AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-Q
May 08, 2018
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, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________
Commission File Number : 001-31911
American Equity Investment Life Holding Company
(Exact name of registrant as specified in its charter)

Iowa	42-1447959
(State or other jurisdiction of incorporation 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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the 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 2, 2018, there were 90,095,990 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, 2018 (Unaudited)	December 31, 2017
Assets		
Investments:		
Fixed maturity securities:		
Available for sale, at fair value (amortized cost: 2018 - $44,510,813; 2017 - $43,116,759)	$45,551,348	$45,372,989
Held for investment, at amortized cost (fair value: 2018 - $69,441; 2017 - $76,460)	77,043	77,041
Mortgage loans on real estate	2,699,637	2,665,531
Derivative instruments	847,741	1,568,380
Other investments	481,825	616,764
Total investments	49,657,594	50,300,705
Cash and cash equivalents	723,784	1,434,045
Coinsurance deposits	4,871,912	4,858,289
Accrued investment income	454,519	429,008
Deferred policy acquisition costs	3,039,311	2,714,523
Deferred sales inducements	2,219,597	2,001,892
Deferred income taxes	159,601	38,147
Other assets	175,006	254,127
Total assets	$61,301,324	$62,030,736
Liabilities and Stockholders' Equity		
Liabilities:		
Policy benefit reserves	$56,072,140	$56,142,673
Other policy funds and contract claims	280,072	282,884
Notes payable	494,215	494,093
Subordinated debentures	242,667	242,565
Amounts due under repurchase agreements	137,223	—
Income taxes payable	72,191	34,285
Other liabilities	1,455,826	1,984,079
Total liabilities	58,754,334	59,180,579
Stockholders' equity:		
Preferred stock, par value $1 per share, 2,000,000 shares authorized, 2018 and 2017 - no shares issued and outstanding	—	—
Common stock, par value $1 per share, 200,000,000 shares authorized; issued and outstanding: 2018 - 89,983,823 shares (excluding 1,814,460 treasury shares); 2017 - 89,331,087 shares (excluding 2,064,727 treasury shares)	89,984	89,331
Additional paid-in capital	798,835	791,446
Accumulated other comprehensive income	399,982	724,599

Retained earnings	1,258,189	1,244,781
Total stockholders' equity	2,546,990	2,850,157
Total liabilities and stockholders' equity	$61,301,324	$62,030,736

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,	
	2018	2017
Revenues:		
Premiums and other considerations	$9,053	$9,402
Annuity product charges	50,723	43,572
Net investment income	510,784	485,597
Change in fair value of derivatives	(451,083)	386,533
Net realized gains on investments, excluding other than temporary impairment ("OTTI") losses	302	2,338
OTTI losses on investments:		
Total OTTI losses	(907)	—
Portion of OTTI losses recognized in (from) other comprehensive income	—	(141)
Net OTTI losses recognized in operations	(907)	(141)
Total revenues	118,872	927,301
Benefits and expenses:		
Insurance policy benefits and change in future policy benefits	12,094	11,875
Interest sensitive and index product benefits	514,095	419,139
Amortization of deferred sales inducements	100,423	62,325
Change in fair value of embedded derivatives	(867,232)	224,170
Interest expense on notes and loan payable	6,372	7,722
Interest expense on subordinated debentures	3,630	3,336
Amortization of deferred policy acquisition costs	140,639	89,678
Other operating costs and expenses	31,240	27,579
Total benefits and expenses	(58,739)	845,824
Income before income taxes	177,611	81,477
Income tax expense	36,649	27,538
Net income	$140,962	$53,939
Earnings per common share	$1.57	$0.61
Earnings per common share - assuming dilution	$1.55	$0.60
Weighted average common shares outstanding (in thousands):		
Earnings per common share	90,017	88,647
Earnings per common share - assuming dilution	91,139	89,976

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 (LOSS)
(Dollars in thousands)
(Unaudited)

	Three Months Ended March 31,	
	2018	2017
Net income	$140,962	$53,939
Other comprehensive income (loss):		
Change in net unrealized investment gains/losses (1)	(572,033)	129,124
Noncredit component of OTTI losses (1)	—	65
Reclassification of unrealized investment gains/losses to net income (1)	(339)	930
Other comprehensive income (loss) before income tax	(572,372)	130,119
Income tax effect related to other comprehensive income (loss)	120,201	(45,542)
Other comprehensive income (loss)	(452,171)	84,577
Comprehensive income (loss)	$(311,209)	$138,516

(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, 2016	$ 88,001	$ 770,344	$ 339,966	$ 1,093,284	$ 2,291,595
Net income for period	—	—	—	53,939	53,939
Other comprehensive income	—	—	84,577	—	84,577
Share-based compensation	—	2,403	—	—	2,403
Issuance of 629,553 shares of common stock under compensation plans	630	3,087	—	—	3,717
Balance at March 31, 2017	$ 88,631	$ 775,834	$ 424,543	$ 1,147,223	$ 2,436,231
Balance at December 31, 2017	$ 89,331	$ 791,446	$ 724,599	$ 1,244,781	$ 2,850,157
Net income for period	—	—	—	140,962	140,962
Other comprehensive loss	—	—	(452,171)	—	(452,171)
Implementation of accounting standard related to the reclassification of certain tax effects	—	—	127,554	(127,554)	—
Share-based compensation	—	3,526	—	—	3,526
Issuance of 652,736 shares of common stock under compensation plans	653	3,863	—	—	4,516
Balance at March 31, 2018	$ 89,984	$ 798,835	$ 399,982	$ 1,258,189	$ 2,546,990

See accompanying notes to unaudited consolidated financial statements.

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

	Three Months Ended March 31, 2018			2017		
Operating activities						
Net income	$	140,962		$	53,939	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:						
Interest sensitive and index product benefits	514,095			419,139		
Amortization of deferred sales inducements	100,423			62,325		
Annuity product charges	(50,723		)	(43,572		)
Change in fair value of embedded derivatives	(867,232		)	224,170		
Change in traditional life and accident and health insurance reserves	2,049			726		
Policy acquisition costs deferred	(96,562		)	(110,574		)
Amortization of deferred policy acquisition costs	140,639			89,678		
Provision for depreciation and other amortization	900			957		
Amortization of discounts and premiums on investments	6,002			2,800		
Realized gains (losses) on investments and net OTTI losses recognized in operations	605			(2,197		)
Distributions from equity method investments	66			122		
Change in fair value of derivatives	450,906			(386,842		)
Deferred income taxes	(1,253		)	(3,670		)
Share-based compensation	3,526			2,403		
Change in accrued investment income	(25,511		)	(26,371		)
Change in income taxes recoverable/payable	37,906			31,161		
Change in other assets	(470		)	33		
	(4,343		)	(6,985		)

Change in other policy funds and contract claims				
Change in collateral held for derivatives	(784,932	)	233,992	
Change in other liabilities	(6,472	)	(38,754	)
Other	(3,757	)	(4,431	)
Net cash provided by (used in) operating activities	(443,176	)	498,049	
Investing activities				
Sales, maturities, or repayments of investments:				
Fixed maturity securities - available for sale	265,837		517,301	
Mortgage loans on real estate	68,017		75,110	
Derivative instruments	479,675		349,732	
Other investments	153,936		4,868	
Acquisitions of investments:				
Fixed maturity securities - available for sale	(1,310,985	)	(1,216,014	)
Mortgage loans on real estate	(101,037	)	(100,797	)
Derivative instruments	(200,542	)	(147,283	)
Other investments	(15,131	)	(1,550	)
Purchases of property, furniture and equipment	(1,099	)	(1,402	)
Net cash used in investing activities	(661,329	)	(520,035	)

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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,	
	2018	2017
Financing activities		
Receipts credited to annuity and single premium universal life policyholder account balances	$1,020,429	$1,073,583
Coinsurance deposits	(6,867)	63,746
Return of annuity policyholder account balances	(738,219)	(727,494)
Net proceeds from amounts due under repurchase agreements	137,223	—
Proceeds from issuance of common stock	4,516	3,717
Change in checks in excess of cash balance	(22,838)	(10,084)
Net cash provided by financing activities	394,244	403,468
Increase (decrease) in cash and cash equivalents	(710,261)	381,482
Cash and cash equivalents at beginning of period	1,434,045	791,266
Cash and cash equivalents at end of period	$723,784	$1,172,748
Supplemental disclosures of cash flow information		
Cash paid during period for:		
Interest expense	$3,488	$18,682
Income taxes	—	47
Non-cash operating activity:		
Deferral of sales inducements	43,670	65,245

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, 2018
(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, 2018 are not necessarily indicative of the results that may be expected for the year ended December 31, 2018. 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, 2017.

Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") related to revenue arising from contracts with customers. This ASU, which replaces most current revenue recognition guidance, including industry specific guidance, prescribes that an entity should recognize revenue to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. We adopted this ASU on January 1, 2018. The adoption of this ASU had no impact on our consolidated financial statements as revenues related to insurance contracts and investment contracts are excluded from its scope.

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. Additionally, it changes the accounting for financial liabilities measured at fair value under the fair value option and eliminates some disclosures regarding fair value of financial assets and liabilities measured at amortized cost. We adopted this ASU on January 1, 2018. The adoption of this ASU had no impact on our consolidated financial statements.

In August 2016, the FASB issued an ASU that clarifies how certain cash receipts and cash payments are to be presented and classified in the statement of cash flows. We adopted this ASU on January 1, 2018. The adoption of this ASU resulted in a reclassification of certain cash flows related to equity method investment distributions from investing activities to operating activities within our consolidated statements of cash flows.

In February 2018, the FASB issued an ASU that allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 ("Tax Reform"). We adopted this ASU on January 1, 2018. The adoption of this ASU resulted in a reclassification of $128 million between accumulated other comprehensive income and retained earnings within our consolidated balance sheet.

New Accounting Pronouncements

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. We are in the process of evaluating the impact this guidance may have on our consolidated financial statements.

In June 2016, the FASB issued an ASU that significantly changes the impairment model for most financial assets that are measured at amortized cost and certain other instruments from an incurred loss model to an expected loss model that requires these assets be presented at the net amount expected to be collected. In addition, credit losses on available for sale debt securities should be recorded through an allowance account. This ASU will be effective for us on January 1, 2020, with early adoption permitted. While we are still in the process of evaluating the impact this guidance will have on our consolidated financial statements, we believe the new impairment model will lead to earlier recognition of credit losses for our commercial mortgage loans.

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In March 2017, the FASB issued an ASU that applies to certain callable debt securities where the amortized cost basis is at a premium to the price repayable by the issuer at the earliest call date. Under this guidance, the premium will be amortized to the first call date. This ASU will be effective for us on January 1, 2019, with early adoption permitted. We are in the process of evaluating the impact this guidance may have on our consolidated financial statements.

Income Tax Reform

As a result of Tax Reform, the federal corporate tax rate was reduced from 35% to 21% effective January 1, 2018.

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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, 2018		December 31, 2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Assets				
Fixed maturity securities:				
Available for sale	$45,551,348	$45,551,348	$45,372,989	$45,372,989
Held for investment	77,043	69,441	77,041	76,460
Mortgage loans on real estate	2,699,637	2,684,976	2,665,531	2,670,037
Derivative instruments	847,741	847,741	1,568,380	1,568,380
Other investments	481,825	472,642	616,764	605,894
Cash and cash equivalents	723,784	723,784	1,434,045	1,434,045
Coinsurance deposits	4,871,912	4,402,849	4,858,289	4,347,990
Interest rate caps	890	890	415	415
Interest rate swap	427	427	—	—
Counterparty collateral	124,778	124,778	186,108	186,108
Liabilities				
Policy benefit reserves	55,713,429	47,137,678	55,786,011	46,344,931
Single premium immediate annuity (SPIA) benefit reserves	279,678	288,991	282,563	292,153
Notes payable	494,215	506,345	494,093	521,800
Subordinated debentures	242,667	229,588	242,565	244,117
Amounts due under repurchase agreements	137,223	137,223	—	—
Interest rate swap	—	—	789	789

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, 2018 and December 31, 2017 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, 2018				
Assets				
Fixed maturity securities:				
Available for sale:				
United States Government full faith and credit	$ 11,433	$ 5,541	$ 5,892	$ —
United States Government sponsored agencies	1,270,106	—	1,270,106	—
United States municipalities, states and territories	4,137,005	—	4,137,005	—
Foreign government obligations	231,671	—	231,671	—
Corporate securities	29,584,123	875		