AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
May 10, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________
Commission File Number : 001-31911
American Equity Investment Life Holding Company
(Exact name of registrant as specified in its charter)

Iowa	42-1447959
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6000 Westown Parkway
West Des Moines, Iowa 50266
(Address of principal executive offices, including zip code)
(515) 221-0002
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer," “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

APPLICABLE TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of May 4, 2016, there were 82,283,325 shares of the registrant's common stock, $1 par value, outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2016 (Unaudited)	December 31, 2015
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2016 - $36,696,786; 2015 - $35,823,710)	$38,410,000	$36,421,839
Held for investment, at amortized cost (fair value: 2016 - $67,672; 2015 - $65,377)	76,672	76,622
Equity securities, available for sale, at fair value (cost: 2016 - $7,517; 2015 - $7,515)	7,813	7,828
Mortgage loans on real estate	2,471,435	2,435,257
Derivative instruments	387,469	337,256
Other investments	290,556	291,530
Total investments	41,643,945	39,570,332
Cash and cash equivalents	707,177	397,749
Coinsurance deposits	3,586,871	3,187,470
Accrued investment income	393,333	362,104
Deferred policy acquisition costs	2,667,185	2,905,136
Deferred sales inducements	2,047,763	2,232,148
Deferred income taxes	101,098	232,683
Income taxes recoverable	9,026	29,599
Other assets	106,538	112,171
Total assets	$51,262,936	$49,029,392
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	$47,456,425	$45,495,431
Other policy funds and contract claims	314,068	324,850
Notes payable	393,482	393,227
Subordinated debentures	241,550	241,452
Other liabilities	623,095	629,897
Total liabilities	49,028,620	47,084,857
Stockholders' equity:		
Preferred stock, par value $1 per share, 2,000,000 shares authorized, 2016 and 2015 - no shares issued and outstanding	—	—
Common stock, par value $1 per share, 200,000,000 shares authorized; issued and outstanding: 2016 - 82,155,327 shares (excluding 3,198,805 treasury shares); 2015 - 81,354,079 shares (excluding 3,448,750 treasury shares)	82,155	81,354
Additional paid-in capital	635,732	630,367
Accumulated other comprehensive income	530,119	201,663

Retained earnings	986,310	1,031,151
Total stockholders' equity	2,234,316	1,944,535
Total liabilities and stockholders' equity	$51,262,936	$49,029,392

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31, 2016	2015
Revenues:		
Premiums and other considerations	$7,345	$6,997
Annuity product charges	36,505	28,682
Net investment income	450,826	399,669
Change in fair value of derivatives	(74,065)	(31,100)
Net realized gains (losses) on investments, excluding other than temporary impairment ("OTTI") losses	2,687	4,879
OTTI losses on investments:		
Total OTTI losses	(6,018)	(132)
Portion of OTTI losses recognized in (from) other comprehensive income	324	—
Net OTTI losses recognized in operations	(5,694)	(132)
Total revenues	417,604	408,995
Benefits and expenses:		
Insurance policy benefits and change in future policy benefits	9,109	9,220
Interest sensitive and index product benefits	97,671	282,825
Amortization of deferred sales inducements	27,479	10,953
Change in fair value of embedded derivatives	265,857	51,213
Interest expense on notes payable	6,880	7,339
Interest expense on subordinated debentures	3,168	3,016
Amortization of deferred policy acquisition costs	49,713	14,286
Other operating costs and expenses	26,830	21,122
Total benefits and expenses	486,707	399,974
Income (loss) before income taxes	(69,103)	9,021
Income tax expense (benefit)	(24,262)	3,118
Net income (loss)	$(44,841)	$5,903
Earnings (loss) per common share	$(0.55)	$0.08
Earnings (loss) per common share - assuming dilution	$(0.55)	$0.07
Weighted average common shares outstanding (in thousands):		
Earnings (loss) per common share	82,129	77,042
Earnings (loss) per common share - assuming dilution	82,961	79,118

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net income (loss)	$(44,841)	$5,903
Other comprehensive income:		
Change in net unrealized investment gains/losses (1)	505,348	264,113
Noncredit component of OTTI losses (1)	(147)	—
Reclassification of unrealized investment gains/losses to net income (loss) (1)	116	1,019
Other comprehensive income before income tax	505,317	265,132
Income tax effect related to other comprehensive income	(176,861)	(92,795)
Other comprehensive income	328,456	172,337
Comprehensive income	$283,615	$178,240

(1) Net of related adjustments to amortization of deferred sales inducements and deferred policy acquisition costs.

See accompanying notes to unaudited consolidated financial statements.

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

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders' Equity
Balance at December 31, 2015	$ 81,354	$ 630,367	$ 201,663	$ 1,031,151	$ 1,944,535
Net loss for period	—	—	—	(44,841)	(44,841)
Other comprehensive income	—	—	328,456	—	328,456
Share-based compensation, including excess income tax benefits	—	2,674	—	—	2,674
Issuance of 721,349 shares of common stock under compensation plans, including excess income tax benefits	721	2,771	—	—	3,492
Issuance of 79,899 shares of common stock to settle warrants that have reached their expiration	80	(80)	—	—	—
Balance at March 31, 2016	$ 82,155	$ 635,732	$ 530,119	$ 986,310	$ 2,234,316
Balance at December 31, 2014	$ 76,062	$ 513,218	$ 721,401	$ 829,195	$ 2,139,876
Net income for period	—	—	—	5,903	5,903
Other comprehensive income	—	—	172,337	—	172,337
Share-based compensation, including excess income tax benefits	—	4,515	—	—	4,515
Issuance of 618,880 shares of common stock under compensation plans, including excess income tax benefits	619	3,470	—	—	4,089
Balance at March 31, 2015	$ 76,681	$ 521,203	$ 893,738	$ 835,098	$ 2,326,720

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31, 2016	2015
Operating activities		
Net income (loss)	$(44,841)	$ 5,903
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Interest sensitive and index product benefits	97,671	282,825
Amortization of deferred sales inducements	27,479	10,953
Annuity product charges	(36,505)	(28,682)
Change in fair value of embedded derivatives	265,857	51,213
Increase in traditional life and accident and health insurance reserves	(858)	(868)
Policy acquisition costs deferred	(156,934)	(121,822)
Amortization of deferred policy acquisition costs	49,713	14,286
Provision for depreciation and other amortization	875	1,267
Amortization of discounts and premiums on investments	(3,103)	(1,428)
Realized gains/losses on investments and net OTTI losses recognized in operations	3,007	(4,747)
Change in fair value of derivatives	73,657	30,636
Deferred income taxes	(45,276)	(22,541)
Share-based compensation	2,234	1,687
Change in accrued investment income	(31,229)	(31,682)
Change in income taxes recoverable/payable	20,573	22,542
Change in other assets	(1,164)	(918)
Change in other policy funds and contract claims	(12,544)	(14,171)
Change in collateral held for derivatives	(26,754)	(326,248)
Change in other liabilities	(38,041)	(7,113)
Other	(2,205)	(1,307)
Net cash provided by (used in) operating activities	141,612	(140,215)
Investing activities		
Sales, maturities, or repayments of investments:		
Fixed maturity securities - available for sale	581,647	276,734
Mortgage loans on real estate	84,248	109,846
Derivative instruments	6,747	214,667
Other investments	4,274	7,218
Acquisition of investments:		
Fixed maturity securities - available for sale	(1,383,082)	(1,434,934)
Mortgage loans on real estate	(118,009)	(104,793)
Derivative instruments	(130,608)	(124,948)
Other investments	(1,046)	(3,385)
Purchases of property, furniture and equipment	(244)	(295)
Net cash used in investing activities	(956,073)	(1,059,890)

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

	Three Months Ended March 31,	
	2016	2015
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	$2,089,739	$1,307,792
Coinsurance deposits	(378,412)	(33,061)
Return of annuity policyholder account balances	(581,260)	(492,242)
Proceeds from amounts due under repurchase agreements	—	15,075
Excess tax benefits realized from share-based compensation plans	440	2,828
Proceeds from issuance of common stock	3,740	4,089
Change in checks in excess of cash balance	(10,358)	(12,126)
Net cash provided by financing activities	1,123,889	792,355
Increase (decrease) in cash and cash equivalents	309,428	(407,750)
Cash and cash equivalents at beginning of period	397,749	701,514
Cash and cash equivalents at end of period	$707,177	$293,764
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$16,278	$16,580
Income taxes	200	114
Non-cash operating activity:		
Deferral of sales inducements	107,673	93,591
Non-cash financing activities:		
Common stock issued to settle warrants that have expired	80	—

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2016
(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 month period ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ended December 31, 2016. 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, 2015.

Adopted Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Subsequently, in August 2015, the FASB issued an ASU that states that the Securities and Exchange Commission staff would not object to an entity deferring and presenting debt issuance costs related to line-of-credit arrangements as an asset and expensing those costs ratably over the term of the line of credit arrangement. These ASU's became effective for us on January 1, 2016, and retroactive application is required. They did not have a material impact on our consolidated financial statements.

New Accounting Pronouncements

In January 2016, the FASB issued an ASU that, among other aspects of recognition, measurement, presentation and disclosure of financial instruments, primarily requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This ASU will be effective for us on January 1, 2018, and we have not determined the effect it will have on our consolidated financial statements.

In February 2016, the FASB issued an ASU that will require recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU affects accounting and disclosure more dramatically for lessees as accounting for lessors is mainly unchanged. This ASU will be effective for us on January 1, 2019, with early adoption permitted, and we have not determined the effect it will have on our consolidated financial statements.

In March 2016, the FASB issued an ASU related to the accounting for share-based payment transactions. The aspects of accounting guidance affected by this ASU are income taxes, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This ASU will be effective for us on January 1, 2017, with early adoption permitted, and we have not determined the effect it will have on our consolidated financial statements.

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2. Fair Values of Financial Instruments

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

	March 31, 2016		December 31, 2015	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$38,410,000	$38,410,000	$36,421,839	$36,421,839
Held for investment	76,672	67,672	76,622	65,377
Equity securities, available for sale	7,813	7,813	7,828	7,828
Mortgage loans on real estate	2,471,435	2,504,371	2,435,257	2,471,864
Derivative instruments	387,469	387,469	337,256	337,256
Other investments	285,200	288,303	285,044	290,075
Cash and cash equivalents	707,177	707,177	397,749	397,749
Coinsurance deposits	3,586,871	3,220,784	3,187,470	2,860,882
Interest rate caps	740	740	1,410	1,410
Counterparty collateral	85,477	85,477	82,312	82,312
Liabilities				
Policy benefit reserves	47,113,312	39,941,007	45,151,460	38,435,515
Single premium immediate annuity (SPIA) benefit reserves	313,559	325,251	324,264	336,066
Notes payable	393,482	411,252	393,227	417,752
Subordinated debentures	241,550	212,638	241,452	216,933
Interest rate swap	5,375	5,375	3,139	3,139

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

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

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

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

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

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security. There were no transfers between levels during any period presented.

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Our assets and liabilities which are measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015 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)			
March 31, 2016				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$473,402	$441,625	$31,777	$ —
United States Government sponsored agencies	1,566,287	—	1,566,287	—
United States municipalities, states and territories	3,883,737	—	3,883,737	—
Foreign government obligations	221,861	—	221,861	—
Corporate securities	25,168,468	9	25,168,459	—
Residential mortgage backed securities	1,432,353	—	1,432,353	—
Commercial mortgage backed securities	4,503,261	—	4,503,261	—
Other asset backed securities	1,160,631	—	1,160,631	—
Equity securities, available for sale: finance, insurance and real estate	7,813	—	7,813	—
Derivative instruments	387,469	—	387,469	—
Cash and cash equivalents	707,177	707,177	—	—
Interest rate caps	740	—	740	—
Counterparty collateral	85,477	—	85,477	—
	$39,598,676	$1,148,811	$38,449,865	$ —
Liabilities				
Interest rate swap	$5,375	$—	$5,375	$ —
Fixed index annuities - embedded derivatives	6,254,466	—	—	6,254,466
	$6,259,841	$—	$5,375	$ 6,254,466
December 31, 2015				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$471,256	$438,598	$32,658	$ —
United States Government sponsored agencies	1,398,611	—	1,398,611	—
United States municipalities, states and territories	3,755,367	—	3,755,367	—
Foreign government obligations	212,565	—	212,565	—
Corporate securities	23,802,394	121	23,802,273	—
Residential mortgage backed securities	1,462,072	—	1,462,072	—
Commercial mortgage backed securities	4,174,396	—	4,174,396	—
Other asset backed securities	1,145,178	—	1,145,178	—
Equity securities, available for sale: finance, insurance and real estate	7,828	—	7,828	—
Derivative instruments	337,256	—	337,256	—
Cash and cash equivalents	397,749	397,749	—	—
Interest rate caps	1,410	—	1,410	—

Counterparty collateral	82,312	—	82,312	—
	$37,248,394	$836,468	$36,411,926	$ —
Liabilities				
Interest rate swap	$3,139	$—	$3,139	$ —
Fixed index annuities - embedded derivatives	5,983,622	—	—	5,983,622
	$5,986,761	$—	$3,139	$ 5,983,622

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

Fixed maturity securities and equity securities

The fair values of fixed maturity securities and equity securities in an active and orderly market are determined by utilizing independent pricing services. The independent pricing services incorporate a variety of observable market data in their valuation techniques, including:

- reported trading prices,
- benchmark yields,
- broker-dealer quotes,
- benchmark securities,
- bids and offers,
- credit ratings,
- relative credit information, and
- other reference data.

The independent pricing services also take into account perceived market movements and sector news, as well as a security's terms and conditions, including any features specific to that issue that may influence risk and marketability. Depending on the security, the priority of the use of observable market inputs may change as some observable market inputs may not be relevant or additional inputs may be necessary.

The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. When quoted market prices are not available, the third parties use yield data and other factors relating to instruments or securities with similar characteristics to determine fair value for securities that are not actively traded. We generally obtain one value from our primary external pricing service. In situations where a price is not available from this service, we may obtain further quotes or prices from additional parties as needed. In addition, for our callable United States Government sponsored agencies, we obtain multiple broker quotes and take the average of the broker prices received. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of March 31, 2016 and December 31, 2015.

Mortgage loans on real estate

Mortgage loans on real estate are not measured at fair value on a recurring basis. The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using current competitive market interest rates currently being offered for similar loans. The fair values of impaired mortgage loans on real estate that we have considered to be collateral dependent are based on the fair value of the real estate collateral (based on appraised values) less estimated costs to sell. The inputs utilized to determine fair value of all mortgage loans are unobservable market data (competitive market interest rates and appraised property values); therefore, fair value of mortgage loans falls into Level 3 in the fair value hierarchy.

Derivative instruments

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

Other investments

None of the financial instruments included in other investments are measured at fair value on a recurring basis. Financial instruments included in other investments are policy loans, equity method investments and company owned life insurance (COLI). We have not attempted to determine the fair values associated with our policy loans, as we believe any differences between carrying value and the fair values afforded these instruments are immaterial to our consolidated financial position and, accordingly, the cost to provide such disclosure does not justify the benefit to be derived. The fair value of our equity method investments qualify as Level 3 fair values and were determined by calculating the present value of future cash flows discounted by a risk free rate, a risk spread and a liquidity discount. The risk spread and liquidity discount are rates determined by our investment professionals and are unobservable market inputs. The fair value of our COLI approximates the cash surrender value of the policies and whose fair values fall within Level 2 of the fair value hierarchy.

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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.

Interest rate swap and caps

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

Counterparty collateral

Amounts reported in other assets on 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.

Policy benefit reserves, coinsurance deposits and SPIA benefit reserves

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. For period-certain annuity benefit contracts, the fair value is determined by discounting the benefits at the interest rates currently in effect for newly purchased immediate annuity contracts. 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. Policy benefit reserves, coinsurance deposits and SPIA benefit reserves are not measured at fair value on a recurring basis. All of the fair values presented within these categories fall within Level 3 of the fair value hierarchy as most of the inputs are unobservable market data.

Notes payable

The fair values of our senior unsecured notes are based upon pricing matrices developed by a third party pricing service when quoted market prices are not available and are categorized as Level 2 within the fair value hierarchy. Notes payable are not remeasured at fair value on a recurring basis.

Subordinated debentures

Fair values for subordinated debentures are estimated using discounted cash flow calculations based principally on observable inputs including our incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued. These fair values are categorized as Level 2 within the fair value hierarchy. Subordinated debentures are not measured at fair value on a recurring basis.

Fixed index annuities - embedded derivatives

We estimate the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves 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.

Within this determination we have the following significant unobservable inputs: 1) the expected cost of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary and 2) our best estimates for future policy decrements, primarily lapse, partial withdrawal and mortality rates. As of March 31, 2016 and December 31, 2015, we utilized an estimate of 3.10% and 3.10%, respectively, for the expected cost of annual call options, which are based on estimated account value growth and a historical review of our actual option costs.

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Our best estimate assumptions for lapse, partial withdrawal and mortality rates are based on our actual experience and our outlook as to future expectations for such assumptions. These assumptions, which are consistent with the assumptions used in calculating deferred policy acquisition costs and deferred sales inducements, are reviewed on a quarterly basis and are revised as our experience develops and/or as future expectations change. Our mortality rate assumptions are based on 65% of the 1983 Basic Annuity Mortality Tables. The following table presents average lapse rate and partial withdrawal rate assumptions, by contract duration, used in estimating the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves at each reporting date:

Contract Duration (Years)	Average Lapse Rates		Average Partial Withdrawal Rates	
	Three Months Ended March 31, 2016	Year Ended December 31, 2015	Three Months Ended March 31, 2016	Year Ended December 31, 2015
1 - 5	1.77%	1.58%	3.29%	3.08%
6 - 10	6.60%	8.55%	3.30%	3.55%
11 - 15	11.24%	12.01%	3.31%	3.59%
16 - 20	12.03%	12.99%	3.17%	3.22%
20+	11.68%	12.54%	3.17%	3.22%

Lapse rates are generally expected to increase as surrender charge percentages decrease. Lapse expectations reflect a significant increase in the year in which the surrender charge period on a contract ends.

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 months ended March 31, 2016 and 2015:

	Three Months Ended March 31, 2016	2015
	(Dollars in thousands)	
Available for sale securities		
Beginning balance	$ —	$ 375
Principal returned	—	(12)
Amortization of premium/accretion of discount	—	(57)
Total gains (losses) (realized/unrealized):		
Included in other comprehensive income	—	36
Included in operations	—	—
Ending balance	$ —	$ 342

The Level 3 assets included in the table above are not material to our financial position, results of operations or cash flows, and it is management's opinion that the sensitivity of the inputs used in determining the fair value of these assets is not material as well.

	Three Months Ended March 31, 2016	2015
	(Dollars in thousands)	
Fixed index annuities - embedded derivatives		
Beginning balance	$5,983,622	$5,574,653
Premiums less benefits	91,129	360,395
Change in fair value, net	179,715	(69,877)
Ending balance	$6,254,466	$5,865,171

Change in fair value, 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.

Certain derivatives embedded in our fixed index annuity contracts are our most significant financial instrument measured at fair value that are categorized as Level 3 in the fair value hierarchy. The contractual obligations for future annual index credits within our fixed index annuity contracts are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We estimate the fair value of these embedded derivatives at each valuation date by the method described above under fixed index annuities - embedded derivatives. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

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The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at March 31, 2016, were to increase by 100 basis points, the fair value of the embedded derivatives would decrease by $441.0 million recorded through operations as a decrease in the change in fair value of embedded derivatives and there would be a corresponding decrease of $262.6 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as an increase in amortization of deferred policy acquisition costs and deferred sales inducements. A decrease by 100 basis points in the discount rate used to discount the excess projected contract values would increase the fair value of the embedded derivatives by $494.3 million recorded through operations as an increase in the change in fair value of embedded derivatives and there would be a corresponding increase of $287.4 million to our combined balance for deferred policy acquisition costs and deferred sales inducements recorded through operations as a decrease in amortization of deferred policy acquisition costs and deferred sales inducements.

3. Investments

At March 31, 2016 and December 31, 2015, 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)			
March 31, 2016				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$469,957	$3,505	$(60)	$473,402
United States Government sponsored agencies	1,519,674	46,980	(367)	1,566,287
United States municipalities, states and territories	3,448,482	437,336	(2,081)	3,883,737
Foreign government obligations	210,964	18,429	(7,532)	221,861
Corporate securities	24,113,794	1,490,814	(436,140)	25,168,468
Residential mortgage backed securities	1,313,775	120,977	(2,399)	1,432,353
Commercial mortgage backed securities	4,472,852	102,466	(72,057)	4,503,261
Other asset backed securities	1,147,288	34,010	(20,667)	1,160,631
	$36,696,786	$2,254,517	$(541,303)	$38,410,000
Held for investment:				
Corporate security	$76,672	$—	$(9,000)	$67,672
Equity securities, available for sale:				
Finance, insurance, and real estate	$7,517	$296	$—	$7,813
December 31, 2015				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$470,567	$988	$(299)	$471,256
United States Government sponsored agencies	1,386,219	26,801	(14,409)	1,398,611
United States municipalities, states and territories	3,422,667	341,328	(8,628)	3,755,367
Foreign government obligations	210,953	12,547	(10,935)	212,565
Corporate securities	23,597,530	887,288	(682,424)	23,802,394
Residential mortgage backed securities	1,366,985	98,576	(3,489)	1,462,072
Commercial mortgage backed securities	4,238,265	41,412	(105,281)	4,174,396
Other asset backed securities	1,130,524	34,534	(19,880)	1,145,178
	$35,823,710	$1,443,474	$(845,345)	$36,421,839

Held for investment:				
Corporate security	$76,622	$—	$(11,245)	$65,377
Equity securities, available for sale:				
Finance, insurance, and real estate	$7,515	$313	$—	$7,828

At March 31, 2016, 32% of our fixed income securities have call features, of which 0.2% ($75.1 million) were subject to call redemption and another 1.2% ($448.0 million) will become subject to call redemption during the next twelve months. Approximately 71% of our fixed income securities that have call features are not callable until within six months of their stated maturities.

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The amortized cost and fair value of fixed maturity securities at March 31, 2016, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives and are shown below as separate lines.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Due in one year or less	$166,640	$170,202	$—	$—
Due after one year through five years	2,643,302	2,774,423	—	—
Due after five years through ten years	10,835,215	11,043,464	—	—
Due after ten years through twenty years	8,715,797	9,407,493	—	—
Due after twenty years	7,401,917	7,918,173	76,672	67,672
	29,762,871	31,313,755	76,672	67,672
Residential mortgage backed securities	1,313,775	1,432,353	—	—
Commercial mortgage backed securities	4,472,852	4,503,261	—	—
Other asset backed securities	1,147,288	1,160,631	—	—
	$36,696,786	$38,410,000	$76,672	$67,672

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

	March 31, 2016	December 31, 2015
	(Dollars in thousands)	
Net unrealized gains on available for sale fixed maturity securities and equity securities	$1,713,510	$598,442
Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements	(932,610)	(322,859)
Deferred income tax valuation allowance reversal	22,534	22,534
Deferred income tax expense	(273,315)	(96,454)
Net unrealized gains reported as accumulated other comprehensive income	$530,119	$201,663

The National Association of Insurance Commissioners (“NAIC”) assigns designations to fixed maturity securities. These designations range from Class 1 (highest quality) to Class 6 (lowest quality). In general, securities are assigned a designation based upon the ratings they are given by the Nationally Recognized Statistical Rating Organizations (“NRSRO’s”). The NAIC designations are utilized by insurers in preparing their annual statutory statements. NAIC Class 1 and 2 designations are considered “investment grade” while NAIC Class 3 through 6 designations are considered “non-investment grade.” Based on the NAIC designations, we had 97% and 98% of our fixed maturity portfolio rated investment grade at March 31, 2016 and December 31, 2015, respectively.

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

	March 31, 2016		December 31, 2015	
NAIC Designation	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
1	$23,648,794	$25,264,168	$23,363,259	$24,207,801
2	11,955,752	12,223,107	11,709,730	11,589,325
3	1,023,746	894,557	758,531	643,293
4	128,238	86,816	60,480	44,312
5	2,100	1,537	—	—
6	14,828	7,487	8,332	2,485

$36,773,458	$38,477,672	$35,900,332	$36,487,216

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The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 730 and 1,246 securities, respectively) have been in a continuous unrealized loss position, at March 31, 2016 and December 31, 2015:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Dollars in thousands)					
March 31, 2016						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$6,803	$(60)	$—	$—	$6,803	$(60)
United States Government sponsored agencies	89,633	(367)	—	—	89,633	(367)
United States municipalities, states and territories	72,441	(946)	21,519	(1,135)	93,960	(2,081)
Foreign government obligations	19,523	(116)	17,200	(7,416)	36,723	(7,532)
Corporate securities:						
Finance, insurance and real estate	763,808	(25,577)	205,317	(18,958)	969,125	(44,535)
Manufacturing, construction and mining	1,597,989	(120,533)	616,441	(140,715)	2,214,430	(261,248)
Utilities and related sectors	969,160	(57,648)	294,026	(38,246)	1,263,186	(95,894)
Wholesale/retail trade	231,211	(6,500)	54,985	(6,543)	286,196	(13,043)
Services, media and other	429,239	(12,617)	120,737	(8,803)	549,976	(21,420)
Residential mortgage backed securities	61,677	(2,372)	1,307	(27)	62,984	(2,399)
Commercial mortgage backed securities	1,613,984	(64,626)	93,864	(7,431)	1,707,848	(72,057)
Other asset backed securities	424,447	(11,702)	51,617	(8,965)	476,064	(20,667)
	$6,279,915	$(303,064)	$1,477,013	$(238,239)	$7,756,928	$(541,303)
Held for investment:						
Corporate security:						
Insurance	$67,672	$(9,000)	$—	$—	$67,672	$(9,000)
December 31, 2015						
Fixed maturity securities:						
Available for sale:						
United States Government full faith and credit	$37,730	$(299)	$—	$—	$37,730	$(299)
United States Government sponsored agencies	957,053	(14,409)	—	—	957,053	(14,409)
United States municipalities, states and territories	261,823	(8,474)	2,846	(154)	264,669	(8,628)
Foreign government obligations	42,966	(1,762)	15,463	(9,173)	58,429	(10,935)
Corporate securities:						
Finance, insurance and real estate	2,077,223	(59,607)	49,912	(14,855)	2,127,135	(74,462)
Manufacturing, construction and mining	3,517,967	(246,456)	376,229	(131,003)	3,894,196	(377,459)
Utilities and related sectors	2,240,652	(138,940)	97,184	(22,565)	2,337,836	(161,505)
Wholesale/retail trade	473,050	(17,863)	38,682	(8,125)	511,732	(25,988)
Services, media and other	1,037,011	(39,937)	32,050	(3,073)	1,069,061	(43,010)
Residential mortgage backed securities	162,770	(2,958)	6,438	(531)	169,208	(3,489)
Commercial mortgage backed securities	2,679,510	(105,002)	11,495	(279)	2,691,005	(105,281)

Other asset backed securities	457,055	(10,581)	46,657	(9,299)	503,712	(19,880)
	$13,944,810	$(646,288)	$676,956	$(199,057)	$14,621,766	$(845,345)
Held for investment:						
Corporate security:						
Insurance	$65,377	$(11,245)	$—	$—	$65,377	$(11,245)

Based on the results of our process for evaluating available for sale securities in unrealized loss positions for other than temporary impairments, which is discussed in detail later in this footnote, we have determined that the unrealized losses on the securities in the preceding table are temporary. The unrealized losses at March 31, 2016 are principally related to timing of the purchases of these securities, which carry less yield than those available at March 31, 2016. In addition, a general widening of credit spreads has occurred in risk asset classes due to economic uncertainty and concerns of prolonged economic weakness.

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The commodity related sectors had a high concentration of gross unrealized losses in our corporate fixed income securities portfolio as of March 31, 2016 and December 31, 2015. Commodity prices, specifically oil, gas and base metals, declined significantly in late 2015, but prices have risen in 2016 to levels that appear sustainable and should support prices and NRSRO ratings longer term. The value of oil has been significantly depressed as the amount of supply from new production has exceeded demand. In addition, iron ore and other key industrial metals have depressed prices as investors perceive the economic slowdown in Asia Pacific will curb demand as supply remains high. The companies in the metal and mining sectors experienced the largest decline in values of their debt in late 2015. In the above table, oil and metals and mining exposure is reflected within the foreign government; manufacturing, construction and mining; and utilities and related sectors. Within these sectors, we continue to monitor the impact to our investment portfolio for those companies that may be adversely affected, both directly and indirectly. Even though the energy holdings and a majority of the metals and mining holdings have seen significant improvements in values as oil and iron ore prices have increased, they could continue to see price volatility and possible downgrades in credit ratings. If oil and commodity prices fall lower and remain at depressed levels for an extended period of time or decline further, certain issuers and investments may come under further stress. At this time, we believe the unrealized losses are temporary due to the fact that the price decline is driven by an over-supply of oil in the energy sector, which we feel is unsustainable long term. Our exposure is in companies that we believe have more financial flexibility and significant operational scale to manage through the downturn. In addition, price declines in the metal and mining sector have been heavily influenced by excess production and softer demand. Companies in the mining sector are more susceptible to rating downgrades and we believe companies will be under continued financial strain if prices decline again. We believe company issuers in our portfolio will be able to meet their debt service obligations.

Approximately 67% and 84% of the unrealized losses on fixed maturity securities shown in the above table for March 31, 2016 and December 31, 2015, respectively, are on securities that are rated investment grade, defined as being the highest two NAIC designations. All of the fixed maturity securities with unrealized losses are current with respect to the payment of principal and interest.

Changes in net unrealized gains on investments for the three months ended March 31, 2016 and 2015 are as follows:

	Three Months Ended March 31,	
	2016	2015
	(Dollars in thousands)	
Fixed maturity securities held for investment carried at amortized cost	$2,245	$7,099
Investments carried at fair value:		
Fixed maturity securities, available for sale	$1,115,085	$520,166
Equity securities, available for sale	(17)	42
	1,115,068	520,208
Adjustment for effect on other balance sheet accounts:		
Deferred policy acquisition costs and deferred sales inducements	(609,751)	(255,076)
Deferred income tax asset/liability	(176,861)	(92,795)