
Convertible debt retirement, net of income taxes	—	—	171	(1,520)
Net effect of derivatives, embedded derivatives and other index annuity, net of offsets	8,998	18,903	52,795	27,173
Effect of counterparty default	—	737	—	3,948
Operating income	$27,562	$28,153	$82,553	$73,064

Net realized gains on investments and net impairment losses recognized in operations fluctuate from period to period based upon changes in the interest rate and economic environment and the timing of the sale of investments or the recognition of other than temporary impairments. The amounts disclosed above are net of related reductions in amortization of deferred sales inducements and deferred policy acquisition costs and income taxes. The income tax benefit related to net realized gains on investments and net impairment losses recognized in operations for the nine months ended September 30, 2009 includes a benefit of $3.6 million for the reduction of the deferred tax valuation allowance related to other than temporary impairments and capital loss carryforwards established in 2008.

Amounts attributable to the fair value accounting for fixed index annuity derivatives and embedded derivatives fluctuate from period to period based upon changes in the fair values of call options purchased to fund the annual index credits for fixed index annuities and changes in the interest rates used to discount the embedded derivative liability. The amounts disclosed above are net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs and income taxes.

Annuity product charges (surrender charges assessed against policy withdrawals and fees deducted from policyholder account balances for lifetime income benefit riders) increased 17% to $18.5 million in the third quarter of 2010 and increased 11% to $52.7 million for the nine months ended September 30, 2010 compared to $15.8 million and $47.5 million for the same periods in 2009. The increases were primarily due to increases in the amount of fees assessed for lifetime income benefit riders which were $4.3 million in the third quarter of 2010 and $10.1 million for the nine months ended September 30, 2010 compared to $1.6 million and $3.0 million for same periods in 2009. Withdrawals from annuity and single premium universal life policies subject to surrender charges were $104.7 million in the third quarter of 2010 and $321.7 million for the nine months ended September 30, 2010 compared to $95.7 million and $334.1 million for the same periods in 2009. The average surrender charge collected on withdrawals subject to a surrender charge was 13.6% in the third quarter of 2010 and 13.2% for the nine months ended September 30, 2010 compared to 14.7% and 13.2% for the same periods in 2009.

Net investment income increased 8% to $260.5 million in the third quarter of 2010 and increased 10% to $758.2 million for the nine months ended September 30, 2010 compared to $241.5 million and $688.9 million for the same periods in 2009. The increase was principally attributable to the growth in our annuity business and a corresponding increase in our invested assets. Average invested assets excluding derivative instruments (on an amortized cost basis) increased 15% to $17.5 billion in the third quarter of 2010 and 15% to $16.6 billion for the nine months ended September 30, 2010 compared to $15.1 billion and $14.5 billion for the same periods in 2009. The average yield earned on average invested assets was 5.98% in the third quarter of 2010 and 6.08% for the nine months ended September 30, 2010 compared to 6.38% and 6.32% for the same periods in 2009. The decrease in yield earned on average invested assets was attributable to a lag in reinvestment of proceeds from bonds called for redemption during first nine months of 2010 into new assets causing excess liquidity. Based on yields received for purchases of fixed maturity securities in 2010, we estimate that approximately $11.9 million and $20.6 million in net investment income was foregone during the three and nine months ended September 30, 2010, respectively, as a result of the excess liquidity, and the average yield on invested assets would have been 6.25% for the three and nine months ended September 30, 2010 if such income had been earned.

Change in fair value of derivatives (principally call options purchased to fund annual index credits on fixed index annuities) is affected by the performance of the indices upon which our options are based and the aggregate cost of options purchased. The components of change in fair value of derivatives are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Call options:				
Gain (loss) on option expiration	$25,069	$(65,118)	$194,836	$(197,182)
Change in unrealized gain/loss	68,040	188,239	(226,556)	307,201
2015 notes hedges	1,483	—	1,483	—
Interest rate swaps	(612)	(1,614)	(2,505)	(1,841)
	$93,980	$121,507	$(32,742)	$108,178

The differences between the change in fair value of derivatives between periods are primarily due to the performance of the indices upon which our call options are based. A substantial portion of our call options are based upon the S&P 500 Index with the remainder based upon other equity and bond market indices. The range of index appreciation for options expiring during the three months and nine months ended September 30, 2010 and 2009 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
S&P 500 Index				

Point-to-point strategy	1.9% - 22.7%	0.0% - 0.0%	1.9% - 68.6%	0.0% - 0.0%
Monthly average strategy	3.9% - 25.3%	0.0% - 0.0%	1.5% - 51.2%	0.0% - 0.0%
Monthly point-to-point strategy	0.0% - 7.3%	0.0% - 0.0%	0.0% - 23.7%	0.0% - 0.0%
Lehman Brothers U.S. Aggregate and U.S. Treasury indices	4.9% - 10.2%	6.0% - 6.4%	0.0% - 10.7%	1.6% - 6.4%

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the fixed index annuity policies (caps, participation rates and asset fees) which allow us to manage the cost of the options purchased to fund the annual index credits. The change in fair value of derivatives is also influenced by the aggregate costs of options purchased. The aggregate cost of options has increased primarily due to an increased amount of fixed index annuities in force. The aggregate cost of options is also influenced by the amount of policyholder funds allocated to the various indices and market volatility which affects option pricing. Costs for options purchased during the nine months ended September 30, 2010 decreased compared to the same period in 2009 due to lower volatility in equity markets. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. All options purchased from affiliates of Lehman had expired as of September 30, 2010. The amount of option proceeds due on expired options which had been purchased from Lehman that we did not receive payment on was $2.6 million for the third quarter of 2009 and $12.0 million for the nine months ended September 30, 2009. No amount has been recognized for any recovery of these amounts that may result from our claim in Lehman's bankruptcy proceedings.

Net realized gains 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. The components of net realized gains on investments for the three months and nine months ended September 30, 2010 and 2009 are set forth in the table that follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Available for sale fixed maturity securities:				
Gross realized gains	$9,732	$10,334	$22,019	$16,461
Gross realized losses	—	(2,619)	(2,359)	(2,672)
	9,732	7,715	19,660	13,789
Equity securities:				
Gross realized gains	3,264	3,279	9,471	3,282
Gross realized losses	(71)	—	(71)	—
	3,193	3,279	9,400	3,282
Mortgage loans on real estate:				
Increase in allowance for credit losses	(1,043)	(5,484)	(6,212)	(6,484)
Other investments:				
Impairment losses	(584)	—	(584)	—
	$11,298	$5,510	$22,264	$10,587

Gross realized gains increased in 2010 due to tax planning strategies to generate taxable capital gains that will permit deductions of capital losses for income tax purposes. Gross realized losses primarily relate to securities that experienced credit events resulting in the decision to sell the securities at a loss. See Financial Conditions - Investments for additional discussion of impairment losses recognized on mortgage loans on real estate.

Net OTTI losses recognized in operations decreased to $4.0 million in the third quarter of 2010 and $8.0 million for the nine months ended September 30, 2010 compared to $44.6 million and $63.7 million for the same periods in 2009. See Financial Condition - Investments for additional discussion of write downs of securities for other than temporary impairments.

Gain (loss) on extinguishment of debt includes a $0.3 million loss on an extinguishment of $6.7 million principal amount of our 2024 convertible senior notes in May 2010. The notes had a carrying value of $6.3 million with unamortized debt issue costs and unamortized debt discounts of $0.3 million and were extinguished for $6.6 million in cash. There was no value assigned to reacquire the equity component of the debt. We recognized a $3.1 million gain on an exchange of five million shares of our common stock for $37.2 million principal amount of our 2024 convertible notes during the nine months ended September 30, 2009. The fair value of the common stock exchanged totaled $31.3 million and the notes extinguished carried unamortized debit issue costs and debt discount totaling $2.8

million.

Interest sensitive and index product benefits increased 111% to $159.2 million in the third quarter of 2010, and 182% to $584.8 million for the nine months ended September 30, 2010, compared to $75.3 million and $207.0 million for the same periods in 2009. The components of interest credited to account balances are summarized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Index credits on index policies	$85,893	$7,740	$381,425	$25,259
Interest credited (including changes in minimum guaranteed interest for index annuities)	68,971	65,897	194,061	178,794
Living income benefit rider	4,291	1,651	9,356	2,975
	$159,155	$75,288	$584,842	$207,028

The changes in index credits were attributable to changes in the appreciation of the underlying indices (see discussion above under change in fair value of derivatives) and the amount of funds allocated by policyholders to the respective index options. Total proceeds received upon

expiration of the call options purchased to fund the annual index credits were $84.0 million and $364.3 million for the three months and nine months ended September 30, 2010, respectively, compared to $0.7 million and $5.7 million for the same periods in 2009. Proceeds for the 2009 periods were adversely affected by the Lehman defaults as discussed above. The increases in interest credited were due to an increase in the average amount of 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 16% during the nine months ended September 30, 2010 to $17.6 billion from $15.1 billion during the same period in 2009.

Amortization of deferred sales inducements was $5.2 million in the third quarter of 2010, and increased 21% to $21.5 million for the nine months ended September 30, 2010 compared to $(8.1) million and $17.8 million for the same periods in 2009. In general, amortization of deferred sales inducements has been increasing each period due to growth in our annuity business and the deferral of sales inducements incurred with respect to sales of premium bonus annuity products. Bonus products represented 95% and 94% of our net annuity deposits during the nine months ended September 30, 2010 and 2009, respectively. The anticipated increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business and amortization associated with net realized gains on investments and net OTTI losses recognized in operations.

Fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the derivatives (purchased call options) because the purchased call options are one-year options while the options valued in the fair value of embedded derivatives cover the expected life of the contracts which typically exceeds ten years. The gross profit adjustments resulting from fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business decreased amortization by $21.7 million for the third quarter of 2010 and $54.2 million for the nine months ended September 30, 2010 compared to decreases of $19.7 million and $25.1 million for the same periods in 2009. The gross profit adjustments from net realized gains on investments and net OTTI losses recognized in operations increased amortization by $2.0 million for the third quarter of 2010 and $3.5 million for the nine months ended September 30, 2010 and decreased amortization by $8.6 million and $12.4 million for the same periods in 2009. Excluding the amortization amounts attributable to fair value accounting for derivatives and embedded derivatives, net realized gains on investments and net OTTI losses recognized in operations, amortization for the three and nine months ended September 30, 2010 would have been $24.9 million and $72.2 million, respectively, compared to $20.2 million and $55.3 million for the same periods in 2009. See Critical Accounting Policies - Deferred Policy Acquisition Costs and Deferred Sales Inducements included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

Change in fair value of embedded derivatives was an increase of $114.8 million in the third quarter of 2010 and decrease of $11.5 million for the nine months ended September 30, 2010 compared to increases of $259.7 million and $414.6 million for the same periods in 2009. The changes 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 these index credits discussed above in change in fair value of derivatives; (ii) changes in discount rates used in estimating our liability for policy growth; and (iii) the growth in the host component of the policy liability. See Critical Accounting Policies - Policy Liabilities for Fixed Index Annuities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009. The primary reasons for the increase in the fair value of embedded derivatives in the third quarter of 2010 were an increase in the expected index credits that resulted from the increase in the fair value of the call options acquired to fund these index credits and decreases in the discount rates used in estimating our liability for policy growth. The primary reasons for the decrease in the fair value of embedded derivatives for the nine months ended September 30, 2010 were a decrease in the expected index credits that resulted from the decrease in the fair value of the call options acquired to fund these index

credits offset in part by decreases in the discount rates used in estimating our liability for policy growth.

Interest expense on notes payable increased 47% to $4.9 million in the third quarter of 2010 and 26% to $14.3 million for the nine months ended September 30, 2010 compared to $3.4 million and $11.3 million for the same periods in 2009. These increases were primarily due to the December 2009 issuance of an additional $52.2 million of 5.25% convertible notes and a higher effective rate of interest on $63.6 million principal amount of 5.25% convertible senior notes that were issued in December 2009 in exchange for the same principal amount of another issue of 5.25% convertible notes. The increase in interest expense on the convertible notes for the nine months ended September 30, 2010 was partially offset by a decrease in interest expense on borrowings under our revolving line of credit. The weighted average interest on the bank credit facility was 1.09% and 1.70% for the nine months ended September 30, 2010 and 2009, respectively, and average borrowings outstanding were $145.1 million and $100.9 million for the same periods, respectively.

Interest expense on subordinated debentures decreased 1% to $3.8 million in the third quarter of 2010 and 7% to $11.2 million for the nine months ended September 30, 2010 compared to $3.8 million and $12.1 million for the same periods in 2009. These decreases were primarily due to decreases in the weighted average interest rate on the outstanding subordinated debentures which were 5.48% and 5.92% for the third quarter of 2010 and 2009, respectively. The weighted average interest rates have decreased because $149 million principal amount of the subordinated debentures have a floating rate of interest based upon the three month London Interbank Offered Rate plus an applicable margin. See Financial Condition - Liabilities included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

Interest expense on amounts due under repurchase agreements was $0.1 million and $0.3 million for the three and nine months ended September 30, 2009. There were no amounts outstanding during the three and nine months ended September 30, 2010. The weighted average interest rates were 0.3% for the third quarter of 2009 and 0.4% for the nine months ended September 30, 2009, and average borrowings outstanding were $128.7 million and $112.4 million for the same periods, respectively.

Amortization of deferred policy acquisition costs increased to $45.8 million in the third quarter of 2010, and 65% to $74.0 million for the nine months ended September 30, 2010, compared to $(3.0) million and $44.9 million for the same periods in 2009. In general, amortization of deferred policy acquisition costs has been increasing each period due to the growth in our annuity business and the deferral of policy acquisition costs incurred with respect to sales of annuity products. The anticipated increase in amortization from these factors has been affected by amortization associated with fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business and amortization associated with net realized gains on investments and net OTTI losses recognized in operations.

As discussed above, fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business creates differences in the recognition of revenues and expenses from derivative instruments including the embedded derivative liabilities in our fixed index annuity contracts. The gross profit adjustments resulting from fair value accounting for derivatives and embedded derivatives utilized in our fixed index annuity business decreased amortization by $4.3 million in the third quarter of 2010 and $68.5 million for the nine months ended September 30, 2010, compared to a decreases of $31.8 million and $56.1 million for the same periods in 2009. The gross profit adjustment from net realized gains on investments and net OTTI losses recognized in operations increased amortization by $2.3 million and $4.1 million for the three and nine months ended September 30, 2010, compared to a decreases of $12.7 million and $18.1 million for the three and nine months ended September 30, 2009. Excluding the amortization amounts attributable to fair value accounting for derivatives, net realized gains on investments and net OTTI losses recognized in operations, amortization for the three months and nine months ended September 30, 2010 would have been $47.8 million and $138.3 million, respectively, compared to $41.5 million and $119.1 million for the same periods in 2009.

Other operating costs and expenses increased 16% to $16.2 million in the third quarter of 2010 and 8% to $48.9 million for the nine months ended September 30, 2010, compared to $14.0 million and $45.3 million for the same periods in 2009. The increase in the third quarter of 2010 was primarily due to the increases of $1.4 million in legal costs and $1.6 million in salaries and benefits and insurance, offset by decreases in taxes and assessments of $0.5 million. The increase for the nine months ended September 30, 2010, was primarily due to an increase in salaries and benefits of $4.7 million offset by a decrease in legal costs of $0.3 million. The increase in legal costs in the third quarter of 2010 is primarily related to the cost of defense related to the Stephens v. American Equity Investment Life Insurance Company class action lawsuit. As disclosed in note 8 to our unaudited consolidated financial statements in Item 1 of this Form 10-Q, the trial in this matter began on November 1, 2010 and legal expenses may remain at at elevated levels until the matter is concluded. The increase in salaries and benefits for the two periods is primarily related to an increase in the number of employees due to the growth in our business. Also, we recorded compensation expense of $1.2 million during the nine months ended September 30, 2010 related to the grant of stock options to several retirement eligible employees and post employment benefit expense of $0.5 million during the first quarter of 2010 and $1.2 million during the second quarter of 2009 related to post employment benefit agreement with our Executive Chairman, David J. Noble which was approved by our board of directors on June 4, 2009.

Income tax expense (benefit) increased to $10.9 million in the third quarter of 2010 and increased 55% to $17.5 million for the nine months ended September 30, 2010, compared to $(2.1) million and $11.3 million for the same periods in 2009. These increases were primarily due to the increase in income before income taxes. The effective tax rates were 34.7% for the third quarter of 2010 and 34.0% for the nine months ended September 30, 2010, compared to 41.2% and 25.8% for the same periods in 2009. The effective tax rate for nine months ended September 30, 2010 was less than the applicable statutory federal income tax rate of 35% due to state income tax benefits attributable to losses in the non-life subgroup. The effective tax rate for the nine months ended September 30, 2009 was less than the applicable statutory federal income tax rate of 35% primarily due to a decrease in the deferred tax valuation allowance established in 2008 for other than temporary impairments and capital loss carryforwards which decreased income tax expense in the first quarter of 2009 by $3.6 million. This decrease was primarily due to an increase in anticipated

future taxable income from capital gain sources, offset in part by a smaller increase in the amount of other than temporary impairments that give rise to the deferred income tax asset for which a valuation allowance is necessary.

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, mortgage loans on real estate and short-term investments.

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 and corporate securities rated investment grade by established nationally recognized statistical rating organizations ("NRSRO's") or in securities of comparable investment quality, if not rated and commercial mortgage loans on real estate.

The composition of our investment portfolio is summarized in the table below:

	September 30, 2010			December 31, 2009		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Fixed maturity securities:						
United States Government full faith and credit	$3,698	—	%	$3,310	—	%
United States Government sponsored agencies	4,366,314	23.7	%	5,557,971	36.2	%
United States municipalities, states and territories	1,261,070	6.8	%	355,634	2.3	%
Corporate securities	6,578,478	35.7	%	3,933,198	25.6	%
Residential mortgage backed securities	2,728,841	14.8	%	2,489,101	16.2	%
Total fixed maturity securities	14,938,401	81.0	%	12,339,214	80.3	%
Equity securities	82,172	0.4	%	93,086	0.6	%
Mortgage loans on real estate	2,528,459	13.7	%	2,449,778	15.9	%
Derivative instruments	283,920	1.5	%	479,272	3.1	%
Short-term investments	599,961	3.3	%	—	—	%
Other investments	19,810	0.1	%	12,760	0.1	%
	$18,452,723	100.0	%	$15,374,110	100.0	%

During the nine months ended September 30, 2010 and 2009, we received $4.0 billion and $3.6 billion, respectively, in redemption proceeds primarily related to calls of our callable United States Government sponsored agency securities, of which $1.6 billion and $1.9 billion, respectively, were classified as held for investment. We reinvested the proceeds from these redemptions primarily in United States Government sponsored agencies, corporate securities, and United States municipalities, states, and territories classified as available for sale. In addition, we held approximately $600 million in short-term investments at September 30, 2010. At September 30, 2010, 40% of our fixed income securities have call features and 14% ($2.0 billion) are subject to call redemption during the fourth quarter of 2010. Another 18% ($2.5 billion) will become subject to call redemption during the first three quarters of 2011.

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 return on our investments. We have approximately 30% of our fixed maturities invested in U.S. federal government sponsored agency securities (Federal Home Loan Mortgage Corporation and Federal National Mortgage Association make up the majority), which have historically been a source of dependable income and high credit quality. Since 2007, we have built a portfolio of residential mortgage backed securities ("RMBS") that provide our portfolio a source of regular cash flow and higher yielding assets than our agency securities. In 2009, we began building a portfolio of bonds issued by municipalities, states and territories of the United States that provide us with attractive yields while generally consistent with our aversion to credit risk. The remainder of our fixed maturity portfolio is mostly made up of publicly traded and privately placed bonds and redeemable preferred stocks.

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

	September 30, 2010		December 31, 2009	
Rating Agency Rating	Carrying Amount	Percent of Fixed Maturity Securities	Carrying Amount	Percent of Fixed Maturity Securities
	(Dollars in thousands)			

Aaa/Aa/A	$10,234,520	68.5	%	$8,666,467	70.2	%
Baa	3,380,406	22.6	%	2,442,897	19.8	%
Total investment grade	13,614,926	91.1	%	11,109,364	90.0	%
Ba	309,816	2.1	%	367,427	3.0	%
B	102,210	0.7	%	358,288	2.9	%
Caa and lower	903,946	6.0	%	481,389	3.9	%
In or near default	7,503	0.1	%	22,746	0.2	%
Total below investment grade	1,323,475	8.9	%	1,229,850	10.0	%
	$14,938,401	100	%	$12,339,214	100.0	%

The NAIC's Securities Valuation Office ("SVO") is responsible for the day-to-day credit quality assessment and valuation of securities owned by state regulated insurance companies. Insurance companies report ownership of securities 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 an NRSRO, the SVO utilizes that rating and assigns an NAIC designation based upon the following system:

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

In November 2010, the NAIC membership approved continuation of a process developed in 2009 to assess non-agency RMBS for the 2010 filing year that does not rely on NRSRO ratings. The NAIC has retained the services of PIMCO Advisory to model each non-agency RMBS owned by U.S. insurers at year-end 2009 and 2010. PIMCO Advisory will provide 5 prices for each security for life insurance companies to utilize in determining the NAIC designation for each RMBS based on each insurer's statutory book value price. This process results in a more appropriate level of RBC requirements for non-agency RMBS.

The table below presents our fixed maturity securities by NAIC designation:

	September 30, 2010				December 31, 2009			
NAIC Designation	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount	Amortized Cost	Fair Value	Carrying Amount	Percent of Total Carrying Amount
	(Dollars in thousands)				(Dollars in thousands)			
1	$10,482,067	$10,863,122	$10,862,015	72.6 %	$9,495,015	$9,370,647	$9,374,900	76.0 %
2	3,434,818	3,703,832	3,703,832	24.8 %	2,571,815	2,555,826	2,555,826	20.7 %
3	349,422	298,439	328,772	2.2 %	409,860	315,948	344,914	2.8 %
4	32,259	32,079	32,079	0.2 %	24,375	20,799	20,799	0.2 %
5	2,943	4,200	4,200	0.1 %	21,013	20,749	20,749	0.1 %
6	7,096	7,503	7,503	0.1 %	25,685	22,026	22,026	0.2 %
	$14,308,605	$14,909,175	$14,938,401	100.0%	$12,547,763	$12,305,995	$12,339,214	100.0%

A summary of our RMBS by collateral type and split by NAIC designation, as well as a separate summary of securities for which we have recognized OTTI and those which we have not yet recognized any OTTI is as follows:

Collateral Type	NAIC Designation	September 30, 2010 Principal Amount	Amortized Cost	Fair Value	December 31, 2009 Principal Amount	Amortized Cost	Fair Value
		(Dollars in thousands)					
OTTI has not been recognized							
Government agency	1	$67,103	$66,390	$73,631	$69,496	$68,715	$72,306
Prime	1	1,818,274	1,722,604	1,761,936	1,713,391	1,595,502	1,585,337
	2	26,291	24,730	24,499	127,951	127,210	106,395
	3	21,474	21,145	18,795	1,474	1,471	977
	4	10,627	10,195	10,347	—	—	—
Alt-A	1	55,282	54,732	52,375	93,963	87,071	70,749
	2	5,123	5,219	4,304	46,456	47,301	38,030
		$2,004,174	$1,905,015	$1,945,887	$2,052,731	$1,927,270	$1,873,794
OTTI has been recognized							
Prime	1	$226,865	$205,822	$180,883	$173,149	$156,108	$126,301
	2	195,252	185,801	159,643	223,473	212,221	156,522
	3	69,651	65,530	61,645	60,965	58,965	44,853
Alt-A	1	269,492	232,093	213,585	194,682	164,402	127,341
	2	160,021	137,310	117,387	111,673	96,700	75,557
	3	71,622	59,857	47,112	134,085	115,522	81,922
	6	4,899	4,238	2,699	5,394	4,701	2,811
		$997,802	$890,651	$782,954	$903,421	$808,619	$615,307
Total by collateral type							
Government agency		$67,103	$66,390	$73,631	$69,496	$68,715	$72,306
Prime		2,368,434	2,235,827	2,217,748	2,300,403	2,151,477	2,020,385
Alt-A		566,439	493,449	437,462	586,253	515,697	396,410
		$3,001,976	$2,795,666	$2,728,841	$2,956,152	$2,735,889	$2,489,101
Total by NAIC designation							
	1	$2,437,016	$2,281,641	$2,282,410	$2,244,681	$2,071,798	$1,982,034
	2	386,687	353,060	305,833	509,553	483,432	376,504
	3	162,747	146,532	127,552	196,524	175,958	127,752
	4	10,627	10,195	10,347	—	—	—
	6	4,899	4,238	2,699	5,394	4,701	2,811
		$3,001,976	$2,795,666	$2,728,841	$2,956,152	$2,735,889	$2,489,101

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

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
		(Dollars in thousands)		
September 30, 2010				
Due in one year or less	$30,372	$30,721	$—	$—
Due after one year through five years	406,359	451,668	—	—
Due after five years through ten years	1,608,610	1,851,088	—	—
Due after ten years through twenty years	1,852,257	1,965,964	—	—
Due after twenty years	7,325,388	7,620,166	289,953	260,727
	11,222,986	11,919,607	289,953	260,727
Residential mortgage backed securities	2,795,666	2,728,841	—	—
	$14,018,652	$14,648,448	$289,953	$260,727
December 31, 2009				
Due in one year or less	$18,948	$18,656	$—	$—
Due after one year through five years	446,487	467,458	—	—
Due after five years through ten years	1,333,196	1,446,348	—	—
Due after ten years through twenty years	1,449,264	1,450,402	555,000	549,461
Due after twenty years	4,928,896	4,832,166	1,080,083	1,052,403
	8,176,791	8,215,030	1,635,083	1,601,864
Residential mortgage backed securities	2,735,889	2,489,101	—	—
	$10,912,680	$10,704,131	$1,635,083	$1,601,864

Unrealized Losses

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

	Number of Securities	Amortized Cost	Unrealized Losses	Fair Value
		(Dollars in thousands)		
September 30, 2010				
Fixed maturity securities, available for sale:				
United States municipalities, states and territories	14	$63,484	$(866)	$62,618
Corporate securities:				
Finance, insurance and real estate	33	247,022	(15,407)	231,615
Manufacturing, construction and mining	15	118,737	(3,707)	115,030
Utilities and related sectors	17	140,023	(5,902)	134,121
Wholesale/retail trade	6	31,471	(1,465)	30,006
Services, media and other	7	71,915	(591)	71,324
Residential mortgage backed securities	96	1,457,072	(148,958)	1,308,114
	188	$2,129,724	$(176,896)	$1,952,828
Fixed maturity securities, held for investment:				
Corporate security:				
Finance, insurance and real estate	1	$75,751	$(30,334)	$45,417
Equity securities, available for sale:				
Finance, insurance and real estate	7	$29,782	$(732)	$29,050
December 31, 2009				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	2	$338	$(6)	$332
United States Government sponsored agencies	27	3,026,593	(118,388)	2,908,205
United States municipalities, states and territories	32	114,232	(2,263)	111,969
Corporate securities:				
Finance, insurance and real estate	68	443,859	(50,555)	393,304
Manufacturing, construction and mining	28	178,642	(10,462)	168,180
Utilities and related sectors	36	226,604	(13,156)	213,448
Wholesale/retail trade	17	80,599	(5,423)	75,176
Services, media and other	17	113,308	(5,324)	107,984
Residential mortgage backed securities	109	1,719,481	(306,372)	1,413,109
	336	$5,903,656	$(511,949)	$5,391,707
Fixed maturity securities, held for investment:				
United States Government sponsored agencies	4	$365,000	$(5,900)	$359,100
Corporate security:				
Finance, insurance, and real estate	1	75,649	(28,966)	46,683
	5	$440,649	$(34,866)	$405,783
Equity securities, available for sale				
Finance, insurance and real estate	14	$41,948	$(3,269)	$38,679

Unrealized losses decreased $342.1 million from $550.1 million at December 31, 2009 to $208.0 million at September 30, 2010. Unrealized losses decreased by recognizing $8.0 million of credit OTTI losses on debt securities in the nine months ended September 30, 2010. The remaining decrease in unrealized losses was due to improving market conditions and tightening of credit spreads resulting in higher fair values for many of our corporate and RMBS securities.

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

NAIC Designation	Carrying Value of Securities with Gross Unrealized Losses	Percent of Total	Gross Unrealized Losses	Percent of Total
	(Dollars in thousands)			
September 30, 2010				
1	$1,120,396	55.2 %	$(86,256)	41.6 %
2	636,363	31.4 %	(62,309)	30.1 %
3	248,963	12.3 %	(56,725)	27.4 %
4	17,582	0.9 %	(332)	0.2 %
5	—	— %	—	— %
6	5,275	0.2 %	(1,608)	0.8 %
	$2,028,579	100.0 %	$(207,230)	100.0 %
December 31, 2009				
1	$4,577,573	78.5 %	$(295,280)	54.0 %
2	904,027	15.5 %	(147,214)	26.9 %
3	302,630	5.2 %	(94,679)	17.3 %
4	20,799	0.4 %	(3,576)	0.7 %
5	14,499	0.2 %	(467)	0.1 %
6	12,828	0.2 %	(5,599)	1.0 %
	$5,832,356	100.0 %	$(546,815)	100.0 %

The following tables show our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 196 and 355 securities, respectively) have been in a continuous unrealized loss position at September 30, 2010 and December 31, 2009:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
September 30, 2010						
Fixed maturity securities:						
Available for sale:						
United States municipalities, states and territories	$62,618	$(866)	$—	$—	$62,618	$(866)
Corporate securities:						
Finance, insurance and real estate	107,957	(2,927)	123,658	(12,480)	231,615	(15,407)
Manufacturing, construction and mining	70,801	(1,418)	44,229	(2,289)	115,030	(3,707)
Utilities and related sectors	119,726	(1,577)	14,395	(4,325)	134,121	(5,902)
Wholesale/retail trade	20,856	(134)	9,150	(1,331)	30,006	(1,465)
Services, media and other	71,324	(591)	—	—	71,324	(591)
Residential mortgage backed securities	166,817	(8,688)	1,141,297	(140,270)	1,308,114	(148,958)
	$620,099	$(16,201)	$1,332,729	$(160,695)	$1,952,828	$(176,896)
Held for investment:						
Corporate security:						
Finance, insurance and real estate	$—	$—	$45,417	$(30,334)	$45,417	$(30,334)
Equity securities, available for sale:						
Finance, insurance and real estate	$12,192	$(590)	$16,858	$(142)	$29,050	$(732)
December 31, 2009						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$332	$(6)	$—	$—	$332	$(6)
United States Government sponsored agencies	2,908,205	(118,388)	—	—	2,908,205	(118,388)
United States municipalities, states and territories	111,969	(2,263)	—	—	111,969	(2,263)
Corporate securities:						
Finance, insurance and real estate	154,093	(10,560)	239,211	(39,995)	393,304	(50,555)
Manufacturing, construction and mining	93,922	(2,032)	74,258	(8,430)	168,180	(10,462)
Utilities and related sectors	149,515	(5,046)	63,933	(8,110)	213,448	(13,156)
Wholesale/retail trade	35,629	(623)	39,547	(4,800)	75,176	(5,423)
Services, media and other	46,625	(512)	61,359	(4,812)	107,984	(5,324)
Residential mortgage backed securities	226,567	(22,781)	1,186,542	(283,591)	1,413,109	(306,372)
	$3,726,857	$(162,211)	$1,664,850	$(349,738)	$5,391,707	$(511,949)

Held for investment:						
United States Government sponsored agencies	$359,100	$(5,900)	$—	$—	$359,100	$(5,900)
Corporate security:						
Finance, insurance and real estate	—	—	46,683	(28,966)	46,683	(28,966)
	$359,100	$(5,900)	$46,683	$(28,966)	$405,783	$(34,866)
Equity securities, available for sale:						
Finance, insurance and real estate	$9,802	$(147)	$28,877	$(3,122)	$38,679	$(3,269)

The following is a description of the factors causing the unrealized losses by investment category as of September 30, 2010:

United States municipalities, states and territories: These securities are relatively long in duration, making the value of such securities sensitive to changes in market interest rates. These securities carry yields less than those available at September 30, 2010.

Corporate securities: The unrealized losses in these securities are due partially to the continuation of wider than historic credit spreads in certain sectors of the corporate bond market. While credit spreads narrowed, several sectors remain at spreads wider than pre-crisis levels, such as financials and select economic sensitive issuers. As the result of wider spreads, these issues carry yields less than those available in the market as of September 30, 2010.

Residential mortgage backed securities: At September 30, 2010, we had no exposure to sub-prime residential mortgage backed securities. All of our residential mortgage backed securities are pools of first-lien residential mortgage loans. Substantially all of the securities that we own are in the most senior tranche of the securitization in which they are structured and are not subordinated to any other tranche. Our "Alt-A" residential mortgage backed securities are comprised of 36 securities with a total amortized cost basis of $493.4 million and a fair value of $437.5 million. Despite recent improvements in the capital markets, the fair values of RMBS continue at prices below amortized cost. RMBS prices will likely remain below our cost basis until the housing market is able to absorb current and future foreclosures.

Equity securities: The unrealized loss on equity securities, which are primarily investment grade perpetual preferred stocks with exposure to REITS, investment banks and finance companies, are due to the ongoing concerns relating to capital, asset quality and earnings stability due to the financial crisis. All of the equity securities in an unrealized loss position for 12 months or more are investment grade perpetual preferred stocks that are absent credit deterioration. A continued difficult housing market has raised concerns in regard to earnings and dividend stability in many companies which directly affect the values of these securities.

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

Approximately 72% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2010 are on securities that are rated investment grade, defined as being the highest two NAIC designations. Approximately 28% of the unrealized losses on fixed maturity securities shown in the above table for September 30, 2010 are on securities rated below investment grade. All of the securities with unrealized losses are current with respect to the payment of principal and interest.

44

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2010				
Fixed maturity securities:				
Investment grade:				
Less than six months	61	$519,101	$510,823	$(8,278)
Six months or more and less than twelve months	3	28,240	27,668	(572)
Twelve months or greater	39	467,433	439,546	(27,887)
Total investment grade	103	1,014,774	978,037	(36,737)
Below investment grade:				
Less than six months	3	50,922	46,264	(4,658)
Six months or more and less than twelve months	2	38,037	35,344	(2,693)
Twelve months or greater	81	1,101,742	938,600	(163,142)
Total below investment grade	86	1,190,701	1,020,208	(170,493)
Equity securities:				
Less then six months	1	2,657	2,492	(165)
Six months or more and less than twelve months	1	10,125	9,700	(425)
Twelve months or greater	5	17,000	16,858	(142)
Total equity securities	7	29,782	29,050	(732)
	196	$2,235,257	$2,027,295	$(207,962)
December 31, 2009				
Fixed maturity securities:				
Investment grade:				
Less than six months	120	$2,516,264	$2,463,732	$(52,532)
Six months or more and less than twelve months	26	1,591,620	1,500,847	(90,773)
Twelve months or greater	95	883,552	777,079	(106,473)
Total investment grade	241	4,991,436	4,741,658	(249,778)
Below investment grade:				
Less than six months	3	60,580	57,220	(3,360)
Six months or more and less than twelve months	12	85,605	64,159	(21,446)
Twelve months or greater	85	1,206,684	934,453	(272,231)
Total below investment grade	100	1,352,869	1,055,832	(297,037)
Equity securities:				
Less then six months	2	7,291	7,242	(49)
Six months or more and less than twelve months	1	2,658	2,560	(98)
Twelve months or greater	11	31,999	28,877	(3,122)
Total equity securities	14	41,948	38,679	(3,269)
	355	$6,386,253	$5,836,169	$(550,084)

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

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
September 30, 2010				
Investment grade:				
Less than six months	1	$15,936	$11,878	$(4,058)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	—	—	—	—
Total investment grade	1	15,936	11,878	(4,058)
Below investment grade:				
Less than six months	1	11,857	9,404	(2,453)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	11	180,741	122,570	(58,171)
Total below investment grade	12	192,598	131,974	(60,624)
	13	$208,534	$143,852	$(64,682)
December 31, 2009				
Investment grade:				
Less than six months	2	$34,271	$30,198	$(4,073)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	2	11,940	8,601	(3,339)
Total investment grade	4	46,211	38,799	(7,412)
Below investment grade:				
Less than six months	13	118,198	101,805	(16,393)
Six months or more and less than twelve months	9	158,359	111,878	(46,481)
Twelve months or greater	27	365,706	252,062	(113,644)
Total below investment grade	49	642,263	465,745	(176,518)
	53	$688,474	$504,544	$(183,930)

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 residential mortgage backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
September 30, 2010				
Due in one year or less	$—	$—	$—	$—
Due after one year through five years	36,952	35,996	—	—
Due after five years through ten years	62,344	61,223	—	—
Due after ten years through twenty years	132,632	125,552	—	—
Due after twenty years	440,724	421,943	75,751	45,417

	672,652	644,714	75,751	45,417
Residential mortgage backed securities	1,457,072	1,308,114	—	—
	$2,129,724	$1,952,828	$75,751	$45,417
December 31, 2009				
Due in one year or less	$12,000	$11,707	$—	$—
Due after one year through five years	82,754	75,462	—	—
Due after five years through ten years	100,597	95,678	—	—
Due after ten years through twenty years	707,824	682,247	365,000	359,100
Due after twenty years	3,281,000	3,113,504	75,649	46,683
	4,184,175	3,978,598	440,649	405,783
Residential mortgage backed securities	1,719,481	1,413,109	—	—
	$5,903,656	$5,391,707	$440,649	$405,783

Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 25% or greater change in market price relative to its amortized cost and a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our RMBS as we monitor all of our RMBS on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At September 30, 2010, the amortized cost and fair value of securities on the watch list are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains/ (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
		(Dollars in thousands)				
Investment grade						
Corporate fixed maturity securities:						
Finance and insurance	2	$6,012	$(805)	$5,207	35-42	—
Below investment grade						
Corporate fixed maturity securities:						
Retail	1	10,481	(1,331)	9,150	64	—
	3	$16,493	$(2,136)	$14,357		

Our analysis of these securities that we have determined are temporarily impaired and their credit performance at September 30, 2010 is as follows:

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

Retail: The decline in value of this bond relates to a debt-financed share repurchase combined with a weakening economy which has led to a decrease in sales. We have determined that this security was not other than temporarily impaired due to the issuer's very strong market position and a consistent history of strong operating performance, improving economic conditions and rising security prices.

The securities on the watch list are current with respect to payments of principal and interest. 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 and, as such, there were no other than temporary impairments on these securities at September 30, 2010.

Other Than Temporary Impairments

We have a policy and process in place to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

We recognized other than temporary impairments and additional credit losses on a number of securities for which we have previously recognized OTTI as follows:

General Description	Number of Securities	Total OTTI Losses	Portion of OTTI Losses in Other Comprehensive Income	Net OTTI Losses in Operations
		(Dollars in thousands)		
Three months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	7	—	(1,830)	(1,830)
	9	$(2,160)	$(1,830)	$(3,990)
Three months ended September 30, 2009				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(3,619)	$(2,257)	$(5,876)
Insurance	1	(211)	(696)	(907)
Residential mortgage backed securities	47	(78,712)	52,594	(26,118)
Equity securities, available for sale:				
Finance	1	(10,182)	—	(10,182)
Insurance	2	(1,492)	—	(1,492)
	52	$(94,216)	$49,641	$(44,575)
Nine months ended September 30, 2010				
Fixed maturity securities, available for sale:				
Corporate securities:				
Finance	1	$(822)	$—	$(822)
Retail	1	(1,338)	—	(1,338)
Residential mortgage backed securities	10	(14,187)	8,316	(5,871)
	12	$(16,347)	$8,316	$(8,031)
Nine months ended September 30, 2009				
Fixed maturity securities, available for sale:				
United States Government full faith and credit	1	$(245)	$—	$(245)
Corporate securities:				
Finance	3	(8,388)	(1,521)	(9,909)
Insurance	2	(641)	(1,165)	(1,806)
Home building	3	(756)	(70)	(826)
Residential mortgage backed securities	49	(140,454)	110,768	(29,686)
Equity securities, available for sale:				
Finance	7	(18,292)	—	(18,292)
Insurance	2	(1,492)	—	(1,492)
Real estate	2	(1,400)	—	(1,400)
	69	$(171,668)	$108,012	$(63,656)

Several factors have led us to believe that full recovery of amortized cost will not be expected. These include, but are not limited to: (i) a significant change in the operating performance of a company; (ii) a material change in the

expected contractual obligation of an issuer; (iii) a significant change in ratings as defined by the NRSRO; and (iv) the time frame in which a recovery to amortized cost may occur. We recognized OTTI of $2.2 million on two corporate fixed maturity securities during the three and nine months ended September 30, 2010, because we changed from a position of holding these securities until price recovery to intending to sell them prior to price recovery.

Deterioration of the issuers' credit worthiness and liquidity profile were major factors in leading us to make the determination that other than temporary impairments were present in our corporate bonds and preferred stocks. Our analysis demonstrated that we could not expect a recovery of our cost basis within our expected holding period for debt securities or within a reasonable period of time for equity securities.

In the case of residential mortgage backed securities, we considered the ratings downgrades, increased default and loss severity projections, actual defaults, and expected cash flow projections to determine that other than temporary impairments were present. We continue to monitor the cash flows and economics surrounding these securities to determine changes in expected future cash flows. The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the nine months ended September 30, 2010 and 2009 which are all senior level tranches within the structure of the securities:

		Discount Rate		Default Rate		Loss Severity	
Sector	Vintage	Min	Max	Min	Max	Min	Max
September 30, 2010							
Prime	2005	7.5 %	7.5 %	11 %	11 %	45 %	45 %
	2006	7.3 %	7.3 %	7 %	11 %	45 %	55 %
	2007	5.8 %	6.6 %	11 %	19 %	45 %	60 %
Alt-A	2005	6.2 %	7.4 %	12 %	27 %	45 %	50 %
	2007	7.0 %	7.0 %	44 %	45 %	57 %	60 %
September 30, 2009							
Prime	2005	7.7 %	7.7 %	7 %	7 %	50 %	50 %
	2006	6.5 %	9.2 %	8 %	14 %	35 %	55 %
	2007	5.8 %	7.9 %	8 %	31 %	35 %	50 %
Alt-A	2005	5.6 %	8.7 %	10 %	16 %	10 %	50 %
	2006	6.0 %	7.3 %	16 %	27 %	40 %	60 %
	2007	6.2 %	7.5 %	15 %	52 %	45 %	70 %

In making the decisions to write down the securities described above, we considered whether the factors leading to those write downs impacted any other securities held in our portfolio. In cases where we determined that a decline in value was related to an industry-wide concern, we considered the impact of such concern on all securities we held within that industry classification.

The following table is a summary of securities that are a part of our investment portfolio and for which at any time during our holding period we have recognized OTTI and the activity since recognizing OTTI:

	Number of Securities	Amortized Cost Prior to OTTI	OTTI Recognized in Operations	Return of Principal Since OTTI was Recognized	Premium Amortization/ Discount Accretion Since OTTI was Recognized	Amortized Cost
		(Dollars in thousands)				
September 30, 2010						
Corporate fixed maturity securities	7	$42,441	$(22,766)	$(5,000)	$(196)	$14,479
Residential mortgage backed securities	58	980,177	(61,332)	(29,475)	1,281	890,651
Equity securities:						
Finance, insurance and real estate	10	46,640	(22,258)	(2)	—	24,380

	75	$1,069,258	$(106,356)	$(34,477)	$1,085	$929,510
December 31, 2009						
Corporate fixed maturity securities	7	$48,610	$(22,425)	$(247)	$(335)	$25,603
Residential mortgage backed securities	55	869,653	(55,461)	(4,752)	192	809,632
Equity securities:						
Finance, insurance and real estate	18	110,481	(75,020)	(816)	—	34,645
	80	$1,028,744	$(152,906)	$(5,815)	$(143)	$869,880

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

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
September 30, 2010				
Corporate fixed maturity securities	$14,479	$(2,701)	$7,503	$19,281
Residential mortgage backed securities	890,651	(213,561)	105,865	782,955
Equity securities:				
Finance, insurance and real estate	24,380	—	9,289	33,669
	$929,510	$(216,262)	$122,657	$835,905
December 31, 2009				
Corporate fixed maturity securities	$25,603	$(9,488)	$7,763	$23,878
Residential mortgage backed securities	809,632	(205,245)	11,809	616,196
Equity securities:				
Finance, insurance and real estate	34,645	—	13,045	47,690
	$869,880	$(214,733)	$32,617	$687,764

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location, and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, adjusted for amortization of premiums and accrual of discounts net of valuation allowances. At September 30, 2010 and December 31, 2009 the largest principal amount outstanding for any single mortgage loan was $10.9 million and $11.2 million, respectively, and the average loan size was $2.4 million for both periods. We have the contractual ability to pursue full personal recourse on 13.4% of the loans and partial personal recourse on 32.2% of the loans, and master leases provide us recourse against the principals of the borrowing entity on 5.8% of the loans. In addition, the average loan to value ratio for the overall portfolio was 54.9% and 56.3% at September 30, 2010 and December 31, 2009, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value ratio 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 may obtain a current appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type as follows:

	September 30, 2010			December 31, 2009		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Geographic distribution						
East	$580,822	22.9	%	$560,256	22.8	%
Middle Atlantic	164,084	6.5	%	168,246	6.9	%
Mountain	399,951	15.8	%	388,940	15.9	%
New England	43,165	1.7	%	44,541	1.8	%
Pacific	238,125	9.4	%	216,382	8.8	%
South Atlantic	498,266	19.6	%	464,077	18.9	%
West North Central	398,664	15.7	%	410,883	16.7	%
West South Central	212,594	8.4	%	201,719	8.2	%
	$2,535,671	100.0	%	$2,455,044	100.0	%
Loan loss allowance	(7,212	)		(5,266	)	
	2,528,459			2,449,778		
Property type distribution						
Office	$672,909	26.6	%	$664,701	27.1	%
Medical Office	157,852	6.2	%	145,390	5.9	%
Retail	563,801	22.2	%	564,023	23.0	%
Industrial/Warehouse	626,743	24.7	%	610,279	24.8	%
Hotel	151,834	6.0	%	155,594	6.4	%
Apartment	136,764	5.4	%	122,854	5.0	%
Mixed use/other	225,768	8.9	%	192,203	7.8	%
	$2,535,671	100.0	%	$2,455,044	100.0	%
Loan loss allowance	(7,212	)		(5,266	)	
	2,528,459			2,449,778		

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At September 30, 2010, we had commitments to fund commercial mortgage loans totaling $23.4 million, with fixed

interest rates ranging from 6.00% to 6.38%.

During three months ended September 30, 2010, three mortgage loans were satisfied by taking ownership of the real estate serving as collateral on the loans. These loans had a total principal amount outstanding totaling $6.9 million, for which a specific loan loss allowance of $3.8 million was established and recognized in 2009. During the nine months ended September 30, 2010, five mortgage loans were satisfied by taking ownership of the real estate serving as collateral on the loans, which had a total principal amount outstanding of $11.7 million, for which specific loan loss allowances totaling $4.3 million were established and recognized during the nine months ended September 30, 2010. Additional impairment of $0.6 million was recognized on two properties that were taken as settlement of the mortgage loans they supported. The properties were revalued by a third party appraiser and the fair value less the estimated costs to sell was less than the carrying value of the properties. We increased the allowance for credit losses on our mortgage loans by $1.0 million and $6.2 million during the three and nine months ended September 30, 2010, respectively, and $5.5 million and $6.5 million during the three and nine months ended September 30, 2009, respectively.

At September 30, 2010, we have three mortgage loans that are in the process of being satisfied by our taking ownership of the real estate serving as collateral on the loan. These three loans have an outstanding principal balance of $10.7 million, and we have recorded a specific loan loss allowances totaling $4.3 million, with $4.1 million of that loss recognized during the first quarter of 2010. We also have 20 commercial mortgage loans at September 30, 2010 with an outstanding principal balance of $62.0 million (2% of the commercial mortgage loan portfolio) that have been given "workout" terms which generally allow for interest only payments or the capitalization of interest for a specified period of time and we have recorded a specific loan loss allowance on one of these loans (principal balance of $5.7 million) of $1.0 million. At September 30, 2010, we have 7 commercial mortgage loans with an outstanding principal balance of $24.7 million that were delinquent (60 days or more at the reporting date) in their principal and interest payments and we have recorded a specific loan loss allowance on one of these loans (principal balance of $5.9 million) of $0.2 million..

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified and an analysis of the mortgage loan portfolio for the need for a general loan allowance for probable losses on all other loans. 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. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions. Based upon this process and analysis, we increased our general loan loss allowance by $0.6 million to $1.7 million during the third quarter of 2010. The $1.7 million general loan loss allowance was recorded during the nine months ended September 30, 2010.

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 and loans delinquent for 60 days or more at the reporting date).

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans with allowances	$22,206	$15,869
Mortgage loans with no allowance for losses	75,150	70,214
Allowance for probable loan losses	(7,212)	(5,266)
Net carrying value	$90,144	$80,817

Derivative Instruments

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

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

52

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

	September 30, 2010	December 31, 2009
	(Dollars in thousands)	
Assets		
Derivative Instruments		
Call options	$283,920	$479,272
Other assets		
2015 notes hedges	38,483	—
	$322,403	$479,272
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$1,706,262	$1,375,866
Other liabilities		
2015 notes embedded conversion derivative	38,483	—
Interest rate swaps	2,531	1,891
	$1,747,276	$1,377,757

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in thousands)			
Revenues				
Change in fair value of derivatives:				
Call options	$93,109	$123,121	$(31,720)	$110,019
2015 notes hedges (see note 7)	1,483	—	1,483	—
Interest rate swaps	(612)	(1,614)	(2,505)	(1,841)
	$93,980	$121,507	$(32,742)	$108,178
Benefits and expenses				
Change in fair value of embedded derivatives:				
2015 notes embedded conversion derivatives (see note 7)	$1,483	$—	$1,483	$—
Fixed index annuities	113,340	259,737	(12,996)	414,636
	114,823	259,737	(11,513)	414,636

We have fixed index annuity products that guarantee the return of principal to the policyholder and credit interest based on a percentage of the gain in a specified market index. When fixed index annuity deposits are received, a portion of the deposit is used to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to fixed index annuity policyholders. Substantially all such call options are one year options purchased to match the funding requirements of the underlying policies. The call options are marked to fair value with the change in fair value included as a component of revenues. The change in fair value of derivatives includes the gains or losses recognized at the expiration of the option term or upon early termination and the changes in fair value

for open positions. On the respective anniversary dates of the index policies, the index used to compute the annual index credit is reset and we purchase new one-year call options to fund the next annual index credit. We manage the cost of these purchases through the terms of our fixed index annuities, which permit us to change caps, participation rates, and/or asset fees, subject to guaranteed minimums on each policy's anniversary date. By adjusting caps, participation rates, or asset fees, we can generally manage option costs except in cases where the contractual features would prevent further modifications.

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

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

Counterparty	Credit Rating	September 30, 2010 Notional Amount	September 30, 2010 Fair Value	December 31, 2009 Notional Amount	December 31, 2009 Fair Value
		(Dollars in thousands)			
Bank of America	A+	$168,425	$5,679	$796	$—
BNP Paribas	AA	1,003,936	35,416	1,647,627	101,888
Lehman	NR	—	—	1,437	—
Bank of New York	AA-	68,804	434	112,193	6,153
Credit Suisse	A+	1,974,164	41,346	2,711,027	163,321
Barclays	AA-	1,509,386	39,848	258,853	10,082
SunTrust	BBB+	123,722	3,888	427,572	27,735
Wells Fargo	AA	1,792,700	51,941	1,189,234	70,746
J.P. Morgan	AA-	2,918,631	87,563	1,648,394	99,347
UBS	A+	722,114	17,805	—	—
		$10,281,882	$283,920	$7,997,133	$479,272

As of September 30, 2010 and December 31, 2009, we held $188.7 million and $346.1 million, respectively, of cash and cash equivalents received from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $102.2 million and $149.5 million at September 30, 2010 and December 31, 2009, respectively.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. All options purchased from affiliates of Lehman had expired as of September 30, 2010. The amount of option proceeds due on expired options which had been purchased from Lehman that we did not receive payment on was $2.6 million for the third quarter 2009 and $12.0 million for the nine months ended September 30, 2009. No amount has been recognized for any recovery of these amounts that may result from our claim in Lehman's bankruptcy proceedings.

Liquidity and Capital Resources

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were $1.7 billion in the nine months ended September 30, 2010 compared to $1.4 billion for the nine months ended September 30, 2009, with the increase attributable to a $448.9 million increase in net annuity deposits after coinsurance and a $139.6 million (after coinsurance) increase in funds returned to policyholders. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed maturity securities and fixed rate commercial mortgage loans. As reported above under Financial Condition - Investments, during first nine months of 2010 we experienced a significant amount of calls of United States Government sponsored agency securities. As a result we have had elevated levels of short-term investments and cash and cash equivalents during the first nine months of 2010. We have been reinvesting the proceeds from the called securities in United States Government sponsored agencies, securities, investment grade corporate fixed maturity securities and United States municipalities, states and territories securities with yields that meet our investment spread objectives. The accelerated pace of these calls is expected to continue in the fourth quarter of 2010 and may continue beyond 2010. At September 30, 2010, 14% ($2.0 billion) of our fixed income securities are subject to call redemption during the fourth quarter of 2010 and another 18% ($2.5 billion) will become subject to call redemption during the

first three quarters of 2011. If interest rates remain unchanged at current levels we expect these amounts to be called. Our ability to continue to reinvest the proceeds from called securities in assets with acceptable credit quality and yield characteristics similar to the called securities will be dependent on future market conditions.

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. 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. The ability to pay such dividends and to make such other payments is limited by applicable laws and regulations of the states in which our subsidiaries are domiciled, which subject our 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. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from A.M. Best. Given recent economic events that have affected the insurance industry, both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries.

The statutory capital and surplus of our life insurance subsidiaries at September 30, 2010 was $1.4 billion. American Equity Investment Life Insurance Company (American Equity Life) made surplus note interest payments to us of $3.1 million during the nine months ended September 30, 2010. For the remainder of 2010, up to $167.5 million can be distributed by American Equity Life as dividends under applicable laws and regulations without prior regulatory approval. Dividends 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 $435.4 million of statutory earned surplus at September 30, 2010. The transfer of funds by American Equity Life is also restricted by a covenant in our revolving line of credit which requires American Equity Life to maintain a minimum risk-based capital ratio of 200%.

We have a $150 million line of credit which was fully drawn as of the beginning of the third quarter of 2010. In September 2010, we issued $200.0 million principal amount of the 2015 notes. Concurrently with the issuance of the 2015 notes, we entered into the 2015 notes hedges to reduce the potential cash outlay from the expected conversion of the 2015 notes. In separate transactions, we sold the 2015 warrants. The 2015 notes, 2015 notes hedges and 2015 warrants produced net cash proceeds of $171.9 million. We used $150.0 million of these proceeds to pay off the amount drawn on our line of credit. In December 2009, we issued $115.8 million of convertible senior notes, of which $52.2 million was issued for cash. All of the cash proceeds from issuing these convertible senior notes are being used for working capital and general corporate purposes. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution under a currently effective shelf registration statement on Form S-3. The terms of any offering would be established at the time of the offering, subject to market conditions.

As part of our investment strategy, we enter into securities repurchase agreements (short-term collateralized borrowings). These borrowings are collateralized by investment securities with fair values approximately equal to the amount due. We currently have no amount borrowed through these repurchase agreements and have had no amounts borrowed during the current year. The maximum amount borrowed during 2009 was $440.0 million. When we do borrow cash on these repurchase agreements, we pledge collateral in the form of debt securities and we use the cash to purchase debt securities ahead of the time we collect the cash from selling annuity policies to avoid a lag between the investment of funds and the obligation to credit interest to policyholders.

On August 20, 2009, we entered into distribution agreements with Fox-Pitt Kelton Cochran Caronia Waller (USA) LLC (“FPK”) and Sandler O’Neill & Partners, L.P. ("Sandler O'Neill"). On December 3, 2009, Macquarie Capital (USA) Inc. ("Macquarie Capital") assumed all of FPK's rights and obligations under our distribution agreement with FPK. Under the distribution agreements, we can offer and sell shares of our common stock up to an aggregate offering price of $50 million. On August 4, 2010, we provided notice to Macquarie Capital and Sandler O'Neill that we were terminating the distribution agreements. From October 1, 2009 through August 4, 2010, we did not sell any shares of our common stock pursuant to these distribution agreements. From August 20, 2009 through September 30, 2009, we sold 132,300 shares of our common stock, resulting in gross proceeds to us of $1.1 million.

New Accounting Pronouncements

In January 2010, the FASB issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity will be required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. This guidance will be effective on January 1, 2011, and we do not expect the adoption to have a material impact on our consolidated financial statements.

In July 2010, the FASB issued an accounting standards update that expands disclosures and provide users more transparency about allowances for credit losses and the credit quality of the financing receivables of an entity. This guidance requires additional disclosures about an entity's financing receivables, such as credit quality indicators, aging of past due financing receivables, and significant purchases and sales of financing receivables. In addition, disclosures must be disaggregated by portfolio segment or class based on how an entity develops its allowance for credit losses and how it manages its credit exposure. Most of the disclosure requirements are effective for the fourth quarter of 2010 with certain additional disclosures required for the first quarter of 2011. We are currently evaluating the impact of this guidance on our consolidated financial statements.

In October 2010, as a result of a consensus of the FASB Emerging Issues Task Force, the FASB issued an accounting standards update that modifies the definition of the types of costs incurred that can be capitalized in the acquisition of new and renewal insurance contracts. This guidance defines the costs that qualify for deferral as incremental direct costs that result directly from and are essential to successful contract transactions and would not have been incurred by the insurance entity had the contract transactions not occurred. In addition, it lists certain costs as deferrable as those that are directly related to underwriting, policy issuance and processing, medical and inspection, and sales force contract selling as deferrable, as well as the portion of an employee's total compensation related directly to time spent performing those activities for actual acquired contracts and other costs related directly to those activities that would not have been incurred if the contract had not been acquired. This amendment to current GAAP should be applied prospectively and is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with retrospective application permitted. We are currently evaluating the impact of the guidance on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs: and (vi) other factors. An OTTI shall be considered to have occurred when we have an intention to sell available for sale securities in an unrealized loss position. If we do not intend to sell a debt security, we consider all available evidence to make an assessment of whether it is more likely than not that we will be required to sell the security before the recovery of its amortized cost basis. If it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, an OTTI will be considered to have occurred. We have a portfolio of held for investment securities which consists principally of long duration bonds issued by U.S. government agencies. These securities are purchased to secure long-term yields which meet our spread targets and support the underlying liabilities.

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate subordinated debentures. Our floating rate trust preferred securities issued by Trust III, IV, VII, VIII, IX, X, XI (beginning on December 31, 2010) and XII bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was $144.5 million at September 30, 2010, of which $20 million had been swapped to fixed rates (see note 5 to our unaudited consolidated financial statements in Item 1 of this Form 10-Q). The applicable interest rate on our borrowings under our revolving line of credit is floating at LIBOR plus 0.80% or the greater of prime rate or federal funds rate plus 0.50%, as elected by us. In 2009, we swapped the floating interest rate to fixed rates for the $150 million of the borrowings outstanding on our revolving line of credit. The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (caps, participation rates or asset fee rates for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

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

If interest rates were to increase 10% (37 basis points) from levels at September 30, 2010, we estimate that the fair value of our fixed maturity securities would decrease by approximately $433.5 million. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be a decrease of $126.3 million in the accumulated other comprehensive income and a decrease in stockholders' equity. The computer models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

At September 30, 2010, 40% of our fixed income securities have call features and 14% ($2.0 billion) are subject to call redemption during the fourth quarter of 2010. Another 18% ($2.5 billion) will become subject to call redemption during the first three quarters of 2011. During the nine months ended September 30, 2010 and 2009, we received $4.0 billion and $3.6 billion, respectively, in redemption proceeds related to the exercise of such call options. We have reinvestment risk related to these redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to the redeemed bonds. Such reinvestment risk typically occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on annuity liabilities, we have the ability to reduce crediting rates (caps, participation rates or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At September 30, 2010, approximately 99% of our annuity liabilities were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies.

We purchase call options on the applicable indices to fund the annual index credits on our fixed index annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for fixed index products. For the nine months ended September 30, 2010 and 2009, the annual index credits to policyholders on their anniversaries were $381.4 million and $25.3 million, respectively. Proceeds received at expiration of these options related to such credits were $364.3 million and $5.7 million for the nine months ended September 30, 2010 and 2009, respectively. The difference between proceeds received at expiration of these options and index credits is primarily due to credits attributable to minimum guaranteed interest self funded by us. Proceeds for the nine months ended September 30, 2009 were adversely affected by $12.0 million in proceeds not received from affiliates of Lehman Brothers which declared bankruptcy in the third quarter of 2008.

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15 and 15d-15, our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective as of September 30, 2010 in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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 Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), the Department of Labor, and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, the Employee Retirement Income Security Act of 1974, as amended, and laws governing the activities of broker-dealers.

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in two purported class action lawsuits alleging improper sales practices and similar claims as described below. It is often not possible to determine the ultimate outcome of pending legal proceedings or to provide reasonable ranges of potential losses with any degree of certainty. One of the lawsuits referred to below is in the initial trial phase while the other is in the pre-litigation and discovery stages and we do not have sufficient information to make an assessment of the plaintiffs' claims for liability or damages. The plaintiffs are seeking undefined amounts of damages or other relief, including punitive damages, which are difficult to quantify and cannot be estimated based on the information currently available. We do not believe that these lawsuits, including those discussed below, will have a material adverse effect on our financial position, results of operations or cash flows. However, there can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

We are a defendant in two cases, including (i) Stephens v. American Equity Investment Life Insurance Company, et. al., in the San Luis Obispo Superior Court, San Francisco, California (complaint filed November 29, 2004) (the "SLO Case") and (ii) McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation, in the United States District Court for the Central District of California, Western Division (complaint filed September 7, 2005) (the "Los Angeles Case").

The plaintiffs in the SLO Case represent a class of individuals who are California residents and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. The named plaintiffs in this case are: Chalys M. Stephens and John P. Stephens. Plaintiffs seek injunctive relief and restitution on behalf of all class members under California Business & Professions Code section 17200 et seq.; compensatory damages for breach of contract and breach of fiduciary duty; other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq.; and punitive damages under common law causes of action for fraud and breach of the covenant of good faith and fair dealing. We are vigorously defending the underlying allegations and may seek to decertify the entire class after further discovery into the merits of the case and during the initial trial phase. Trial in this matter began November 1, 2010.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek recessionary and injunctive relief including restitution and disgorgement of profits on

behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. We are vigorously defending against both class action status as well as the underlying claims.

Item 1A. Risk Factors

Our 2009 Annual Report on Form 10-K and Exhibit 99.2 of our Form 8-K filed on September 20, 2010 described our Risk Factors.

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

There were no issuer purchases of equity securities for the quarter ended September 30, 2010.

We have a Rabbi Trust, the NMO Deferred Compensation Trust, which purchases our common shares to fund the amount of shares earned by our agents under the NMO Deferred Compensation Plan. At September 30, 2010, agents had earned 81,745 shares which had vested but had not yet been purchased and contributed to the Rabbi Trust.

In addition, we have a share repurchase program under which we are authorized to purchase up to 10,000,000 shares of our common stock. As of September 30, 2010, we have repurchased 3,845,296 shares of our common stock under this program. We suspended the repurchase of our common stock under this program in August of 2008.

The maximum number of shares that may yet be purchased under these plans is 6,236,449 at September 30, 2010.

Item 6. Exhibits

(a) Exhibits:

10.2	Short-Term Performance Incentive Plan
12.1	Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

Date: November 9, 2010

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

By: /s/ Wendy C. Waugaman
Wendy C. Waugaman, President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ John M. Matovina
John M. Matovina, Vice Chairman, Chief Financial Officer and Treasurer
(Principal Financial Officer)

By: /s/ Ted M. Johnson
Ted M. Johnson, Vice President - Controller
(Principal Accounting Officer)

60