

AMERICAN EQUITY INVESTMENT LIFE HOLDING CO
Form 10-K/A
March 28, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K/A
Amendment No. 1**

(Mark One)

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

For the fiscal year ended December 31, 2004

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: 001-31911

American Equity Investment Life Holding Company

(Exact name of registrant as specified in its charter)

Iowa
(State of Incorporation)

42-1447959
(I.R.S. Employer Identification No.)

**5000 Westown Parkway, Suite 440
West Des Moines, Iowa**
(Address of principal executive offices)

50266
(Zip Code)

Registrant's telephone number, including area code

(515) 221-0002
(Telephone)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common stock, par value \$1

Name of each exchange on which registered
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$1

Indicate by check mark whether the Registrant (1) has filed all 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

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subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

Aggregate market value of the shares of the Registrant's common equity held by non-affiliates of the Registrant was \$344,207,862 based on the closing price of \$9.95 per share, the closing price of the common stock on the New York Stock Exchange on June 30, 2004.

Shares of common stock outstanding as of February 28, 2005: 38,375,157

Documents incorporated by reference: Portions of the Registrant's definitive proxy statement for the annual meeting of shareholders to be held June 9, 2005, which will be filed within 120 days after December 31, 2004, are incorporated by reference into Part III of this report.

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.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2004
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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A is being filed with respect to our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the Securities and Exchange Commission on March 14, 2005. This Amendment No. 1 includes "Management's Annual Report on Internal Control over Financial Reporting" required by Item 308(a) of Regulation S-K and the related "Attestation Report of our Independent Registered Public Accounting Firm" required by Item 308(b) of Regulation S-K. This Amendment No. 1 does not contain updates to reflect any events occurring after the original March 14, 2005 filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2004. All information contained in this Amendment No. 1 is subject to updating and supplementing as provided in our reports filed with the Securities and Exchange Commission, as may be amended, for periods subsequent to the date of the original filing of the Annual Report on Form 10-K.

PART I

ITEM 1. BUSINESS

Introduction

We were formed on December 15, 1995 to develop, market, issue and administer annuities and life insurance. We are a full service underwriter of a broad array of annuity and insurance products. Our business consists primarily of the sale of fixed rate and index annuities and, accordingly, we have only one business segment. Our business strategy is to focus on our annuity business and earn predictable returns by managing investment spreads and investment risk. We are currently licensed to sell our products in 48 states and the District of Columbia.

On December 9, 2003, we completed an initial public offering of 18,700,000 shares of our common stock at a price of \$9.00 per share. Pursuant to the over-allotment option granted to the underwriters in the offering, the underwriters purchased an additional 2,000,000 shares on December 29, 2003 and an additional 805,000 shares on January 7, 2004, which fully exercised the over-allotment option. The proceeds from our initial public offering (including proceeds from shares issued pursuant to the over-allotment option), net of the underwriting discount and expenses, were approximately \$178.0 million.

Investor related information, including periodic reports filed on Forms 10-K, 10-Q and 8-K and all amendments to such reports may be found on our internet website at www.american-equity.com as soon as reasonably practicable after such reports are filed with the SEC. In addition, the Company has available on its website its: (i) code of business conduct and ethics; (ii) audit committee charter; (iii) compensation committee charter; (iv) nominating/corporate governance committee charter and (v) corporate governance guidelines.

Annuity Market Overview

Our target market includes the group of individuals ages 45-75 who are seeking to accumulate tax-deferred savings. We believe that significant growth opportunities exist for annuity products because of favorable demographic and economic trends. According to the U.S. Census Bureau, there were 35 million Americans age 65 and older in 2000, representing 12% of the U.S. population. By 2030, this sector of the population is expected to increase to 20% of the total population. Our fixed rate and index annuity products are particularly attractive to this group as a result of the guarantee of principal with respect to those products, competitive rates of credited interest, tax-deferred growth and alternative payout options.

According to LIMRA International, total industry sales of individual annuities were \$224.4 billion in 2004 and \$218.8 billion in 2003. Fixed annuity sales, which include index and fixed rate annuities

were \$90.9 billion in 2004 and \$89.4 billion in 2003. Sales of index annuities increased 69% to a record \$24.3 billion in 2004 from \$14.4 billion in 2003. We believe index annuities, which have a crediting rate linked to the change in various indices, appeal to policyholders interested in participating in returns linked to equity and/or bond markets without the risk of loss of principal. Our wide range of fixed rate annuity products has enabled us to enjoy favorable growth during volatile equity and bond markets.

Strategy

Our business strategy is to focus on our annuity business and earn predictable returns by managing investment spreads and investment risk. Key elements of this strategy include the following:

Expand our Current Independent Agency Network. We believe that our successful relationships with approximately 70 national marketing organizations and, through them, 46,000 independent agents, represent a significant competitive advantage. We intend to grow and enhance our core distribution channel by expanding our relationships with national marketing organizations and independent agents, by addressing their product needs and by providing the highest quality service possible.

Continue to Introduce Innovative and Competitive Products. We intend to be at the forefront of the fixed and index annuity industry in developing and introducing innovative and new competitive products. We were the first company to introduce an index annuity which allowed policyholders to earn returns linked to the Dow Jones Indexsm. We were also one of the first companies to offer an index product offering a choice among interest crediting strategies which includes both equity and bond indices as well as a traditional fixed rate strategy. We believe that our continued focus on anticipating and being responsive to the product needs of our independent agents and policyholders will lead to increased customer loyalty, revenues and profitability.

Use our Expertise to Achieve Targeted Spreads on Annuity Products. We have had a successful track record in achieving the targeted spreads on our annuity products. We intend to leverage our experience and expertise in managing the investment spread during a range of interest rate environments to achieve our targeted spreads.

Maintain our Profitability Focus and Improve Operating Efficiency. We are committed to improving our profitability by advancing the scope and sophistication of our investment management and spread capabilities and continuously seeking out operating efficiencies within our company. We have made substantial investments in technology improvements to our business, including the development of a password-secure website which allows our independent agents to receive proprietary sales, marketing and product materials and the implementation of software designed to enable us to operate in a completely paperless environment with respect to policy administration. Further, we have implemented competitive incentive programs for our national marketing organizations, agents and employees to stimulate performance.

Take Advantage of the Growing Popularity of Some of Our Products. We believe that the growing popularity of some of our products that allow equity and bond market participation without the risk of loss of the premium deposit presents an attractive opportunity to grow our business. We intend to capitalize on our reputation as a leading marketer of index annuities in this expanding segment of the annuity market.

Products

Our products include fixed rate annuities, index annuities, a variable annuity and life insurance.

Fixed Rate Annuities

These products, which accounted for approximately 16% and 36% of our total annuity deposits collected for the years ended December 31, 2004 and 2003, respectively, include single premium deferred annuities ("SPDAs"), flexible premium deferred annuities ("FPDAs") and single premium immediate annuities ("SPIAs"). An SPDA generally involves the tax-deferred accumulation of interest on a single premium paid by the policyholder. After a number of years, as specified in the annuity contract, the annuitant may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years, or for a combination of these payment options. We also sell SPDAs, under which the annual crediting rate is guaranteed for either a three-year or a five-year period. FPDAs are similar to SPDAs in many respects, except that the FPDA allows additional deposits in varying amounts by the policyholder without a new application.

Our SPDAs and FPDAs (excluding the multi-year rate guaranteed products) generally have an interest rate (the "crediting rate") that is guaranteed by us for the first policy year. After the first policy year, we have the discretionary ability to change the crediting rate once annually to any rate at or above a guaranteed minimum rate. The guaranteed rate on our non-multi-year rate guaranteed policies in force and new issues ranges from 2.25% to 4.00%. The guaranteed rate on our multi-year rate guaranteed policies in force ranges from 3.05% to 4.80% for the three-year rate guaranteed product and from 3.25% to 7% for the five-year rate guaranteed product. The initial crediting rate is largely a function of the interest rate we can earn on invested assets acquired with new annuity deposits and the rates offered on similar products by our competitors. For subsequent adjustments to crediting rates, we take into account the yield on our investment portfolio, annuity surrender assumptions, competitive industry pricing and crediting rate history for particular groups of annuity policies with similar characteristics.

Approximately 99% and 92% of our fixed rate annuity sales during the years ended December 31, 2004 and 2003, respectively, were "bonus" products. The initial crediting rate on these products specifies a bonus crediting rate ranging from 1% to 7% of the annuity deposit. After the first year, the bonus interest portion of the initial crediting rate is automatically discontinued, and the renewal crediting rate is established. Generally, there is a compensating adjustment in the commission paid to the agent to offset the first year interest bonus. In all situations, we obtain an acknowledgment from the policyholder, upon policy issuance, that a specified portion of the first year interest will not be paid in renewal years. As of December 31, 2004, crediting rates on our outstanding SPDAs and FPDAs generally ranged from 3.10% to 7.50%, excluding interest bonuses guaranteed for the first year. The average crediting rate on FPDAs and SPDAs including interest bonuses at December 31, 2004 was 4.42%, and the average crediting rate on those products excluding bonuses was 4.18%.

Policyholders are typically permitted to withdraw all or a part of the premium paid, plus accrued interest credited to the account (the "accumulation value"), subject to the assessment of a surrender charge for withdrawals in excess of specified limits. Most of our SPDAs and FPDAs provide for penalty-free withdrawals of up to 10% of the accumulation value each year after the first year, subject to limitations. Withdrawals in excess of allowable penalty-free amounts are assessed a surrender charge during a penalty period which generally ranges from 3 to 15 years after the date the policy is issued. This surrender charge is initially 8.25% to 25% of the accumulation value and generally decreases by approximately one to two percentage points per year during the surrender charge period. Surrender charges are set at levels aimed at protecting us from loss on early terminations and reducing the likelihood of policyholders terminating their policies during periods of increasing interest rates. This practice lengthens the effective duration of the policy liabilities and enhances our ability to maintain profitability on such policies.

Our SPIAs are designed to provide a series of periodic payments for a fixed period of time or for life, according to the policyholder's choice at the time of issue. The amounts, frequency, and length of

time of the payments are fixed at the outset of the annuity contract. SPIAs are often purchased by persons at or near retirement age who desire a steady stream of payments over a future period of years. The implicit interest rate on SPIAs is based on market conditions when the policy is issued. The implicit interest rate on our outstanding SPIAs averaged 3.83% and 4.25% at December 31, 2004 and 2003, respectively.

Index Annuities

Index annuities accounted for approximately 84% and 64% of the total annuity deposits collected for the years ended December 31, 2004 and 2003, respectively. These products allow policyholders to link returns to the performance of a particular index without the risk of loss of their principal. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more index based strategies and a traditional fixed rate strategy.

The annuity contract value is equal to the premiums paid increased for returns which are based upon a percentage (the "participation rate") of the annual appreciation (based in certain situations on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. The participation rate, which we may reset annually, generally varies among the index products from 50% to 100%. Some of the products also have an "asset fee" ranging from 1.5% to 5%, which is deducted from the interest to be credited. The asset fees may be adjusted annually by us, subject to stated limits. In addition, some products apply an overall limit (or "cap"), ranging from 5% to 13%, on the amount of annual interest the policyholder may earn in any one contract year, and the applicable cap also may be adjusted annually subject to stated minimums. The minimum guaranteed contract values are equal to 80% to 100% of the premium collected plus interest credited at an annual rate ranging from 2% to 3.5%. We purchase options on the applicable indices as an investment to provide the income needed to fund the amount of the index credits on the index products. The setting of the participation rates, asset fees and caps is a function of the interest rate we can earn on the invested assets acquired with annuity fund deposits, cost of options and features offered on similar products by competitors. Approximately 57% and 39% of our index annuity sales for the years ended December 31, 2004 and 2003, respectively, were "premium bonus" products. The initial annuity deposit on these policies is increased at issuance by the specified premium bonus ranging from 1.5% to 10%. Generally, there is a compensating adjustment in the commission paid to the agent to offset the premium bonus.

The index annuities provide for penalty-free withdrawals of up to 10% of premium or accumulation value (depending on the product) in each year after the first year of the annuity's term. Other withdrawals are subject to a surrender charge ranging initially from 5% to 20% over a surrender period ranging from 5 to 17 years. During the applicable surrender charge period, the surrender charges on some index products remain level, while on other index products, the surrender charges decline by one to two percentage points per year. After a number of years, as specified in the annuity contract, the annuitant may elect to take the proceeds of the annuity either in a single payment or in a series of payments for life, for a fixed number of years, a combination of these payment options, or re-enter into a new contract term.

Variable Annuities

Variable annuities differ from fixed rate and index annuities in that the policyholder, rather than the insurance company, bears the investment risk and the policyholder's return of principal and rate of return are dependent upon the performance of the particular investment option selected by the policyholder. Profits on variable annuities are derived from the fees charged to contract owners rather than from the investment spread.

Life Insurance

These products include traditional ordinary and term, universal life and other interest-sensitive life insurance products. We have approximately \$2.6 billion of life insurance in force as of December 31, 2004. We intend to continue offering a complete line of life insurance products for individual and group markets. Premiums related to this business accounted for 3% of the revenues in the years ended December 31, 2004 and 2003 and 5% of the revenues in the year ended December 21, 2002.

Investments

Investment activities are an integral part of our business, and net investment income is a significant component of our total revenues. Profitability of many of our products is significantly affected by spreads between interest yields on investments and rates credited on annuity liabilities. Although substantially all credited rates on non-multi-year rate guaranteed SPDAs and FPDAs may be changed annually, subject to minimum guarantees, changes in crediting rates may not be sufficient to maintain targeted investment spreads in all economic and market environments. In addition, competition and other factors, including the potential for increases in surrenders and withdrawals, may limit our ability to adjust or to maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions. For the year ended December 31, 2004, the weighted average yield, computed on the average amortized cost basis of our investment portfolio, was 6.28%; the weighted average cost of our liabilities at December 31, 2004, excluding interest bonuses guaranteed for the first year of the annuity contract, was 3.90%.

We manage the indexed-based risk component of our index annuities by purchasing call options on the applicable indices to fund the annual index credits on these annuities and by adjusting the participation rates, asset fee rates and other product features to reflect the change in the cost of such options (which varies based on market conditions). All of such options are purchased to fund the index credits on our index annuities at their respective anniversary dates, and new options are purchased at each of the anniversary dates to fund the next annual index credits.

For additional information regarding the composition of our investment portfolio and our interest rate risk management, see Quantitative and Qualitative Disclosures About Market Risk and note 3 to our audited consolidated financial statements.

Marketing

We market our products through a variable cost brokerage distribution network of approximately 70 national marketing organizations and 46,000 independent agents as of December 31, 2004. We emphasize high quality service to our agents and policyholders along with the prompt payment of commissions to our agents. We believe this has been significant in building excellent relationships with our existing agency force.

Our independent agents and agencies range in profile from national sales organizations to personal producing general agents. We aggressively recruit new agents and expect to continue to expand our independent agency force. In our recruitment efforts, we emphasize that agents have direct access to our executive officers, giving us an edge in recruiting over larger and foreign-owned competitors. We also have favorable relationships with our national marketing organizations, which have enabled us to efficiently sell through an expanded number of independent agents. We are currently licensed to sell our products in 48 states and the District of Columbia. We have applied for licenses to sell our products in the two remaining states.

The insurance distribution system is comprised of insurance brokers and marketing organizations. We are pursuing a strategy to increase the size of our distribution network by developing additional relationships with national and regional marketing organizations. These organizations typically recruit

agents for us by advertising our products and our commission structure, through direct mail advertising, or through seminars for insurance agents and brokers. These organizations bear most of the cost incurred in marketing our products. We compensate marketing organizations by paying them a percentage of the commissions earned on new annuity policy sales generated by the agents recruited in such organizations. We also conduct incentive programs for marketing organizations and agents from time to time, including equity-based programs for our leading national marketers. For additional information regarding our equity-based programs for our leading national marketers see note 10 to our audited consolidated financial statements. We generally do not enter into exclusive arrangements with these marketing organizations.

Two of our national marketing organizations each accounted for more than 10% of the annuity deposits and insurance premiums collections during the year ended December 31, 2004. The states with the largest share of direct premiums collected during 2004 were: Florida (11.7%), California (10.7%), Texas (8.6%), Illinois (7.2%) and Michigan (5.2%).

Competition and Ratings

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

The sales agents for our products use the ratings assigned to an insurer by independent rating agencies as one factor in determining which insurer's annuity to market. In recent years, the market for annuities has been dominated by those insurers with the highest ratings. American Equity Life has received a financial strength rating of "B++" (Very Good) with a stable outlook from A.M. Best Company and "BBB+" with a stable outlook from Standard & Poor's. A.M. Best Company and Standard & Poor's changed their outlook on our rating from negative to stable subsequent to the completion of our December 2003 initial public offering. In July, 2002, A.M. Best Company and Standard & Poor's adjusted our financial strength ratings from "A-"(Excellent) to "B++"(Very Good) and "A-" to "BBB+", respectively. The adjustments initially had no impact on sales of new annuity products or in lapses of existing balances. Beginning in November, 2002, our monthly sales volumes began to decline primarily as a result of certain actions by us, including reductions in crediting rates and suspension of new sales of some products. The degree to which ratings adjustments also contributed to this decline is unknown. Our ability to grow sales of new annuities and the level of surrenders of our existing annuity contracts in force during 2005 may be affected by the current ratings.

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

A.M. Best Company ratings currently range from "A++" (Superior) to "F" (In Liquidation), and include 16 separate ratings categories. Within these categories, "A++" (Superior) and "A+" (Superior) are the highest, followed by "A" (Excellent) and "A-" (Excellent) then followed by "B++" (Very Good) and "B+" (Very Good). Publications of A.M. Best Company indicate that the "B++" rating is

assigned to those companies that, in A.M. Best Company's opinion, have demonstrated a good ability to meet their ongoing obligations to policyholders.

Standard & Poor's insurer financial strength ratings currently range from "AAA" to "NR", and include 21 separate ratings categories. Within these categories, "AAA" and "AA" are the highest, followed by "A" and "BBB". Publications of Standard & Poor's indicate that an insurer rated "BBB" or higher is regarded as having strong financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are higher rated insurers.

A.M. Best Company and Standard & Poor's review their ratings of insurance companies from time to time. There can be no assurance that any particular rating will continue for any given period of time or that it will not be changed or withdrawn entirely if, in their judgment, circumstances so warrant. If our ratings were to be adjusted again for any reason, we could experience a material decline in the sales of our products and the persistency of our existing business.

Reinsurance

Coinsurance

American Equity Life has entered into two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), an affiliate of Farm Bureau Life Insurance Company ("Farm Bureau"), covering 70% of certain of our fixed rate and index annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003, and 20% of those contracts issued from January 1, 2004 to July 31, 2004, when the agreement was suspended by mutual consent of the parties. As a result of the suspension, new business will no longer be ceded to EquiTrust unless and until the parties mutually agree to resume the coinsurance of new business. The business reinsured under these agreements is not eligible for recapture before the expiration of 10 years. EquiTrust has received a financial strength rating of "A" from A.M. Best Company. As of December 31, 2004, Farm Bureau beneficially owned 14.4% of our issued and outstanding common stock.

Total annuity deposits ceded were \$202.1 million, \$649.4 million and \$837.9 million for the years ended December 31, 2004, 2003 and 2002, respectively. We received expense allowances of \$22.6 million, \$65.6 million and \$99.4 million under this agreement for the years ended December 31, 2004, 2003 and 2002, respectively. The balance due under this agreement to EquiTrust was \$32.0 million at December 31, 2004 and \$22.6 million at December 31, 2003, and represents the market value of the call options related to the ceded business held by us to fund the index credits and cash due to or from EquiTrust related to the transfer of ceded annuity deposits. At December 31, 2004 and 2003, the aggregate policy benefit reserves transferred to EquiTrust under these agreements were \$2.1 billion and \$1.9 billion, respectively. We remain liable with respect to the policy liabilities ceded to EquiTrust should it fail to meet the obligations assumed by it.

American Equity Life has also entered into a modified coinsurance agreement to cede 70% of its variable annuity business to EquiTrust. Separate account deposits ceded under this agreement during the years ended December 31, 2004, 2003 and 2002 were immaterial. Under this agreement and related administrative services agreements, we paid EquiTrust \$0.2 million for the each of years ended December 31, 2004, 2003 and 2002. The modified coinsurance agreement will continue until termination by written notice at the election of either party. Any such termination will apply to the submission or acceptance of new policies, and business reinsured under the agreement prior to any such termination is not eligible for recapture before the expiration of 10 years.

Financial Reinsurance

American Equity Life has entered into two reinsurance transactions with Hannover Life Reassurance Company of America, ("Hannover"), which are treated as reinsurance under statutory accounting practices and as financial reinsurance under accounting principles generally accepted in the United States, ("GAAP"). Hannover has received a financial strength rating of "A+" from A.M. Best Company. The first transaction became effective November 1, 2002 (the "2002 Hannover Transaction") and the second transaction became effective September 30, 2003 (the "2003 Hannover Transaction"). The agreements for these transactions include a coinsurance segment and a yearly renewable term segment reinsuring a portion of death benefits payable on certain annuities issued from January 1, 2002 to December 31, 2002 (2002 Hannover Transaction) and issued from January 1, 2003 to September 30, 2003 (2003 Hannover Transaction). The coinsurance segments provide reinsurance to the extent of 6.88% (2002 Hannover Transaction) and 13.41% (2003 Hannover Transaction) of all risks associated with our annuity policies covered by these reinsurance agreements. The 2002 Hannover Transaction provided \$29.8 million in net statutory surplus benefit during 2002 and the 2003 Hannover Transaction provided \$29.7 million in net statutory surplus benefit during 2003. The statutory surplus benefits provided by these agreements were reduced by \$13.1 million in 2004 and \$6.8 million in 2003. The remaining statutory surplus benefit under these agreements will be reduced in the following years as follows: 2005 \$11.6 million; 2006 \$12.4 million; 2007 \$13.2 million; 2008 \$6.2 million. Risk charges

attributable to the 2003 and 2002 Hannover Transactions of \$2.2 million, \$1.6 million and \$0.2 million were incurred during 2004, 2003 and 2002, respectively.

The statutory surplus benefit provided by the 2003 Hannover Transaction replaced the statutory surplus benefit previously provided by a financial reinsurance agreement with a subsidiary of Swiss Reinsurance Company. We terminated this agreement and recaptured all reserves subject to this agreement effective September 30, 2003. This agreement was effective January 1, 2001, and provided an initial statutory surplus benefit of \$35.0 million in 2001. The statutory surplus benefit remaining at January 1, 2003 was \$30.9 million, all of which was eliminated during 2003. Risk charges and interest expense incurred on the cash portion of the surplus benefit provided by the agreement were \$0.2 million and \$0.6 million for the years ended December 31, 2003 and 2002, respectively.

Indemnity Reinsurance

Consistent with the general practice of the life insurance industry, American Equity Life enters into agreements of indemnity reinsurance with other insurance companies in order to reinsure portions of the coverage provided by its life and accident and health insurance products. Indemnity reinsurance agreements are intended to limit a life insurer's maximum loss on a large or unusually hazardous risk or to diversify its risks. The maximum loss retained by us on all life insurance policies we have issued was \$0.1 million or less as of December 31, 2004. Indemnity reinsurance does not discharge the original insurer's primary liability to the insured. American Equity Life's reinsured business related to these blocks of business is primarily ceded to two reinsurers. Reinsurance related to life and accident and health insurance that was ceded by us primarily to two reinsurers was immaterial. We believe the assuming companies will be able to honor all contractual commitments, based on our periodic review of their financial statements, insurance industry reports and reports filed with state insurance departments.

Regulation

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

grant and revoke licenses to transact business;

regulate and supervise trade practices and market conduct;

establish guaranty associations;

license agents;

approve policy forms;

approve premium rates for some lines of business;

establish reserve requirements;

prescribe the form and content of required financial statements and reports;

determine the reasonableness and adequacy of statutory capital and surplus;

perform financial, market conduct and other examinations;

define acceptable accounting principles;

regulate the type and amount of permitted investments;

limit the amount of dividends and surplus note payments that can be paid without obtaining regulatory approval.

Our life subsidiaries are subject to periodic examinations by state regulatory authorities. In 2002, the Iowa Insurance Division completed an examination of American Equity Life as of December 31,

2000. No adjustments to our financial statements were recommended or required as a result of this examination. The Iowa Insurance Division is currently conducting an examination of American Equity Life as of December 31, 2003. We have not been informed of any material adjustments which will be recommended or required as a result of this examination.

The payment of dividends or the distributions, including surplus note payments, by our life subsidiaries is subject to regulation by each subsidiary's state of domicile's insurance department. Currently, American Equity Life may pay dividends or make other distributions without the prior approval of its state of domicile's insurance department, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's statutory net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory surplus at the preceding December 31. For 2005, up to approximately \$60.9 million can be distributed as dividends by American Equity Life without prior approval of its state of domicile's insurance department. In addition, dividends and surplus note payments may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. American Equity Life had approximately \$114.6 million of earned surplus at December 31, 2004.

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

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

Although the federal government does not directly regulate the business of insurance, federal legislation and administrative policies in several areas, including pension regulation, age and sex discrimination, financial services regulation, securities regulation and federal taxation can significantly affect the insurance business. In addition, legislation has been passed which could result in the federal government assuming some role in regulating insurance companies and which allows combinations between insurance companies, banks and other entities.

In 1998, the Securities and Exchange Commission ("SEC") requested comments as to whether index annuities, such as those sold by us, should be treated as securities under the federal securities laws rather than as insurance products. Treatment of these products as securities would likely require additional registration and licensing of these products and the agents selling them, as well as cause us to seek additional marketing relationships for these products. No action has been taken by the SEC on this issue.

State insurance regulators and the National Association of Insurance Commissioners, or NAIC, are continually reexamining existing laws and regulations and developing new legislation for the passage by state legislatures and new regulations for adoption by insurance authorities. Proposed laws and

regulations or those still under development pertain to insurer solvency and market conduct and in recent years have focused on:

insurance company investments;

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

the implementation of non-statutory guidelines and the circumstances under which dividends may be paid;

product approvals;

agent licensing;

underwriting practices;

insurance and annuity sales practices.

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

The NAIC's RBC requirements provide for four levels of regulatory attention depending on the ratio of a company's total adjusted capital to its RBC. Adjusted capital is defined as the total of statutory capital, surplus, asset valuation reserve and certain other adjustments. Calculations using the NAIC formula at December 31, 2004, indicate that the ratio of total adjusted capital to RBC for us exceeded the highest level at which regulatory action might be initiated by approximately 2.5 times.

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

Federal Income Taxation

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

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

In June 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act") was enacted. The 2001 Act implemented a staged decrease in individual tax rates that began in 2001 and was accelerated when the Jobs and Growth Tax Relief Reconciliation Act of 2003 (the "2003 Act")

was enacted. While the decreases in rates are temporary (the pre-2001 rates will return in 2011), the present value of the tax deferred advantage of annuities and life insurance products is less, which might hinder our ability to sell such products and/or increase the rate at which our current policyholders surrender their policies.

Our life subsidiaries are taxed under the life insurance company provisions of the Internal Revenue Code of 1986, as amended (the "Code"). Provisions in the Code require a portion of the expenses incurred in selling insurance products to be capitalized and deducted over a period of years, as opposed to being immediately deducted in the year incurred. This provision increases the current income tax expense charged to gain from operations for statutory accounting purposes which reduces statutory net income and surplus and, accordingly, may decrease the amount of cash dividends that may be paid by our life subsidiaries.

Employees

As of December 31, 2004, we had approximately 230 full-time employees, of which approximately 220 are located in West Des Moines, Iowa, and 10 are located in the Pell City, Alabama office. We have experienced no work stoppages or strikes and consider our relations with our employees to be excellent. None of our employees are represented by a union.

ITEM 2. PROPERTIES

We do not own any real estate. We lease space for our principal offices in West Des Moines, Iowa, pursuant to written leases for approximately 45,000 square feet. The leases expire on June 30, 2006 and have a renewal option for an additional five year term at a rental rate equal to the prevailing fair market rate. We also lease space for our office in Pell City, Alabama, pursuant to a written lease dated January 3, 2000, for approximately 5,680 square feet. This lease is currently on a month-to-month basis.

ITEM 3. 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 SEC, the National Association of Securities Dealers, Inc., 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.

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 several purported class action lawsuits filed in state courts alleging improper sales practices. In these lawsuits, the plaintiffs are seeking returns of premiums and other compensatory and punitive damages. We have reached a final settlement in one of these cases, the impact of which is expected to be immaterial. The class was certified as such incident to the settlement of that case. No class has been certified in any of the other pending cases at this time. Although we have denied all allegations in these lawsuits and intend to vigorously defend against them, the lawsuits are in the early stages of litigation and neither their outcomes nor a range of possible outcomes can be determined at this time. However, we do not believe that these lawsuits will have a material adverse effect on our business, financial condition or results of operations.

In addition, we are from time to time, subject to other legal proceedings and claims in the ordinary course of business, none of which we believe are likely to have a material adverse effect on our financial position, results of operations or cash flows. 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.

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

None.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock began trading on the New York Stock Exchange ("NYSE") under the symbol "AEL" following our initial public offering ("IPO").

| <u>2004</u> | <u>High</u> | <u>Low</u> | <u>Close</u> |
|-------------------------|-------------|------------|--------------|
| First Quarter | \$ 13.15 | \$ 10.05 | \$ 12.85 |
| Second Quarter | \$ 13.10 | \$ 9.75 | \$ 9.95 |
| Third Quarter | \$ 10.22 | \$ 8.79 | \$ 9.49 |
| Fourth Quarter | \$ 11.00 | \$ 9.41 | \$ 10.77 |
| <u>2003</u> | | | |
| Fourth Quarter | \$ 10.30 | \$ 8.55 | \$ 9.97 |

As of December 31, 2004, the Company had 38,360,343 shares issued and outstanding and approximately 4,500 shareholders of record. In 2004 and 2003, we paid an annual cash dividend of \$0.02 and \$0.01, respectively, per share on our common stock. We intend to continue to pay an annual cash dividend on such shares so long as we have sufficient capital and/or future earnings to do so. However, we anticipate retaining most of our future earnings, if any, for use in our operations and the expansion of our business. Any further determination as to dividend policy will be made by our board of directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition and future prospects and such other factors as our board of directors may deem relevant.

Our credit agreement limits our ability to declare or pay dividends in any fiscal year to 33% of our consolidated net income for the prior year. In addition, since we are a holding company, our ability to pay cash dividends depends in large measure on our subsidiaries' ability to make distributions of cash or property to us. Iowa insurance laws restrict the amount of distributions American Equity Life can pay to us without the approval of the Iowa Insurance Division. See Management's Discussion and Analysis of Financial Condition and Results of Operations and notes 7 and 11 to our audited consolidated financial statements.

On December 9, 2003, we completed an initial public offering of 18,700,000 shares of our common stock at a price of \$9.00 per share. The managing underwriters for the offering were Merrill Lynch, Pierce, Fenner & Smith Incorporated, Advest, Inc., Raymond James & Associates, Inc. and Sanders Morris Harris Inc. The shares of common stock sold in the offering were registered under the Securities Act of 1933, as amended, on a Registration Statement on Form S-1 (Registration No. 333-108794) that was declared effective by the Securities and Exchange Commission on December 3, 2003. Pursuant to the over-allotment option granted to the underwriters in the offering, the underwriters purchased an additional 2,000,000 shares on December 29, 2003 and an additional 805,000 shares on January 7, 2004, which fully exercised the over-allotment option. The offering did not terminate until after the sale of all of the securities registered on the Registration Statement. The aggregate gross proceeds to us from our initial public offering were approximately \$193.5 million. The aggregate net proceeds to us from the offering were approximately \$178.0 million, after deducting an aggregate of approximately \$13.5 million in underwriting discounts and commissions paid to the underwriters and an estimated \$2.0 million in other expenses incurred in connection with the offering. In connection with the IPO, we did not make any payments, directly or indirectly, to any of our directors or officers, or, to our knowledge, any of their associates, or to any person owning ten percent

or more of any class of our equity securities, or to any of our affiliates. All of the net proceeds were contributed to our life subsidiaries to fund future growth of our annuity business.

There were no sales of unregistered equity securities during 2004 not previously reported on Form 8-K.

Issuer Purchases of Equity Securities

We did not have any issuer purchases of equity securities for the quarter ended December 31, 2004.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA

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

| | Year ended December 31, | | | | |
|----------------------------------------------------------------------------------------------------------------|-------------------------|----------------|----------------|----------------|----------------|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| (Dollars in thousands, except per share data) | | | | | |
| Consolidated Statements of Income Data: | | | | | |
| Revenues | | | | | |
| Traditional life and accident and health insurance premiums | \$ 15,115 | \$ 13,686 | \$ 13,664 | \$ 13,141 | \$ 11,034 |
| Annuity and single premium universal life product charges | 22,462 | 20,452 | 15,376 | 12,520 | 8,338 |
| Net investment income | 429,926 | 358,529 | 308,548 | 209,086 | 100,060 |
| Realized gains (losses) on investments | 943 | 6,946 | (122) | 787 | (1,411) |
| Change in fair value of derivatives(a) | 28,696 | 52,525 | (57,753) | (55,158) | (3,406) |
| Total revenues | 497,142 | 452,138 | 279,713 | 180,376 | 114,615 |
| Benefits and expenses | | | | | |
| Insurance policy benefits and change in future policy benefits | 13,423 | 11,824 | 9,317 | 9,762 | 8,728 |
| Interest credited to account balances | 305,762 | 248,075 | 183,503 | 100,125 | 57,312 |
| Change in fair value of embedded derivatives(a) | (8,567) | 66,801 | (5,027) | 12,921 | |
| Interest expense due to related party under General Agency Commission and Servicing Agreement | 2,594 | 3,000 | 3,596 | 5,716 | 5,958 |
| Interest expense on notes payable | 1,749 | 1,486 | 1,901 | 2,881 | 2,339 |
| Interest expense on subordinated debentures(b) | 9,609 | 7,661 | | | |
| Interest expense on amounts due under repurchase agreements and other interest expense | 3,148 | 1,278 | 1,777 | 1,504 | 3,267 |
| Amortization of deferred policy acquisition costs | 67,867 | 47,450 | 34,060 | 20,838 | 7,791 |
| Other operating costs and expenses | 32,016 | 25,618 | 21,635 | 17,176 | 14,602 |
| Total benefits and expenses | 427,601 | 413,193 | 250,762 | 170,923 | 99,997 |
| Income before income taxes, minority interests and cumulative effect of change in accounting principle | 69,541 | 38,945 | 28,951 | 9,453 | 14,618 |
| Income tax expense | 24,257 | 13,505 | 7,299 | 333 | 2,385 |
| Income before minority interests and cumulative effect of change in accounting principle | 45,284 | 25,440 | 21,652 | 9,120 | 12,233 |
| Minority interests in subsidiaries: | | | | | |
| Earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts(b) | | | 7,445 | 7,449 | 7,449 |
| Income before cumulative effect of change in accounting principle | 45,284 | 25,440 | 14,207 | 1,671 | 4,784 |
| Cumulative effect of change in accounting for derivatives(a) | | | | (799) | |

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Year ended December 31,

| | | | | | | | | | | |
|-------------------------------------------------------------------|----|--------|----|--------|----|--------|----|--------|----|-------|
| Net income(c) | \$ | 45,284 | \$ | 25,440 | \$ | 14,207 | \$ | 872 | \$ | 4,784 |
| Per Share Data: | | | | | | | | | | |
| Earnings per common share: | | | | | | | | | | |
| Income before cumulative effect of change in accounting principle | \$ | 1.19 | \$ | 1.45 | \$ | 0.87 | \$ | 0.10 | \$ | 0.29 |
| Cumulative effect of change in accounting for derivatives(a) | | | | | | | | (0.05) | | |
| Earnings per common share | \$ | 1.19 | \$ | 1.45 | \$ | 0.87 | \$ | 0.05 | \$ | 0.29 |
| Earnings per common share assuming dilution: | | | | | | | | | | |
| Income before cumulative effect of change in accounting principle | \$ | 1.08 | \$ | 1.21 | \$ | 0.76 | \$ | 0.09 | \$ | 0.26 |
| Cumulative effect of change in accounting for derivatives(a) | | | | | | | | (0.04) | | |
| Earnings per common share assuming dilution | \$ | 1.08 | \$ | 1.21 | \$ | 0.76 | \$ | 0.05 | \$ | 0.26 |
| Dividends declared per common share | \$ | 0.02 | \$ | 0.01 | \$ | 0.01 | \$ | 0.01 | \$ | 0.01 |

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At December 31,

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|--|------|------|------|------|------|
|--|------|------|------|------|------|

(Dollars in thousands, except per share data)

Consolidated Balance Sheet Data:

| | | | | | |
|----------------------------------------------------------------------------------------------|---------------|--------------|--------------|--------------|--------------|
| Total assets | \$ 11,114,066 | \$ 8,989,177 | \$ 7,327,789 | \$ 4,819,220 | \$ 2,528,126 |
| Policy benefit reserves | 9,807,969 | 8,315,874 | 6,737,888 | 4,420,720 | 2,099,915 |
| Amounts due to related party under General Agency Commission and Servicing Agreement | 35,812 | 40,601 | 40,345 | 46,607 | 76,028 |
| Notes payable | 260,000 | 31,833 | 43,333 | 46,667 | 44,000 |
| Subordinated debentures(b) | 173,576 | 116,425 | | | |
| Company-obligated mandatorily redeemable preferred securities issued by subsidiary trusts(b) | | | 100,486 | 100,155 | 99,503 |
| Total stockholders' equity | 321,504 | 263,716 | 77,478 | 42,567 | 58,652 |

Other Data:

| | | | | | |
|----------------------------------------------------------------------------------------------------------------------|------------|------------|------------|------------|------------|
| Book value per share(d) | \$ 8.38 | \$ 7.19 | \$ 4.67 | \$ 2.24 | \$ 3.35 |
| Return on equity(e) | 15.5% | 28.3% | 23.7% | 1.7% | 10.3% |
| Number of agents | 45,940 | 42,239 | 41,396 | 33,894 | 21,908 |
| Life subsidiaries' statutory capital and surplus | \$ 608,930 | \$ 374,587 | \$ 227,199 | \$ 177,868 | \$ 145,048 |
| Life subsidiaries' statutory net gain (loss) from operations before income taxes and realized capital gains (losses) | 93,640 | 45,822 | 53,535 | (5,675) | 9,190 |
| Life subsidiaries' statutory net income (loss)(c) | 47,711 | 25,404 | 26,010 | (17,187) | 10,420 |

- (a) The accounting change resulted from the adoption of Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which became effective on January 1, 2001.
- (b) Effective December 31, 2003, we adopted Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51*. See note 1 to our audited consolidated financial statements.
- (c) Our GAAP net income and statutory net loss in 2001, were affected by a decision to maintain a significant liquid investment position after the September 11, 2001 terrorist attacks.
- (d) Book value per share is calculated as total stockholders' equity less the liquidation preference of our series preferred stock divided by the total number of shares of common stock outstanding.
- (e) We define return on equity as net income divided by average total stockholders' equity. Average total stockholders' equity is determined based upon the total stockholders' equity at the beginning and the end of the year. The computation of average stockholders' equity for 2003 has been modified to recognize the significant increase in stockholders' equity that resulted from the receipt of the net proceeds from our initial public offering in December 2003.

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

Management's discussion and analysis reviews our consolidated financial position at December 31, 2004 and 2003, and our consolidated results of operations for the three years in the period ended December 31, 2004, and where appropriate, factors that may affect future financial performance. This discussion should be read in conjunction with our consolidated financial statements, notes thereto and selected consolidated financial data appearing elsewhere in this report.

Cautionary Statement Regarding Forward-Looking Information

All statements, trend analyses and other information contained in this report and elsewhere (such as in filings by us with the Securities and Exchange Commission, 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 market value of our investments and the lapse rate and profitability of our policies;

customer response to new products and marketing initiatives;

changes in the 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;

the risk factors or uncertainties listed from time to time in our private placement memorandums or filings with the Securities and Exchange Commission.

Overview

We specialize in the sale of individual annuities (primarily deferred annuities) and, to a lesser extent, we also sell life insurance policies. Under accounting principles generally accepted in the United States, or GAAP, premium collections for deferred annuities are reported as deposit liabilities instead of as revenues. Sources of revenues for products accounted for as deposit liabilities are net investment income, surrender charges deducted from the account balances of policyholders in connection with withdrawals, realized gains and losses on investments and changes in fair value of derivatives. Components of expenses for products accounted for as deposit liabilities are 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.

Earnings from products accounted for as deposit liabilities are primarily generated from the excess of net investment income earned over the interest credited to the policyholder, or the "investment spread". In the case of index annuities, the investment spread consists of net investment income in

excess of the cost of the options purchased to fund the index-based component of the policyholder's return and amounts credited as a result of minimum guarantees.

Our investment spread is summarized as follows:

| | Year ended December 31, | | |
|--------------------------------------------------|----------------------------|-------|-------|
| | 2004 | 2003 | 2002 |
| Average yield on invested assets | 6.28% | 6.43% | 6.91% |
| Cost of money: | | | |
| Aggregate | 3.90% | 4.13% | 4.80% |
| Average net cost of money for index annuities | 3.37% | 3.46% | 4.19% |
| Average crediting rate for fixed rate annuities: | | | |
| Annually adjustable | 3.47% | 3.69% | 4.69% |
| Multi-year rate guaranteed | 5.57% | 5.70% | 5.82% |
| Investment spread: | | | |
| Aggregate | 2.38% | 2.30% | 2.11% |
| Index annuities | 2.91% | 2.97% | 2.72% |
| Fixed rate annuities: | | | |
| Annually adjustable | 2.81% | 2.74% | 2.22% |
| Multi-year rate guaranteed | 0.71% | 0.73% | 1.09% |

The average crediting rates and investment spreads are computed without the impact of amortization of deferred sales inducements. See Critical Accounting Policies Deferred Policy Acquisition Costs and Deferred Sales Inducements. With respect to our index annuities, the cost of money includes the average crediting rate on amounts allocated to the fixed rate options, expenses we incur to fund the annual income credits and minimum guaranteed interest credited on the index business. 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 Derivative Instruments Index Products.

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

Critical Accounting Policies

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

Valuation of Investments

Our fixed maturity securities (bonds and redeemable preferred stocks maturing more than one year after issuance) and equity securities (common and non-redeemable preferred stocks) classified as available for sale are reported at estimated fair value. Unrealized gains and losses, if any, on these

securities are included directly in a separate component of stockholders' equity, net of income taxes and certain adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements. Fair values for securities that are actively traded are determined using quoted market prices. For fixed maturity securities that are not actively traded, fair values are estimated using price matrices developed using yield data and other factors relating to instruments or securities with similar characteristics. The carrying amounts of all our investments are reviewed on an ongoing basis for credit deterioration. If this review indicates a decline in market value that is other than temporary, our carrying amount in the investment is reduced to its fair value and a specific writedown is taken. Such reductions in carrying amount are recognized as realized losses and charged to earnings.

Our periodic assessment of our ability to recover the amortized cost basis of investments that have materially lower quoted market prices requires a high degree of management judgment and involves uncertainty. Factors considered in evaluating whether a decline in value is other than temporary include:

the length of time and the extent to which the fair value has been less than cost;

the financial condition and near-term prospects of the issuer;

whether the investment is rated investment grade;

whether the issuer is current on all payments and all contractual payments have been made as agreed;

our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery;

consideration of rating agency actions;

changes in cash flows of asset-backed and mortgage-backed securities.

In addition, for securities expected to be sold, an other than temporary impairment charge is recognized if we do not expect the fair value of a security to recover to cost or amortized cost prior to the expected date of sale. Once an impairment charge has been recorded, we then continue to review the other than temporarily impaired securities for appropriate valuation on an ongoing basis. Realized losses through a charge to earnings may be recognized in future periods should we later conclude that the decline in market value below amortized cost is other than temporary pursuant to our accounting policy described above.

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At December 31, 2004 and 2003, the amortized cost and estimated fair value of fixed maturity securities and equity securities that were in an unrealized loss position were as follows:

| | December 31, 2004 | | | | December 31, 2003 | | | |
|-----------------------------------------------|------------------------|----------------|-------------------|----------------------|------------------------|----------------|-------------------|----------------------|
| | Number of Positions | Amortized Cost | Unrealized Losses | Estimated Fair Value | Number of Positions | Amortized Cost | Unrealized Losses | Estimated Fair Value |
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Fixed maturity securities: | | | | | | | | |
| Available for sale: | | | | | | | | |
| United States Government and agencies | 32 | \$ 1,705,737 | \$ (58,759) | \$ 1,646,978 | 42 | \$ 2,274,503 | \$ (57,686) | \$ 2,216,817 |
| Public utilities | 4 | 27,057 | (189) | 26,868 | | | | |
| Corporate securities | 11 | 65,488 | (6,916) | 58,572 | 14 | 101,027 | (10,753) | 90,274 |
| Redeemable preferred stocks | 4 | 20,000 | (584) | 19,416 | | | | |
| Mortgage and asset-backed securities: | | | | | | | | |
| United States Government and agencies | 2 | 5,873 | (72) | 5,801 | 4 | 111,257 | (1,258) | 109,999 |
| Non-government | 12 | 278,393 | (15,279) | 263,114 | 22 | 421,583 | (37,725) | 383,858 |
| | 61 | \$ 2,075,491 | \$ (81,610) | \$ 1,993,881 | 86 | \$ 2,935,427 | \$ (107,611) | \$ 2,827,816 |
| Held for investment: | | | | | | | | |
| United States Government and agencies | 56 | \$ 3,213,468 | \$ (94,958) | \$ 3,118,510 | 33 | \$ 1,751,532 | \$ (110,065) | \$ 1,641,467 |
| | 56 | \$ 3,213,468 | \$ (94,958) | \$ 3,118,510 | 33 | \$ 1,751,532 | \$ (110,065) | \$ 1,641,467 |
| Equity securities, available for sale: | | | | | | | | |
| Non-redeemable preferred stocks | 3 | \$ 14,784 | \$ (294) | \$ 14,490 | 2 | \$ 13,683 | \$ (132) | \$ 13,551 |
| Common stocks | 3 | 2,945 | (572) | 2,373 | 2 | 1,995 | (294) | 1,701 |
| | 6 | \$ 17,729 | \$ (866) | \$ 16,863 | 4 | \$ 15,678 | \$ (426) | \$ 15,252 |

The amortized cost and estimated fair value of fixed maturity securities at December 31, 2004 and 2003, by contractual maturity, that were in an unrealized loss position are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage-backed and asset-

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

| | December 31, 2004 | | | | December 31, 2003 | | | |
|---------------------------------------------|------------------------|----------------------|---------------------|----------------------|------------------------|----------------------|---------------------|----------------------|
| | Available-for-sale | | Held for investment | | Available-for-sale | | Held for investment | |
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| | (Dollars in thousands) | | | | (Dollars in thousands) | | | |
| Due after one year through five years | \$ 5 | \$ 5 | \$ | \$ | \$ 5 | \$ 4 | \$ | \$ |
| Due after five years through ten years | 224,858 | 213,750 | | | 200,268 | 188,072 | | |
| Due after ten years through twenty years | 681,795 | 653,505 | 745,904 | 740,631 | 838,834 | 816,539 | 35,000 | 34,324 |
| Due after twenty years | 884,567 | 857,706 | 2,467,564 | 2,377,879 | 1,363,480 | 1,329,344 | 1,716,532 | 1,607,143 |
| | 1,791,225 | 1,724,966 | 3,213,468 | 3,118,510 | 2,402,587 | 2,333,959 | 1,751,532 | 1,641,467 |
| Mortgage-backed and asset-backed securities | 284,266 | 268,915 | | | 532,840 | 493,857 | | |
| | \$ 2,075,491 | \$ 1,993,881 | \$ 3,213,468 | \$ 3,118,510 | \$ 2,935,427 | \$ 2,827,816 | \$ 1,751,532 | \$ 1,641,467 |

See Financial Condition Investments for significant concentrations in the investment portfolio.

At December 31, 2004 and 2003, the fair value of investments we owned that were non-investment grade or not rated was \$63.9 million and \$91.5 million, respectively. Non-investment grade or not rated securities represented 0.8% and 1.7% at December 31, 2004 and 2003, respectively, of the fair value of our fixed maturity securities. The unrealized losses on investments we owned that were non-investment grade or not rated at December 31, 2004 and 2003, were \$10.2 million and \$10.8 million, respectively. The unrealized losses on such securities at December 31, 2004 and 2003 represented 5.7% and 4.9%, respectively, of gross unrealized losses on fixed maturity securities.

At December 31, 2004, we identified certain invested assets which have characteristics (i.e. significant unrealized losses compared to book value and industry trends) creating uncertainty as to our future assessment of other than temporary impairments. This list is referred to as our watch list. We have excluded 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. We have reviewed these investments and concluded that there were no other than temporary impairments on these investments at December 31, 2004.

At December 31, 2004, the amortized cost and estimated fair value of each fixed maturity security on the watch list are as follows:

| Issuer | Amortized Cost | Unrealized Losses | Estimated Fair Value | Maturity Date | Months Below Amortized Cost |
|----------------------------------------------------------|----------------|-------------------|----------------------|---------------|-----------------------------|
| (Dollars in thousands) | | | | | |
| Continental Airlines 2001-001-B | \$ 7,841 | \$ (1,292) | \$ 6,549 | 06/15/2017 | 48 |
| Land O' Lakes Capital Securities 144A | 8,074 | (2,874) | 5,200 | 03/15/2028 | 28 |
| Northwest Airlines Pass Thru Certificates 1999-1 Class C | 8,208 | (2,335) | 5,873 | 08/01/2015 | 45 |

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| Issuer | Amortized Cost | Unrealized Losses | Estimated Fair Value | Maturity Date | Months Below Amortized Cost |
|-----------------------------|----------------|-------------------|----------------------|---------------|-----------------------------|
| Pegasus Aviation 1999-1A C1 | 5,776 | (3,076) | 2,700 | 03/25/2029 | 40 |
| | \$ 29,899 | \$ (9,577) | \$ 20,322 | | |

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Our analysis of these securities and their credit performance at December 31, 2004 is as follows:

Continental Airlines Pass Thru Certificates 2001-001 Class B are backed by the general credit of Continental Airlines as well as the collateral from a pool of airplanes. We determined that an other than temporary impairment charge was not necessary for the following reasons: (i) we believed that Continental Airlines' improving liquidity reduced the likelihood of bankruptcy and (ii) even if Continental Airlines were to declare bankruptcy, the chance of full recovery on this security was high due to the excess collateral coverage supplied by the aircraft collateral.

Land O' Lakes is a national, farmer-owned food and agricultural cooperative. We determined that an other than temporary impairment charge was not necessary for the following reasons: (i) Land O' Lakes operates in a cyclical industry and had successfully managed through previous cyclical lows; (ii) we calculated that Land O' Lakes had adequate EBITDA to interest coverage of bank debt and 4.51 times for bond debt and determined that Land O' Lakes had adequate liquidity; (iii) Land O' Lakes was in the process of improving its balance sheet by maintaining liquidity and selling non-strategic assets and investments; and (iv) further improvements were expected in the future.

Northwest Airlines Pass Thru Certificates 1999-1 Class C are backed by the general credit of Northwest Airlines as well as the collateral from a pool of airplanes. We determined that an other than temporary impairment charge was not necessary for the following reasons: (i) we believed that a bankruptcy was unlikely since Northwest had begun to see benefits from its attempts to return to profitability; (ii) we believed Northwest had adequate liquidity; (iii) we calculated Northwest to have unrestricted cash at the end of the third quarter of 2004 of approximately \$2.5 billion; (iv) even if Northwest declared bankruptcy, these bonds would have remained current for at least 18 months due to a liquidity coverage feature and the bonds could remain current after 18 months if Northwest affirmed the leases on the planes in the collateral pool in the unlikely event of a bankruptcy; and (v) based upon the liquidity of Northwest (\$2.5 billion at September 30, 2004).

Pegasus Aviation 1999-1A C1 is backed by leases on airplanes and is structured as a pass-through security. We took an impairment charge of \$1.9 million on this security in the fourth quarter of 2001 because we did not expect to receive further principal payments. However, due to the continued problems in the leased airplane industry, the market value of this security had declined further. We determined that no additional other than temporary impairment change was necessary for the following reasons: (i) although we did not expect to receive principal payments on this security, we expected that interest payments would continue to be made until 2019 and (ii) the value of the expected future interest payments supported the current book value.

Each of the four securities on the watch list is current in respect to payments of principal and interest. We have concluded for each of the four securities on the watch list that we have the intent and the ability to hold these securities for a period of time sufficient to allow for a recovery in fair value.

We took writedowns on certain other investments that we concluded did have an other than temporary impairment during 2004, 2003 and 2002 of \$12.8 million, \$9.8 million and \$13.0 million, respectively. Following is a discussion of each security for which we have taken write downs during the years ended December 31, 2004, 2003 and 2002.

We owned the Class A3-A Tranche of the Juniper collateralized bond obligation. We wrote down this security by \$2.0 million to its fair value in the first quarter of 2002. Due to the structure of payments from the collateralized bond obligation, it was likely that we would continue receiving interest payments for the foreseeable future, but it was unlikely that we would receive our entire

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principal at maturity. The fair value of this security continued to decline in subsequent months and we sold the bond at an additional loss of \$0.5 million in the second quarter of 2003.

Pegasus 2001-1A C2 is an asset-backed security backed by leases on 41 specific aircraft. We wrote down this security by \$3.0 million in the third quarter of 2002. The downturn in the airline industry had caused lease rates on renewing leases to be significantly below expectations and this was exacerbated by the terrorist attacks on September 11, 2001. Due to the continuing problems in the airline industry and continued lower lease rates on renewing leases, we took an additional write down of \$2.9 million on this security in the first quarter of 2003.

Jet Equipment Trust is an asset-backed security backed by collateral from a pool of planes and the general credit of United Airlines. We wrote down this security by \$6.4 million in the third quarter of 2002. The downturn in the airline industry and the possibility of United Airlines declaring bankruptcy had caused this security to trade significantly below cost at the time of the original write down. United Airlines declared bankruptcy in the fourth quarter of 2002 and discontinued making lease payments on the planes that support this trust. Due to the fact that any further payments on this security were unlikely, we took an additional write down of \$1.6 million in the fourth quarter of 2002 to reduce the book value to zero.

Oakwood Mortgage 1999-E Class M2 is an asset-backed security backed by installment sales contracts secured by manufactured homes and liens on real estate. We wrote down this security by \$4.2 million in the third quarter of 2003 due to continuing high default rates for the manufactured housing industry causing doubt about the return of the entire principal balance. We wrote this security down by an additional \$2.7 million during the fourth quarter of 2003 due to further deterioration in default rates.

Oakwood Mortgage 2000-C Class M1 is backed by installment sales contracts secured by manufactured homes and liens on real estate. We wrote this security down by \$7.6 million in the first quarter of 2004 due to an increase in default rates and realized losses above expected levels along with a downgrade to below investment grade on March 8, 2004. We took an additional writedown on this security of \$3.7 million in the third quarter of 2004 due to continued deterioration in default rates.

Diversified Asset Securities II Class B-1 is a pool of asset-backed securities that entitle the holders thereof to receive payments that depend primarily on the cash flow from a specified pool of financial assets. We wrote this security down by \$1.5 million during the second quarter of 2004 based upon the deterioration of the underlying collateral along with a downgrade to below investment grade on June 2, 2004. We sold this security for an immaterial loss during the fourth quarter of 2004.

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.

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Below is a list of securities which we have sold at a loss excluding losses arising from interest rate changes and losses deemed immaterial. There were no material realized losses on the sales of securities during 2004.

| Issuer | Amortized Cost | Fair Value | Realized Losses | Months Below Amortized Cost |
|-------------------------------------|-------------------|------------------|--------------------|--------------------------------|
| (Dollars in thousands) | | | | |
| Year Ended December 31, 2003 | | | | |
| Transamerica Capital | \$ 6,765 | \$ 6,437 | \$ 328 | 9 |
| Calpine Canada | 5,023 | 3,613 | 1,410 | 20 |
| American Airlines | 1,750 | 902 | 848 | 10 |
| Ford Motor Co. | 5,003 | 4,567 | 436 | 24 |
| Juniper | 2,594 | 2,075 | 519 | 5 |
| | <u>\$ 21,135</u> | <u>\$ 17,594</u> | <u>\$ 3,541</u> | |
| Year Ended December 31, 2002 | | | | |
| Qwest | \$ 9,851 | \$ 6,113 | \$ 3,738 | 5 |
| | <u>\$ 9,851</u> | <u>\$ 6,113</u> | <u>\$ 3,738</u> | |

Generally, for each of these sales there was an unexpected event resulting in a decline in credit quality which occurred shortly before the sale. This led to the decision to sell a security at a loss concurrent with the decision that an initial or additional impairment charge was required. Accordingly, in all cases, this did not contradict our previous assertion that we had the ability and intent to hold the security until recovery in value. Each of these securities and the factors resulting in the sales of such securities are discussed individually below.

Transamerica Capital was sold to reduce our exposure to European insurance companies and not as a result of deteriorating credit quality.

Calpine Canada was sold because it engaged in re-financing activities that threatened its long term profitability and exacerbated its reliance on leverage. The wholesale power market in which it was engaged was expected to be weak.

American Airlines pass thru certificates, which were collateralized by a pool of airplanes, were sold as a result of inadequate collateral coverage in a potential bankruptcy situation and recent changes regarding the airline's bank covenants regarding required minimum unrestricted cash balances.

Ford Motor Co. was determined to be an improving credit, however we decided to reduce our position in this security to \$10.0 million by selling \$5.0 million principal amount of these securities at a loss of \$0.4 million.

Juniper was a collateralized debt obligation backed by corporate debt obligations rated primarily below investment grade. In the first quarter of 2002, we wrote this security down as a result of downgrades and significant deterioration in the value of the underlying corporate debt. Continued deterioration led us to sell the security in 2003.

Qwest was sold as the result of several factors, including its rapidly deteriorating operating environment, the sale of one of its business units for a value well below expectations and continuing government investigations.

Derivative Instruments Index Products

We offer a variety of index annuities with crediting strategies linked to several equity market indices, including the S&P 500, the Dow Jones Industrial Average and the NASDAQ 100. Several of these products also offer a bond strategy linked to the Lehman Aggregate Bond Index or the Lehman U.S. Treasury Bond Index. These products allow policyholders to earn returns linked to equity or bond

index appreciation without the risk of loss of their principal. Most of these products allow policyholders to transfer funds once a year among several different crediting strategies, including one or more of the index based strategies and a traditional fixed rate strategy. Substantially all of our index products require annual crediting of interest and an annual reset of the applicable index on the contract anniversary date. The computation of the annual index credit is based upon either a one year annual point-to-point calculation (i.e., the gain in the applicable index from one anniversary date to the next anniversary date), a monthly averaging of the index during the contract year, or a one year monthly point-to-point calculation (the net gain determined by adding the twelve monthly gains and losses in the applicable index within the one year period from one anniversary date to the next anniversary date).

The annuity contract value is equal to the premiums paid plus annual index credits based upon a percentage, known as the "participation rate", of the annual appreciation (based in some instances on monthly averages or monthly point-to-point calculations) in a recognized index or benchmark. The participation rate, which we may reset annually, generally varies among the index products from 50% to 100%. Some of the products have an "asset fee" ranging from 1.5 to 5%, which is deducted from the interest to be credited. The asset fees may be adjusted annually by us, subject to stated limits. In addition, some products apply an overall limit, or "cap", ranging from 5% to 13%, on the amount of annual interest the policyholder may earn in any one contract year, and the applicable cap also may be adjusted annually subject to stated minimums. The minimum guaranteed contract values range from 80% to 100% of the premium collected plus interest credited on the minimum guaranteed contract value at an annual rate of 2% to 3.5%.

We purchase one-year call options on the applicable indices as an investment to provide the income needed to fund the amount of the annual index credits on the index products. New one-year options are purchased at the outset of each contract year. We budget an amount to purchase the specific options needed to fund the annual index credits, and the cost of the options represents our cost of providing the credits. The amount we budget for the purchase of index call options is based on our interest spread targets and is comparable to the credited rates of interest we offer on fixed rate annuities. For example, if the yield on our invested assets is 6.25% and our targeted spread is 2.50%, we allocate up to 3.75% of the premium in the first year or account balance after the first year to the purchase of one-year call options. Participation rates, which define the policyholder's level of participation in index gains each year, are determined by option costs. For example, if, based on current market conditions, the amount allocated to the purchase of options is sufficient to purchase an option that will provide a return equal to 70% of the annual gain in the applicable index, we will set the policyholder's participation rate at 70%. We have the ability to modify participation rates each year when a new option is purchased. In general, if option costs increase, participation rates may be decreased, and if option costs decrease, participation rates may be increased. We purchase call options weekly based upon new and renewing index account values during the applicable week, and the purchases are made by category according to the particular products and indices applicable to the new or renewing account values. Any proceeds received on the options at the expiration of the one-year term fund the related index credits to the policyholders. If there is no gain in an index, the policyholder receives a zero index credit on the policy, and we incur no costs beyond the option cost, except in cases where the minimum guaranteed value of a contract exceeds its index value.

Market value changes associated with the call options are reported as an increase or decrease in revenues in our consolidated statements of income in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "*Accounting for Derivative Instruments and Hedging Activities*". The risk associated with prospective purchases of future one-year options is the uncertainty of the cost, which will determine whether we are able to earn our spread on our index business. All our index products permit us to modify participation rates, asset fees or annual income caps at least once a year. This feature is comparable to our fixed rate annuities, which allow us to adjust crediting rates annually. By modifying our participation rates or other features, we can limit our costs of purchasing the related one-year call options, except in cases where 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.

After the purchase of the one-year call options and payment of acquisition costs, we invest the balance of index premiums as a part of our general account invested assets. With respect to the index products, our investment spread is measured as the difference between the aggregate yield on the relevant portion of our invested assets, less the aggregate option costs and the costs associated with minimum guarantees. If the minimum guaranteed value of an index product exceeds the index value (computed on a cumulative basis over the life of the contract) then the general account earnings are available to satisfy the minimum guarantees. If there were little or no gains in the entire series of one-year options purchased over the expected life of an index annuity (typically 10 to 15 years), then we would incur expenses for credited interest over and above our option costs, causing our spread to tighten and reducing our profits or potentially resulting in losses on these products.

Under SFAS No. 133, all derivative instruments (including certain derivative instruments embedded in other contracts) are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings. This impacts the items of revenue and expense we report on our index business as follows:

We must mark to market the purchased call options we use to fund the annual index credits on our index annuities based upon quoted market prices from related counterparties. We record the change in fair value of these options as a component of our revenues. Included within the change in fair value of the options is an element reflecting the time value of the options, which initially is their purchase cost declining to zero at the end of their one-year lives. The change in fair value of derivatives also includes proceeds received at the expiration of the one year option terms and gains or losses recognized upon early termination.

Under SFAS No. 133, the future annual index credits on our index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We are required to estimate the fair value of policy liabilities for index annuities, including the embedded derivatives, by valuing the "host" (or guaranteed) component of the liabilities and projecting (i) the expected index credits on the next policy anniversary dates and (ii) the net cost of annual options we will purchase in the future to fund index credits. Our estimates of the fair value of these embedded derivatives are based on assumptions related to underlying policy terms (including annual participation rates, asset fees, cap rates and minimum guarantees), index values, notional amounts, strike prices and expected lives of the policies. The change in fair value of embedded derivatives increases with increases in volatility in the indices and interest rates. The change in fair value of the embedded derivatives will not correspond to the change in fair value of the purchased options because the purchased 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 exceed 10 years.

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We adjust the amortization of deferred policy acquisition costs and deferred sales inducements to reflect the impact of the items discussed above.

The amounts reported with respect to our index business for SFAS No. 133 are summarized as follows:

| | Year Ended December 31, | | |
|-----------------------------------------------------------------------------------------------------------------|-------------------------|------------|-------------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Change in fair value of derivatives: | | | |
| Proceeds received at expiration or gains recognized upon early termination | \$ 87,619 | \$ 45,827 | \$ 9,735 |
| Cost of money for index annuities | (59,432) | (55,889) | (68,861) |
| Change in difference between fair value and remaining option cost at beginning and end of period | 509 | 62,587 | 1,373 |
| | \$ 28,696 | \$ 52,525 | \$ (57,753) |
| Change in fair value of embedded derivatives | \$ (8,567) | \$ 66,801 | \$ (5,027) |
| Related increase (decrease) in amortization of deferred policy acquisition costs and deferred sales inducements | \$ 6,408 | \$ (1,692) | \$ 1,447 |

Deferred Policy Acquisition Costs and Deferred Sales Inducements

Commissions and certain other costs relating to the production of new business are not expensed when incurred but instead are capitalized as deferred policy acquisition costs or deferred sales inducements. Only costs which are expected to be recovered from future policy revenues and gross profits may be deferred. Deferred policy acquisition costs consist principally of commissions and certain costs of policy issuance. Deferred sales inducements consist of first-year premium and interest bonuses credited to policyholder account balances.

Deferred policy acquisition costs totaled \$713.0 million and \$608.2 million at December 31, 2004 and 2003, respectively. Deferred sales inducements totaled \$159.5 million and \$95.5 million at December 31, 2004 and 2003, respectively. For annuity and single premium universal life products, these costs are being amortized generally in proportion to expected gross profits from investments and, to a lesser extent, from surrender charges and mortality and expense margins. Current period amortization must be adjusted retrospectively if changes occur in estimates of future gross profits/margins (including the impact of realized investment gains and losses). Our estimates of future gross profits/margins are based on actuarial assumptions related to the underlying policies terms, lives of the policies, yield on investments supporting the liabilities and level of expenses necessary to maintain the policies over their entire lives.

We adopted the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants Statement of Position (SOP) 03-1, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts" on January 1, 2004. As it applies to us, SOP 03-1 established guidance for the accounting and presentation of costs related to sales inducements. There was no change to our method of accounting for sales inducements; however, the capitalized costs are now separately disclosed in the consolidated balance sheets and the related amortization expense is included in interest credited to account balances in the consolidated statements of income. Prior to 2004, the capitalized costs were included in deferred policy acquisition costs and the amortization expense was included in the amortization of deferred policy acquisition costs. The 2003 and 2002 amounts have been reclassified to conform with the 2004 presentation.

Deferred Income Tax Assets

As of December 31, 2004 and 2003, we had \$70.6 million and \$58.8 million, respectively, of net deferred income tax assets. The realization of these assets is based upon estimates of future taxable income, which requires management judgement. Based upon projections of future taxable income, and considering all other available evidence, we have not recorded a valuation allowance against these assets.

Results of Operations for the Three Years Ended December 31, 2004

Annuity deposits by product type collected during 2004, 2003 and 2002, were as follows:

| Product Type | Year Ended December 31, | | |
|--------------------------------|-------------------------|--------------|--------------|
| | 2004 | 2003 | 2002 |
| (Dollars in thousands) | | | |
| Index Annuities: | | | |
| Index Strategies | \$ 1,119,398 | \$ 768,105 | \$ 867,880 |
| Fixed Strategy | 545,630 | 330,539 | 614,549 |
| | 1,665,028 | 1,098,644 | 1,482,429 |
| Fixed Rate Annuities: | | | |
| Single-Year Rate Guaranteed | 287,619 | 564,256 | 629,945 |
| Multi-Year Rate Guaranteed | 21,324 | 64,108 | 322,856 |
| | 308,943 | 628,364 | 952,801 |
| Total before coinsurance ceded | 1,973,971 | 1,727,008 | 2,435,230 |
| Coinsurance ceded | 202,064 | 649,434 | 837,882 |
| Net after coinsurance ceded | \$ 1,771,907 | \$ 1,077,574 | \$ 1,597,348 |

For information related to our coinsurance agreements, see note 5 to our audited consolidated financial statements.

Gross annuity deposits for 2004 increased 14% in comparison to 2003 resulting from increased marketing efforts following the completion of our initial public offering ("IPO"). Gross annuity deposits decreased 29% in 2003 compared to 2002 resulting from actions taken by us during 2003 prior to our IPO and during the fourth quarter of 2002 to manage our capital position, including reductions in our interest crediting rates on both new and existing annuities, reductions in sales commissions and suspension of sales of one of our higher commission annuity products and our most popular multi-year rate guaranteed product.

Net annuity deposits after coinsurance ceded increased 64% during 2004 compared to 2003 because we reduced the coinsurance percent in our coinsurance agreement with EquiTrust Life Insurance Company ("EquiTrust"), a subsidiary of FBL Financial Group, Inc. ("FBL"), from 40% in 2003 to 20% in 2004, and effective August 1, 2004, we suspended the EquiTrust coinsurance agreement. Net annuity deposits decreased 33% in 2003 compared to 2002 due to the decrease in gross annuity deposits discussed above.

Net income increased 78% to \$45.3 million in 2004, and 79% to \$25.4 million in 2003, from \$14.2 million in 2002. The increases in net income were principally due to growth in the volume of business in force and increases in the investment spread earned on our annuity liabilities. Our net annuity liabilities (after coinsurance ceded) increased from \$4.0 billion at the beginning of 2002 to \$7.7 billion at the end of 2004. As set forth in a table included earlier in this item, we increased our aggregate investment spread to 2.38% in 2004 compared to 2.30% in 2003 and 2.11% in 2002. The increases in net income also benefitted from increasing amounts of income generated by the spread on

our securities repurchase agreements due to increasing amounts of average borrowings outstanding under such agreements. Net income in each year was also impacted by the application of SFAS No. 133 to our index annuity business which we estimate increased net income in 2004 and 2002 by \$2.6 million and \$3.2 million, respectively, and decreased net income in 2003 by \$1.6 million. Net income in 2003 was also favorably impacted by realized gains on sales of investments of \$2.5 million on an after tax basis.

Annuity and single premium universal life product charges (surrender charges assessed against policy withdrawals and mortality and expense charges assessed against single premium universal life policyholder account balances) increased 10% to \$22.5 million in 2004, and 33% to \$20.5 million in 2003, from \$15.4 million in 2002. Withdrawals from annuity and single premium universal life policies subject to surrender charges were \$147.0 million, \$166.9 million and \$129.1 million for 2004, 2003 and 2002, respectively. The average surrender charge collected on withdrawals subject to surrender charges was 15.2%, 12.2% and 11.2% for 2004, 2003 and 2002, respectively. The increase in average surrender charges collected in 2004 compared to 2003 was principally due to a higher amount of surrenders in 2003 related to products which had a market value adjustment feature which reduced the amount of surrender charges collected on these surrenders.

Net investment income increased 20% to \$429.9 million in 2004 and 16% to \$358.5 million in 2003 from \$308.5 million in 2002. These increases are principally attributable to the growth in our annuity business and corresponding increases in our invested assets, offset by decreases in the average yield earned on our investments. Invested assets (on an amortized cost basis) increased 29% to \$8.0 billion at December 31, 2004 and 18% to \$6.2 billion at December 31, 2003 compared to \$5.2 billion at December 31, 2002, while the yield earned on average invested assets was 6.28%, 6.43% and 6.91% for 2004, 2003 and 2002, respectively. The declines in the yield earned on average invested assets are attributable to a general decline in interest rates and the reinvestment of net redemption proceeds from called securities at lower yields. See Quantitative and Qualitative Disclosures About Market Risk.

Realized gains (losses) on investments fluctuate from year to year due to changes in the interest rate and economic environment and the timing of the sale of investments. Realized gains and losses on investments include gains and losses on the sale of securities as well as losses recognized when the fair value of a security is written down in recognition of an "other than temporary" impairment. The components of realized gains (losses) on investments for the year ended December 31, 2004, 2003 and 2002 are summarized as follows:

| | Year Ended December 31, | | |
|-----------------------------------------------|-------------------------|-----------|-----------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Available for sale fixed maturity securities: | | | |
| Gross realized gains | \$ 13,720 | \$ 19,922 | \$ 19,943 |
| Gross realized losses | (220) | (4,216) | (6,773) |
| Writedowns (other than temporary impairments) | (12,828) | (9,821) | (13,030) |
| | 672 | 5,885 | 140 |
| Equity securities | 271 | 1,061 | (262) |
| | \$ 943 | \$ 6,946 | \$ (122) |

Change in fair value of derivatives (call options purchased to fund annual index credits on index annuities) was an increase of \$28.7 million in 2004, an increase of \$52.5 million in 2003 and a decrease of \$57.8 million in 2002. See Critical Accounting Policies Derivative Instruments Index Products for the components of the change in fair value of derivatives.

The difference between the change in fair value of derivatives between the periods is primarily due to the performance of the indices upon which our options are based. A substantial portion of our 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 years ended December 31, 2004, 2003 and 2002 is as follows:

| | Year Ended December 31, | | |
|----------------------------------------------------------|-------------------------|------------|-----------|
| | 2004 | 2003 | 2002 |
| S&P 500 Index | | | |
| Point-to-point strategy | 5.4%-31.3% | 0.0%-24.5% | |
| Monthly average strategy | 2.3%-29.2% | 0.0%-17.8% | 0.0%-6.1% |
| Lehman Brothers U.S. Aggregate and U.S. Treasury indices | 1.8%- 6.8% | 0.0%-14.2% | 5.8%-9.3% |

Actual amounts credited to policyholder account balances may be less than the index appreciation due to contractual features in the index annuity policies (participation rates and caps) 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 cost of options purchased which is related to the amount of policyholder funds allocated to the various indices, market volatility which affects option pricing and the policy terms and historical experience which affects the strikes and caps of the options we purchase. The aggregate cost of option purchases began declining in the second quarter of 2003 when we refined our hedging process to purchase options that were out of the money to the extent of anticipated minimum guaranteed interest on the index policies. Prior to that, all options were purchased at the money at a higher cost. The aggregate cost of option purchases increased during 2004 because more options were purchased at the money and option pricing increased due to greater market volatility. More options have been purchased at the money (or less out of the money than in preceding periods) because index returns have increased, thereby reducing the impact of minimum guaranteed interest on policy values and option purchases. See Critical Accounting Policies Derivative Instruments Index Products.

Interest credited to account balances increased 23% to \$305.8 million in 2004 and 35% to \$248.1 million in 2003 from \$183.5 million in 2002. These increases were principally attributable to index credits on index policies which increased to \$122.7 million and \$44.2 million in 2004 and 2003 as a result of increases in the underlying indices (see discussion above under change in fair value of derivatives). These increases were also attributable to a 19% increase in the average amount of annuity liabilities outstanding (net of annuity liabilities ceded under coinsurance agreements) during 2004 to \$7.0 billion from \$5.9 billion during 2003 and an increase of 25% from \$4.7 million during 2002. These increases were offset in part by the decrease in weighted average cost of money, which we implemented in connection with our spread management process, of 23 basis points during 2004, 67 basis points during 2003, and 28 basis points during 2002.

A component of interest credited to account balances is the amortization of deferred sales inducements. The amortization of deferred sales inducements was \$10.6 million, \$5.5 million and \$4.1 million for the year December 31, 2004, 2003 and 2002, respectively. The increases in amortization during 2004 and 2003 were principally attributable to growth in the sales of our premium and interest bonus products. The application of SFAS No. 133 to the amortization of deferred sales inducements resulted in a \$1.4 million increase in amortization in 2004, a decrease in amortization of \$0.2 million in 2003 and an increase in amortization of \$0.1 million in 2002. Bonus products made up 64% and 58% of our total annuity deposits during 2004 and 2003, respectively. See Critical Accounting Policies Deferred Policy Acquisition Costs and Deferred Sales Inducements.

Change in fair value of embedded derivatives was a decrease of \$8.6 million during the year ended December 31, 2004 compared to an increase of \$66.8 million in 2003 and a decrease of \$5 million in 2002. The change in the amount of expense recognized during 2004, 2003 and 2002 primarily resulted from the increase or decrease in expected index credits on the next policy anniversary dates, which are related to the change in the fair value of the options acquired to fund these index credits discussed above in the "Change in fair value of derivatives". In addition, the host value of the index reserve liabilities increased primarily as a result of increases in index annuity premium deposits. See Critical Accounting Policies Derivative Instruments Index Products.

Interest expense on subordinated debentures for 2004 increased to \$9.6 million from \$7.7 million in 2003. The comparable amount for 2002 was \$7.4 million and is reported as minority interests in subsidiaries. The increase during 2004 compared to 2003 was due to the issuance of additional floating rate subordinated debentures during 2004 of \$59.2 million and \$12.4 million issued in December 2003. The amount of subordinated debentures outstanding at December 31, 2004 was \$173.6 million compared to \$116.4 million at December 31, 2003. See Financial Condition Liabilities.

Interest expense on amounts due under repurchase agreements and other interest expense increased to \$3.1 million in 2004 from \$1.3 million in 2003 and \$1.8 million in 2002. The amounts include other interest expense of \$0.1 million in 2003 and \$1.1 million in 2002. The increase in 2004 is due to an increase in interest expense on amounts due under repurchase agreements. The decrease in 2003 is due to the reduction in other interest expense, offset in part by an increase in interest expense on amounts due under repurchase agreements. The increases in interest expense on amounts due under repurchase agreements are principally due to increases in the borrowings outstanding which averaged \$196.3 million, \$84.6 million and \$46.0 million during 2004, 2003 and 2002, respectively and changes in the weighted average interest rates on amounts borrowed which were 1.60%, 1.35% and 1.59% for 2004, 2003 and 2002, respectively. Other interest expense in 2003 was attributable to a financial reinsurance agreement that was terminated in 2003. Other interest expense in 2002 was attributable to the aforementioned financial reinsurance agreement and the short-sale of U.S. Treasury securities for tax planning purposes.

Amortization of deferred policy acquisition costs increased 43% to \$67.9 million in 2004 and 40% to \$47.5 million in 2003 from \$34.1 million in 2002. These increases are primarily due to additional annuity deposits as discussed above. Additional amortization associated with net realized gains on investments for the year ended December 31, 2003 was \$3.1 million. The application of SFAS No. 133 resulted in a \$5.0 million increase in amortization in 2004, a decrease in amortization of \$1.5 million in 2003, and an increase in amortization of \$1.4 million in 2002.

Other operating costs and expenses increased 25% to \$32.0 million in 2004 and 18% to \$25.6 million in 2003 from \$21.6 million in 2002. The increase during 2004 compared to 2003 was principally attributable to \$1.8 million of paid and accrued guaranty fund assessments related to the insolvency of London Pacific Life and Annuity Company, an increase of \$1.4 million in salaries and related costs of employment due to the growth in our annuity business, \$0.8 million in marketing and advertising costs, and \$1.1 million in printing and postage costs related to existing policies and marketing of new policies. The increase during 2003 compared to 2002 was principally attributable to an increase of \$0.8 million in professional fees related to litigation, \$1.5 million in salaries and related costs of employment due to growth in our annuity business and \$1.4 million in risk charges related to the reinsurance agreement entered into with Hannover Life Reassurance Company of America on November 1, 2002. This agreement is more fully described in note 5 to our audited consolidated financial statements.

Income tax expense increased 80% to \$24.3 million in 2004 from \$13.5 million in 2003. Income tax expense increased to \$13.5 million in 2003 from \$7.3 million in 2002. These increases were principally due to an increase in pre-tax income. Our effective tax rates for 2004, 2003 and 2002 were 35%, 35%

and 34%, respectively, after taking into consideration the impact of earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts in 2002. See note 6 to our audited consolidated financial statements.

Financial Condition

Investments

Our investment strategy is to maintain a predominantly investment grade fixed income portfolio, provide adequate liquidity to meet our cash obligations to policyholders and others and maximize current income and total investment return through active investment management. Consistent with this strategy, our investments principally consist of fixed maturity securities and 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-agency securities and corporate securities rated investment grade by established nationally recognized rating organizations or in securities of comparable investment quality, if not rated.

We have classified a portion of our fixed maturity investments as available for sale. Available for sale securities are reported at market value and unrealized gains and losses, if any, on these securities (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) are included directly in a separate component of stockholders' equity, thereby exposing stockholders' equity to volatility due to changes in market interest rates and the accompanying changes in the reported value of securities classified as available-for-sale, with stockholders' equity increasing as interest rates decline and, conversely, decreasing as interest rates rise.

Cash and investments increased to \$8.01 billion at December 31, 2004 compared to \$6.23 billion at December 31, 2003 as a result of the growth in our annuity business discussed above. At December 31, 2004, the fair value of our available for sale fixed maturity and equity securities was \$65.0 million less than the amortized cost of those investments, compared to \$86.1 million at December 31, 2003. At December 31, 2004, the amortized cost of our fixed maturity securities held for investment exceeded the market value by \$92.7 million, compared to \$110.1 million at December 31, 2003. The decrease in net unrealized investment losses at December 31, 2004 compared to December 31, 2003 was generally related to a decrease in market interest rates.

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

| December 31, | | | | | |
|----------------------------------------------|----|---------------------|---------------|---------------------|---------------|
| | | 2004 | | 2003 | |
| | | Carrying Amount | Percent | Carrying Amount | Percent |
| (Dollars in thousands) | | | | | |
| Fixed maturity securities: | | | | | |
| United States Government and agencies | \$ | 5,730,894 | 71.5% | \$ 4,289,857 | 68.9% |
| Public utilities | | 44,849 | 0.6% | 51,835 | 0.8% |
| Corporate securities | | 338,407 | 4.2% | 409,482 | 6.6% |
| Redeemable preferred stocks | | 35,369 | 0.4% | 10,079 | 0.2% |
| Mortgage and asset-backed securities: | | | | | |
| Government | | 257,004 | 3.2% | 264,102 | 4.2% |
| Non-Government | | 397,293 | 5.0% | 419,959 | 6.7% |
| Total fixed maturity securities | | 6,803,816 | 84.9% | 5,445,314 | 87.4% |
| Equity securities | | 38,303 | 0.5% | 21,409 | 0.4% |
| Mortgage loans on real estate | | 959,779 | 12.0% | 608,715 | 9.8% |
| Derivative instruments | | 148,006 | 1.8% | 119,833 | 1.9% |
| Policy loans | | 362 | | 324 | |
| Cash and cash equivalents | | 62,664 | 0.8% | 32,598 | 0.5% |
| Total cash and investments | | \$ 8,012,930 | 100.0% | \$ 6,228,193 | 100.0% |

The table below presents our total fixed maturity securities by NAIC designation and the equivalent ratings of a nationally recognized securities rating organization.

| | | December 31, | | | |
|----------------------------------------|--------------------|---------------------|---------------|---------------------|---------------|
| | | 2004 | | 2003 | |
| NAIC | Rating Agency | Carrying Amount | Percent | Carrying Amount | Percent |
| (Dollars in thousands) | | | | | |
| 1 | Aaa/Aa/A | \$ 6,585,322 | 96.8% | \$ 5,191,006 | 95.3% |
| 2 | Baa | 162,298 | 2.4% | 174,519 | 3.2% |
| 3 | Ba | 20,555 | 0.3% | 47,904 | 0.9% |
| 4 | B | 14,124 | 0.2% | 21,109 | 0.4% |
| 5 | Caa and lower | 13,298 | 0.2% | 10,773 | 0.2% |
| 6 | In or near default | 8,219 | 0.1% | 3 | |
| Total fixed maturity securities | | \$ 6,803,816 | 100.0% | \$ 5,445,314 | 100.0% |

At December 31, 2004 and 2003, we held \$959.8 million and \$608.7 million, respectively, of mortgage loans with commitments outstanding of \$58.8 million at December 31, 2004. These mortgage loans are diversified as to property type, location, and loan size, and are collateralized by the related properties. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and require diversification by geographic location and collateral type.

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As of December 31, 2004, there were no delinquencies in our mortgage portfolio. The commercial mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows:

| | December 31, | | | |
|-----------------------------------|--------------------|---------------|--------------------|---------------|
| | 2004 | | 2003 | |
| | Carrying Amount | Percent | Carrying Amount | Percent |
| (Dollars in thousands) | | | | |
| Geographic distribution | | | | |
| East | \$ 196,805 | 20.5% | \$ 115,817 | 19.0% |
| Middle Atlantic | 80,098 | 8.3% | 56,563 | 9.3% |
| Mountain | 148,608 | 15.5% | 79,777 | 13.1% |
| New England | 50,624 | 5.3% | 38,539 | 6.3% |
| Pacific | 84,860 | 8.8% | 42,327 | 7.0% |
| South Atlantic | 166,606 | 17.4% | 105,635 | 17.4% |
| West North Central | 165,041 | 17.2% | 125,163 | 20.5% |
| West South Central | 67,137 | 7.0% | 44,894 | 7.4% |
| | \$ 959,779 | 100.0% | \$ 608,715 | 100.0% |
| Property type distribution | | | | |
| Office | \$ 296,995 | 30.9% | \$ 145,490 | 23.9% |
| Medical Office | 65,396 | 6.8% | 55,314 | 9.1% |
| Retail | 218,133 | 22.7% | 163,434 | 26.8% |
| Industrial/Warehouse | 236,835 | 24.7% | 162,943 | 26.8% |
| Hotel | 25,652 | 2.7% | 20,819 | 3.4% |
| Apartments | 44,984 | 4.7% | 29,565 | 4.9% |
| Mixed use/other | 71,784 | 7.5% | 31,150 | 5.1% |
| | \$ 959,779 | 100.0% | \$ 608,715 | 100.0% |

Liabilities

Our liability for policy benefit reserves increased to \$9.81 billion at December 31, 2004 compared to \$8.32 billion at December 31, 2003, primarily due to additional annuity sales as discussed above. Substantially all of our annuity products have a surrender charge feature designed to reduce the risk of early withdrawal or surrender of the policies and to compensate us for our costs if policies are withdrawn early. Notwithstanding these policy features, the withdrawal rates of policyholder funds may be affected by changes in interest rates and other factors.

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 market values approximately equal to the amount due. We earn investment income on the securities purchased with these borrowings at a rate in excess of the cost of these borrowings. Such borrowings averaged \$196.3 million, \$84.6 million and \$46.0 million for the years ended December 31, 2004, 2003 and 2002, respectively. The weighted average interest rate on amounts due under repurchase agreements was 1.60%, 1.35% and 1.59% for the years ended December 31, 2004, 2003 and 2002, respectively.

In December 2004, we issued \$260.0 million of contingent convertible senior notes due December 6, 2024 through a private placement under Rule 144A of the Securities Act of 1933. The notes are unsecured and bear interest at a fixed rate of 5.25% per annum. Interest is payable semi-annually in arrears on June 6 and December 6 of each year, beginning June 6, 2005. In addition to regular interest on the notes, beginning with the six-month interest period ending June 6, 2012, we

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will also pay contingent interest under certain conditions at a rate of 0.5% per annum based on the average trading price of the notes during a specified period.

The notes are convertible at the holders' option prior to the maturity date into cash and shares of our common stock under certain conditions. The initial conversion price per share is \$14.47 which represents a conversion rate of 69.1085 shares of our common stock per \$1,000 in principal amount of notes. Upon conversion, we will deliver to the holder cash equal to the aggregate principal amount of the notes to be converted and will deliver shares of our common stock for the amount by which the conversion value exceeds the aggregate principal amount of the notes to be converted (commonly referred to as "net share settlement"). See note 7 to our audited consolidated financial statements for additional details concerning the conversion features of the notes and the dilutive effect of the notes in our diluted earnings per share calculation.

We may redeem the notes at any time on or after December 15, 2011. The holders of the notes may require us to repurchase their notes on December 15, 2011, 2014, and 2019 and for a certain period of time following a change in control. The redemption price or the repurchase price shall be payable in cash and equal to 100% of the principal amount of the notes, plus accrued and unpaid interest (including contingent interest and liquidated damages, if any) up to but not including the date of redemption or repurchase.

The notes are senior unsecured obligations and rank equally in the right of payment with all existing and future senior indebtedness and senior to any existing and future subordinated indebtedness. The notes effectively rank junior in the right of payment to any existing and future secured indebtedness to the extent of the value of the assets securing such secured indebtedness. The notes are structurally subordinated to all liabilities of our subsidiaries.

Our subsidiary trusts have issued fixed rate and floating rate trust preferred securities and the trusts have used the proceeds from these offerings to purchase subordinated debentures from us. We also issued subordinated debentures to the trusts in exchange for all of the common securities of each trust. The sole assets of the trusts are the subordinated debentures and any interest accrued thereon. The terms of the preferred securities issued by each trust parallel the terms of the subordinated debentures. Our obligations under the subordinated debentures and related agreements provide a full and unconditional guarantee of payments due under the trust preferred securities. In accordance with Financial Accounting Standards Board Interpretation No. 46, "*Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51*", we do not consolidate our subsidiary trusts and record our subordinated debt obligations to the trusts and our equity investments in the trusts. See notes 1 and 9 to our audited consolidated financial statements for additional information concerning our subordinated debentures payable to and the preferred securities issued by the subsidiary trusts. Following is a summary of subordinated debt obligations to the trusts at December 31, 2004 and 2003:

| | December 31, | | | |
|------------------------------------|------------------------|------------|------------------|--------------------|
| | 2004 | 2003 | Interest Rate | Due Date |
| | (Dollars in thousands) | | | |
| American Equity Capital Trust I | \$ 24,073 | \$ 26,713 | 8% | September 30, 2029 |
| American Equity Capital Trust II | 77,861 | 77,340 | 5% | June 1, 2047 |
| American Equity Capital Trust III | 27,840 | | Floating | April 29, 2034 |
| American Equity Capital Trust IV | 12,372 | 12,372 | Floating | January 8, 2034 |
| American Equity Capital Trust VII | 10,830 | | Floating | September 14, 2034 |
| American Equity Capital Trust VIII | 20,600 | | Floating | December 22, 2034 |
| | \$ 173,576 | \$ 116,425 | | |

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The interest rate for the floating rate subordinated debentures is based upon the three month London Interbank Offered rate plus 4.00% for Trust III and IV and 3.75% for Trust VII and VIII.

American Equity Capital Trust I issued 865,671 shares of trust preferred securities, of which 2,000 shares are held by one of our subsidiaries. During 2004, 88,000 shares of these trust preferred securities converted into 325,923 shares of our common stock. The remaining 777,671 shares of these trust preferred securities are convertible into 2,872,794 shares of our common stock.

American Equity Capital Trust II issued \$97.0 million (97,000 shares) of 5% trust preferred securities and we issued \$100 million of our 5% subordinated debentures. The consideration received by American Equity Capital Trust II in connection with the issue of its trust preferred securities consisted of fixed income trust preferred securities of equal value issued by FBL.

During the third quarter of 2004, we entered into a \$50 million revolving line of credit with three banks. There is no amount outstanding under this revolving line of credit at December 31, 2004. See note 7 to our audited consolidated financial statements for additional details concerning the terms of the revolving line of credit. At December 31, 2003, we had \$31.8 million outstanding under a credit agreement. All amounts outstanding under this agreement were repaid during 2004.

Stockholders' Equity

In 1997, in connection with a rights offering of shares of our common stock, we issued subscription rights to purchase an aggregate of 2,157,375 shares of our common stock to certain officers and directors. The subscription rights have an exercise price of \$5.33 per share. During 2002, the board of directors extended the expiration date of the subscription rights from December 1, 2002 to December 1, 2005 and in conjunction therewith, we recognized compensation expense of \$0.3 million.

During 1998, we issued 625,000 shares of 1998 Series A Participating Preferred Stock (aggregate liquidation preference of \$10.0 million). During 2004, all of these shares converted into 1,875,000 shares of our common stock. Prior to conversion, these shares had participating dividend rights with the shares of our common stock, when and as such dividends were declared.

During 2003, we purchased 1,435,500 shares of our common stock at a total cost of \$9.3 million (\$6.49 per share). We issued these shares and 155,583 shares held as treasury stock to a rabbi trust established for the benefit of agents who have earned shares of our common stock under the American Equity Investment NMO Deferred Compensation Plan. See note 10 to our audited consolidated financial statements.

On December 9, 2003, we completed an initial public offering of 18,700,000 shares of our common stock at a price of \$9.00 per share. Pursuant to the over-allotment option granted to the underwriters in this offering, the underwriters purchased an additional 2,000,000 shares on December 29, 2003 and an additional 805,000 shares on January 7, 2004, which fully exercised the over-allotment option. The proceeds from our initial public offering (including proceeds from shares issued pursuant to the over-allotment option), net of the underwriting discount and expenses, were approximately \$178.0 million.

During 2004, we issued 54,385 shares of our common stock to an agent's beneficiaries in relation to shares earned under the American Equity Investment NMO Deferred Compensation Plan. See note 10 to our audited consolidated financial statements.

Liquidity for Insurance Operations

Our life subsidiaries generally receive adequate cash flow from premium collections and investment income to meet their obligations. Annuity and life insurance liabilities are generally long-term in nature. Policyholders may, however, withdraw funds or surrender their policies, subject to surrender

and withdrawal penalty provisions. At December 31, 2004, approximately 99% of our annuity liabilities were subject to penalty upon surrender, with a weighted average remaining surrender charge period of 8.8 years and a weighted average surrender charge rate of 12%.

We believe that the diversity of our investment portfolio and the concentration of investments in high-quality securities provides sufficient liquidity to meet foreseeable cash requirements. The investment portfolio at December 31, 2004 included \$2.6 billion (amortized cost basis) of publicly traded available for sale investment grade bonds. Although there is no present need or intent to dispose of such investments, our life subsidiaries could readily liquidate portions of their investments, if such a need arose. See Quantitative and Qualitative Disclosures about Market Risk for further discussion of the related interest rate risk exposure. In addition, investments could be used to facilitate borrowings under repurchase agreements. As indicated above, such borrowings have been used by American Equity Life from time to time to increase our return on investments.

Liquidity of Parent Company

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. We need liquidity primarily to service our debt, including the convertible senior notes and subordinated debentures issued to subsidiary trusts, pay operating expenses and pay dividends to stockholders. The primary sources of funds for these payments are: (i) investment advisory fees from our life subsidiaries; (ii) dividends on capital stock and surplus note interest payments from American Equity Life; (iii) investment income on our investments; and (iv) principal and interest payments received on our notes receivable from American Equity Investment Service Company (see discussion that follows). These sources provide adequate cash flow to us to meet our current and reasonably foreseeable future obligations. We may also obtain cash by drawing down our \$50 million revolving line of credit or by issuing debt or equity securities.

The payment of dividends or distributions, including surplus note payments, by our life subsidiaries is subject to regulation by each subsidiary's state of domicile's insurance department. Currently, American Equity Life may pay dividends or make other distributions without the prior approval of its state of domicile's insurance department, unless such payments, together with all other such payments within the preceding twelve months, exceed the greater of (1) American Equity Life's net gain from operations for the preceding calendar year, or (2) 10% of American Equity Life's statutory surplus at the preceding December 31. For 2005, up to approximately \$60.9 million can be distributed as dividends by American Equity Life without prior approval of the Iowa Insurance Division. In addition, dividends and surplus note payments may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities in the life subsidiary's state of domicile. American Equity Life had approximately \$114.6 million of earned surplus at December 31, 2004.

The maximum distribution permitted by law or contract is not necessarily indicative of an insurer's actual ability to pay such distributions, which may be constrained by business and regulatory considerations, such as the impact of such distributions on surplus, which could affect the insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends or make other distributions. Further, state insurance laws and regulations require that the statutory surplus of our life subsidiaries following any dividend or distribution must be reasonable in relation to their outstanding liabilities and adequate for their financial needs.

The transfer of funds by American Equity Life is also restricted by a covenant in our revolving line of credit agreement which requires American Equity Life to maintain a minimum risk-based capital ratio of 200%.

Statutory accounting practices prescribed or permitted for our life subsidiaries differ in many respects from those governing the preparation of financial statements under GAAP. Accordingly,

statutory operating results and statutory capital and surplus may differ substantially from amounts reported in the GAAP basis financial statements for comparable items. Information as to statutory capital and surplus and statutory net income for our life subsidiaries as of December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002 is included in note 11 to our audited consolidated financial statements.

American Equity Life has entered into a general agency commission and servicing agreement with American Equity Investment Service Company, or the Service Company, an affiliated company wholly-owned by our chairman, chief executive officer and president, whereby the affiliate acts as a national supervisory agent with responsibility for paying commissions to our agents. This agreement initially benefits American Equity Life's statutory surplus by extending the payment of a portion of the first year commissions on new annuity business written by American Equity Life over a longer period of time, and thereby enabling American Equity Life to conduct a comparatively greater volume of business. In subsequent periods, American Equity Life's statutory surplus is reduced through the payment of renewal commissions to the affiliate on this business based upon the account balances of the annuities remaining in force (see note 8 to our audited consolidated financial statements). During the years ended December 31, 2004, 2003 and 2002, the Service Company paid \$20.0 million, \$14.4 million and \$11.8 million, respectively, to agents of American Equity Life. American Equity Life paid renewal commissions to the Service Company of \$28.1 million, \$22.1 million and \$21.7 million, respectively, during the years ended December 31, 2004, 2003 and 2002. Future payments by American Equity Life on business in force at December 31, 2004 are dependent upon the account balances of the annuities remaining in force on each remaining quarterly renewal commission payment date.

From time to time the Service Company has borrowed money from us as a source of funds for the commissions it paid to American Equity Life's agents. During 2003, the Service Company borrowed \$14.5 million from us. At December 31, 2004 and 2003, the amount receivable from the Service Company was \$16.2 million and \$27.9 million, respectively. Principal and interest are payable quarterly over five years from the date of the advance.

In the normal course of business, we enter into financing transactions, lease agreements, or other commitments. These commitments may obligate us to certain cash flows during future periods. The following table summarizes such obligations as of December 31, 2004.

| | Payments Due by Period | | | | |
|--------------------------------------------------------------------------------------|-------------------------------|-----------------------------|------------------------|------------------------|--------------------------|
| | Total | Less Than 1 year | 1 - 3 Years | 4 - 5 Years | After 5 Years |
| (Dollars in thousands) | | | | | |
| Annuity and single premium universal life products(1) | \$ 9,111,554 | \$ 681,149 | \$ 2,157,377 | \$ 1,452,691 | \$ 4,820,337 |
| Amounts due to related party under General Agency Commission and Servicing Agreement | 35,812 | 19,148 | 7,565 | 9,099 | |
| Senior convertible notes, including interest payments | 533,000 | 13,650 | 27,300 | 27,300 | 464,750 |
| Subordinated debentures, including interest payments(2) | 557,232 | 11,242 | 22,483 | 22,483 | 501,024 |
| Operating leases | 1,806 | 1,030 | 703 | 73 | |
| Mortgage loan funding | 58,820 | 58,820 | | | |
| Total | \$ 10,298,224 | \$ 785,039 | \$ 2,215,428 | \$ 1,511,646 | \$ 5,786,111 |

(1) Amounts shown in this table are projected payments through the year 2023 which we are contractually obligated to pay to our annuity policyholders. The payments are derived from actuarial models which assume a level interest rate scenario and incorporate assumptions regarding

mortality and persistency, when applicable. These assumptions are based on our historical experience. Amount shown are net of expected reinsurance recoveries.

(2)

Projected interest payments related to variable interest rate subordinated debentures assumes level interest rates. Amount shown is net of \$2.1 million equity investments in the trusts due to the contractual right of offset upon repayment of the notes. See Financial Condition Liabilities.

Pending Accounting Changes

In March 2004, the FASB's Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (EITF 03-1). EITF 03-1 provides guidance regarding the meaning of other-than-temporary impairment and its application to investments classified as either available for sale or held to maturity under FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and to equity securities accounted for under the cost method. Included in EITF 03-1 is guidance on how to account for impairments that are solely due to interest rate changes, including changes resulting from increases in sector credit spreads. This guidance was to become effective for reporting periods beginning after June 15, 2004. However, on September 30, 2004, the FASB issued a Staff Position that delays the effective date for the recognition and measurement guidance of EITF 03-1 until additional clarifying guidance is issued. The issuance of this guidance was delayed during the fourth quarter of 2004, with additional discussion of this issue by the FASB planned for 2005. We are not able to assess the impact of the adoption of EITF 03-1 until final guidance is issued.

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R"). This standard requires expensing stock options and other share-based payments and supersedes SFAS No. 123, which had allowed companies to choose between expensing stock options or showing proforma disclosure only. This standard is effective for us as of July 1, 2005 and will apply to all awards granted, modified, cancelled or purchased after that date as well as the unvested portion of prior awards. We will adopt the standard as of the effective date and do not believe it will have a material effect on our financial statements.

Inflation

Inflation does not have a significant effect on our balance sheet. We have minimal investments in property, equipment or inventories. To the extent that interest rates may change to reflect inflation or inflation expectations, there would be an effect on our balance sheet and operations. Higher interest rates experienced in recent periods have decreased the value of our fixed maturity investments. It is likely that declining interest rates would have the opposite effect. It is not possible to calculate the effect such changes in interest rates, if any, have had on our operating results.

ITEM 7A. 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. 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 amount of interest we pay on our subordinated debentures payable, and the market value of our investments. Our floating rate trust preferred securities issued by Trusts III, IV, VII, and VIII bear interest at the three month LIBOR plus 3.75% - 4.00%. Our outstanding balance of floating rate trust preferred securities at December 31, 2004 was \$69.5 million. 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 (participation or asset fee rates for index annuities) on substantially all of our annuity policies 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% (48 basis points) from levels at December 31, 2004, we estimate that the fair value of our fixed maturity securities would decrease by approximately \$328.0 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 an increase of \$34.5 million in the accumulated other comprehensive loss. 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 as discussed earlier. See Financial Condition Liquidity for Insurance Operations for a further discussion of the liquidity risk.

At December 31, 2004, 85% of our fixed income securities have call features and 9% were subject to call redemption. Another 70% will become subject to call redemption through December 31, 2005. During the years ended December 31, 2004 and 2003, we received \$2.18 billion and \$2.52 billion, respectively, in net 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 our annuity liabilities, we have the ability to reduce crediting rates on most of our annuity liabilities to maintain the spread at our targeted level. At December 31, 2004, approximately 82% of our annuity liabilities are subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates of 2% to 4%.

With respect to our index annuities, we purchase call options on the applicable indices to fund the annual index credits on such annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Proceeds received at expiration of the call options are substantially offset by an increase in the amounts added to policyholder account balances for index products. For the years ended December 31, 2004 and 2003, index credits to policyholders on their anniversaries were \$122.7 million and \$44.2 million, respectively. Proceeds received at expiration of these options related to such credits were \$87.2 million and \$41.1 million, respectively. The difference between proceeds received at expiration of these options and index credits for 2004 is primarily due to credits attributable to minimum guaranteed interest self funded by us. During 2003, we refined our hedging process to 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. This is a risk we attempt to manage through the terms of our index annuities, which permit us to change annual participation rates, asset fees, and caps, subject to contractual features. By modifying participation rates, asset fees or caps, 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 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The consolidated financial statements are included as a part of this report on Form 10-K on pages F-1 through F-34.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures.

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), as of the end of the period covered by this *Annual Report on Form 10-K*, the Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on their evaluation of these disclosure

controls and procedures, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as a result of the material weakness in the Company's internal control over financial reporting discussed below, the disclosure controls and procedures were not effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act.

Management's Report on Internal Control over Financial Reporting.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in the Exchange Act Rule 13a-15(f). The Company's internal control system is designed to provide reasonable assurance to the Company's management and the board of directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004 based upon criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management determined a lack of formal documentation exists surrounding the Company's review of its deferred policy acquisition costs and deferred sales inducements, its unlocking analysis and the related assumptions and estimates used in connection with these items. In addition management concluded that the review of inputs into the models for estimating deferred policy acquisition costs and deferred sales inducements was inadequate. As a result, management has concluded that a material weakness exists and thus is not be able to conclude that its internal control over financial reporting was effective as of the end of the period covered by the Company's Annual Report on Form 10-K. However, this weakness in the Company's internal control over financial reporting did not result in any material misstatement of the Company's financial statements for 2004.

Management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included elsewhere herein.

Remediation

The Company's remediation of this material weakness includes the implementation of additional review procedures for the inputs into the models for deferred policy acquisition costs and deferred sales inducements and a more formal documentation process of the review and approval at each reporting period of the amounts recorded for deferred policy acquisition costs and deferred sales inducements and the assumptions and estimates used in this process. This remediation is expected to be in place prior to the filing of the Company's first quarterly report in 2005.

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Stockholders
American Equity Investment Life Holding Company

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that American Equity Investment Life Holding Company did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weakness identified in management's assessment as described below based on criteria established in Internal Control – Integrated Framework issued by the Committee of

Sponsoring Organizations of the Treadway Commission (the COSO criteria). American Equity Investment Life Holding Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weakness has been identified and included in management's assessment: In its assessment as of December 31, 2004, management identified as a material weakness that there was not an effective review of the inputs into the Company's models for estimating deferred policy acquisition costs and deferred sales inducements and the lack of formal documentation surrounding the Company's review of its deferred policy acquisition costs and deferred sales inducements, its unlocking analysis and the related assumptions and estimates used in connection with these items. As a result of this material weakness in internal control, during the fourth quarter of 2004 the Company recorded an adjustment to its deferred policy acquisition costs and deferred sales inducements assets as of December 31, 2004, and for the related amortization of deferred policy acquisition costs and interest credited to account balances. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2004 consolidated financial statements, and this report does not affect our report dated March 11, 2005, which expressed an unqualified opinion on those consolidated financial statements.

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In our opinion, management's assessment that American Equity Investment Life Holding Company did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, because of the effects of the material weakness described above on the achievement of the objectives of the control criteria, American Equity Investment Life Holding Company has not maintained effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

/s/ Ernst & Young LLP

Des Moines, Iowa
March 23, 2005

Changes in Internal Control over Financial Reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2004 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

There is no information required to be disclosed on Form 8-K for the quarter ended December 31, 2004 which has not been previously reported.

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PART III

The information required by Part III is incorporated by reference from our definitive proxy statement for our annual meeting of shareholders to be held June 9, 2005 to be filed with the Commission pursuant to Regulation 14A within 120 days after December 31, 2004.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

Financial Statements and Financial Statement Schedules. See Index to Consolidated Financial Statements and Schedules on page F-1 for a list of financial statements and financial statement schedules included in this report.

All other schedules to the consolidated financial statements required by Article 7 of Regulation S-X are omitted because they are not applicable, not required, or because the information is included elsewhere in the consolidated financial statements or notes thereto.

Exhibits. See Exhibit Index immediately preceding the Exhibits for a list of Exhibits filed with this report.

**AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES
YEARS ENDED DECEMBER 31, 2004, 2003, AND 2002**

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
American Equity Investment Life Holding Company

We have audited the accompanying consolidated balance sheets of American Equity Investment Life Holding Company as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedules listed in the Index on page F-1. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Equity Investment Life Holding Company at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of reporting certain variable interest entities, in response to a new accounting standard that became effective December 31, 2003.

/s/ ERNST & YOUNG LLP

Des Moines, Iowa
March 14, 2005

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

| | December 31, | |
|---------------------------------------------------------------------------------------|----------------------|---------------------|
| | 2004 | 2003 |
| Assets | | |
| Cash and investments: | | |
| Fixed maturity securities: | | |
| Available for sale, at market (amortized cost: 2004 \$2,769,804; 2003 \$3,703,756) | \$ 2,705,323 | \$ 3,618,025 |
| Held for investment, at amortized cost (market: 2004 \$4,005,775; 2003 \$1,717,224) | 4,098,493 | 1,827,289 |
| Equity securities, available for sale, at market (cost: 2004 \$38,838; 2003 \$21,794) | 38,303 | 21,409 |
| Mortgage loans on real estate | 959,779 | 608,715 |
| Derivative instruments | 148,006 | 119,833 |
| Policy loans | 362 | 324 |
| Cash and cash equivalents | 62,664 | 32,598 |
| Total cash and investments | 8,012,930 | 6,228,193 |
| Coinsurance deposits related party | 2,068,700 | 1,926,603 |
| Accrued investment income | 44,871 | 29,386 |
| Receivables from related parties | 16,596 | 28,015 |
| Deferred policy acquisition costs | 713,021 | 608,197 |
| Deferred sales inducements | 159,467 | 95,467 |
| Deferred income tax asset | 70,562 | 58,833 |
| Federal income taxes recoverable | | 1,737 |
| Other assets | 27,919 | 12,746 |
| Total assets | \$ 11,114,066 | \$ 8,989,177 |

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

| | December 31, | |
|--------------------------------------------------------------------------------------------------------------------------------------------|---------------|--------------|
| | 2004 | 2003 |
| Liabilities and Stockholders' Equity | | |
| Liabilities: | | |
| Policy benefit reserves: | | |
| Traditional life and accident and health insurance products | \$ 62,073 | \$ 44,497 |
| Annuity and single premium universal life products | 9,745,896 | 8,271,377 |
| Other policy funds and contract claims | 94,410 | 60,995 |
| Amounts due to related party under General Agency Commission and Servicing Agreement | 35,812 | 40,601 |
| Other amounts due to related parties | 31,955 | 22,551 |
| Notes payable | 260,000 | 31,833 |
| Subordinated debentures | 173,576 | 116,425 |
| Amounts due under repurchase agreements | 264,875 | 108,790 |
| Federal income taxes payable | 6,620 | |
| Other liabilities | 117,345 | 28,392 |
| Total liabilities | 10,792,562 | 8,725,461 |
| Stockholders' equity: | | |
| Series Preferred Stock, par value \$1 per share, 2,000,000 shares authorized; 1998 Series A | | |
| Participating Preferred Stock issued and outstanding: 2003 625,000 shares | | 625 |
| Common Stock, par value \$1 per share, 75,000,000 shares authorized; issued and outstanding 2004 38,360,343 shares; 2003 35,294,035 shares | 38,360 | 35,294 |
| Additional paid-in capital | 215,793 | 208,436 |
| Accumulated other comprehensive loss | (19,269) | (22,742) |
| Retained earnings | 86,620 | 42,103 |
| Total stockholders' equity | 321,504 | 263,716 |
| Total liabilities and stockholders' equity | \$ 11,114,066 | \$ 8,989,177 |

See accompanying notes.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

| | Year ended December 31, | | |
|-------------------------------------------------------------------------------------------------------------|-------------------------|------------------|------------------|
| | 2004 | 2003 | 2002 |
| Revenues: | | | |
| Traditional life and accident and health insurance premiums | \$ 15,115 | \$ 13,686 | \$ 13,664 |
| Annuity and single premium universal life product charges | 22,462 | 20,452 | 15,376 |
| Net investment income | 429,926 | 358,529 | 308,548 |
| Realized gains (losses) on investments | 943 | 6,946 | (122) |
| Change in fair value of derivatives | 28,696 | 52,525 | (57,753) |
| Total revenues | 497,142 | 452,138 | 279,713 |
| Benefits and expenses: | | | |
| Insurance policy benefits and change in future policy benefits | 13,423 | 11,824 | 9,317 |
| Interest credited to account balances | 305,762 | 248,075 | 183,503 |
| Change in fair value of embedded derivatives | (8,567) | 66,801 | (5,027) |
| Interest expense on amounts due to related party under General Agency Commission and Servicing Agreement | 2,594 | 3,000 | 3,596 |
| Interest expense on notes payable | 1,749 | 1,486 | 1,901 |
| Interest expense on subordinated debentures | 9,609 | 7,661 | |
| Interest expense on amounts due under repurchase agreements and other interest expense | 3,148 | 1,278 | 1,777 |
| Amortization of deferred policy acquisition costs | 67,867 | 47,450 | 34,060 |
| Other operating costs and expenses | 32,016 | 25,618 | 21,635 |
| Total benefits and expenses | 427,601 | 413,193 | 250,762 |
| Income before income taxes and minority interests | 69,541 | 38,945 | 28,951 |
| Income tax expense | 24,257 | 13,505 | 7,299 |
| Income before minority interests | 45,284 | 25,440 | 21,652 |
| Minority interests in subsidiaries: | | | |
| Earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts | | | 7,445 |
| Net income | \$ 45,284 | \$ 25,440 | \$ 14,207 |
| Earnings per common share | \$ 1.19 | \$ 1.45 | \$ 0.87 |
| Earnings per common share assuming dilution | \$ 1.08 | \$ 1.21 | \$ 0.76 |

See accompanying notes.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Dollars in thousands, except per share data)

| | Preferred Stock | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Loss | Retained Earnings | Total Stockholders' Equity |
|-------------------------------------------------------------------------------------|--------------------|-----------------|----------------------------------|-----------------------------------------------|----------------------|----------------------------------|
| Balance at January 1, 2002 | \$ 625 | \$ 14,517 | \$ 57,452 | \$ (33,531) | \$ 3,504 | \$ 42,567 |
| Comprehensive income: | | | | | | |
| Net income for year | | | | | 14,207 | 14,207 |
| Change in net unrealized investment gains/losses | | | | 21,587 | | 21,587 |
| Total comprehensive income | | | | | | 35,794 |
| Issuance of 34,228 shares of common stock | | 34 | 103 | | | 137 |
| Acquisition of 112,750 shares of common stock | | (113) | (744) | | | (857) |
| Dividends on preferred stock (\$.03 per share) | | | | | (19) | (19) |
| Dividends on common stock (\$.01 per share) | | | | | (144) | (144) |
| Balance at December 31, 2002 | 625 | 14,438 | 56,811 | (11,944) | 17,548 | 77,478 |
| Comprehensive income: | | | | | | |
| Net income for year | | | | | 25,440 | 25,440 |
| Change in net unrealized investment gains/losses | | | | (10,798) | | (10,798) |
| Total comprehensive income: | | | | | | 14,642 |
| Issuance of 20,700,000 shares of common stock less issuance expenses of \$15,035 | | 20,700 | 150,565 | | | 171,265 |
| Issuance of 1,591,083 shares of common stock to the NMO Deferred Compensation Trust | | 1,591 | 8,939 | | (533) | 9,997 |
| Acquisition of 1,435,500 shares of common stock | | (1,435) | (7,879) | | | (9,314) |
| Dividends on preferred stock (\$0.03 per share) | | | | | (19) | (19) |
| Dividends on common stock (\$0.01 per share) | | | | | (333) | (333) |
| Balance at December 31, 2003 | 625 | 35,294 | 208,436 | (22,742) | 42,103 | 263,716 |
| Comprehensive income: | | | | | | |
| Net income for year | | | | | 45,284 | 45,284 |
| Change in net unrealized investment gains/losses | | | | 3,473 | | 3,473 |
| Total comprehensive income | | | | | | 48,757 |
| Issuance of 805,000 shares of common stock less issuance expenses of \$507 | | 805 | 5,933 | | | 6,738 |
| Exercise of 6,000 management subscription rights | | 6 | 26 | | | 32 |
| Conversion of \$2,640 of subordinated debentures | | 326 | 2,159 | | | 2,485 |
| Conversion of 625,000 shares of Series Preferred Stock | (625) | 1,875 | (1,250) | | | 543 |
| Issuance of 54,385 shares of common stock | | 54 | 489 | | | 543 |
| Dividends on common stock (\$0.02 per share) | | | | | (767) | (767) |
| Balance at December 31, 2004 | \$ 38,360 | \$ 215,793 | \$ (19,269) | \$ 86,620 | \$ 321,504 | |

See accompanying notes.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

| | Year ended December 31, | | |
|---------------------------------------------------------------------------------------------------|-------------------------|-------------|-------------|
| | 2004 | 2003 | 2002 |
| Operating activities | | | |
| Net income | \$ 45,284 | \$ 25,440 | \$ 14,207 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Adjustments related to interest sensitive products: | | | |
| Interest credited to account balances | 305,762 | 248,075 | 183,503 |
| Annuity and single premium universal life product charges | (22,462) | (20,452) | (15,376) |
| Change in fair value of embedded derivatives | (8,567) | 66,801 | (5,027) |
| Increase in traditional life and accident and health insurance reserves | 17,576 | 11,408 | 7,599 |
| Policy acquisition costs deferred | (168,248) | (89,979) | (152,144) |
| Amortization of deferred policy acquisition costs | 67,867 | 47,450 | 34,060 |
| Provision for depreciation and other amortization | 1,434 | 1,277 | 981 |
| Amortization of discounts and premiums on fixed maturity securities | (139,025) | (153,226) | (134,590) |
| Realized losses (gains) on investments | (943) | (6,946) | 122 |
| Change in fair value of derivatives | (28,696) | (52,525) | 57,753 |
| Deferred income taxes | (13,600) | (2,307) | (11,091) |
| Reduction of amounts due to related party under General Agency Commission and Servicing Agreement | (24,789) | (14,173) | (18,058) |
| Changes in other operating assets and liabilities: | | | |
| Accrued investment income | (15,485) | 7,330 | (14,616) |
| Receivables from related parties | 11,419 | (7,066) | 9,029 |
| Federal income taxes recoverable/payable | 8,357 | (9,924) | 12,411 |
| Other policy funds and contract claims | 33,415 | 25,351 | 13,598 |
| Other amounts due to related parties | 12,730 | 23,241 | (4,412) |
| Other liabilities | 26,108 | 8,243 | (8,275) |
| Other | 181 | (126) | 1,544 |
| Net cash provided by (used in) operating activities | 108,318 | 107,892 | (28,782) |
| Investing activities | | | |
| Sales, maturities, or repayments of investments: | | | |
| Fixed maturity securities available for sale | 1,399,886 | 2,209,090 | 3,527,658 |
| Fixed maturity securities held for investment | 1,157,382 | 869,205 | |
| Equity securities, available for sale | 23,697 | 49,904 | 10,352 |
| Mortgage loans on real estate | 61,553 | 12,768 | 3,160 |
| Derivative instruments | 109,373 | 47,993 | 9,735 |
| | 2,751,891 | 3,188,960 | 3,550,905 |
| Acquisitions of investments: | | | |
| Fixed maturity securities available for sale | (1,381,314) | (2,035,255) | (4,634,925) |
| Fixed maturity securities held for investment | (2,315,130) | (1,469,922) | (215,161) |
| Equity securities, available for sale | (38,645) | (49,170) | (10,055) |
| Mortgage loans on real estate | (412,283) | (287,144) | (229,318) |
| Derivative instruments | (111,689) | (66,062) | (93,963) |
| Policy loans | (38) | (29) | (4) |
| | (4,259,099) | (3,907,582) | (5,183,426) |

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| | Year ended December 31, | | |
|------------------------------------------------|-------------------------|-----------|-------------|
| | | | |
| Purchases of property, furniture and equipment | (2,901) | (829) | (914) |
| Net cash used in investing activities | (1,510,109) | (719,451) | (1,633,435) |

See accompanying notes.

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| | Year ended December 31, | | |
|----------------------------------------------------------------------------------------------|-------------------------|----------------|------------------|
| | 2004 | 2003 | 2002 |
| Financing activities | | | |
| Receipts credited to annuity and single premium universal life policyholder account balances | 1,973,971 | 1,727,008 | 2,435,230 |
| Coinsurance deposits related parties | (202,064) | (649,434) | (837,882) |
| Return of annuity and single premium universal life policyholder account balances | (778,750) | (472,220) | (332,042) |
| Financing fees incurred and deferred | (9,598) | (610) | (100) |
| Proceeds from notes payable | 260,000 | | 10,000 |
| Repayments of notes payable | (31,833) | (11,500) | (13,334) |
| Increase (decrease) in amounts due under repurchase agreements | 156,085 | (132,941) | 241,731 |
| Amounts due to reinsurer | | (10,908) | (3,410) |
| Proceeds from issuance of subordinated debentures | 57,500 | 12,000 | |
| Net proceeds from issuance of common stock | 7,313 | 171,265 | 137 |
| Acquisitions of common stock | | (9,314) | (857) |
| Acquisition of 8% Trust Preferred Securities | | | (60) |
| Dividends paid | (767) | (352) | (163) |
| Net cash provided by financing activities | 1,431,857 | 622,994 | 1,499,250 |
| Increase (decrease) in cash and cash equivalents | 30,066 | 11,435 | (162,967) |
| Cash and cash equivalents at beginning of year | 32,598 | 21,163 | 184,130 |
| Cash and cash equivalents at end of year | \$ 62,664 | \$ 32,598 | \$ 21,163 |

Supplemental disclosures of cash flow information:

Cash paid during the year for:

| | | | |
|-----------------------------------------------------|----------|----------|----------|
| Interest on notes payable and repurchase agreements | \$ 3,978 | \$ 2,629 | \$ 3,897 |
| Interest on subordinated debentures | 8,518 | 7,139 | |
| Income taxes | 29,500 | 25,735 | 5,979 |

Non-cash financing and investing activities:

| | | | |
|------------------------------------------------------------------------------------------------------------------------|--------|--------|--------|
| Premium and interest bonuses deferred as sales inducements | 75,162 | 31,249 | 28,153 |
| Advances by related party under General Agency Commission and Servicing Agreement deferred as policy acquisition costs | 20,000 | 14,429 | 11,796 |
| Issuance of 1,591,083 shares of common stock to NMO Deferred Compensation Trust | | 9,997 | |
| Conversion of subordinated debentures | 2,485 | | |
| Subordinated debentures issued to subsidiary trusts for common equity securities of the subsidiary trust | 1,770 | 372 | |

See accompanying notes.

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004

1. Organization and Significant Accounting Policies

Organization

American Equity Investment Life Holding Company (the Company), through its wholly-owned subsidiaries, American Equity Investment Life Insurance Company and American Equity Investment Life Insurance Company of New York, is licensed to sell insurance products in 48 states and the District of Columbia at December 31, 2004. The Company offers a broad array of annuity and insurance products. The Company's business consists primarily of the sale of index and fixed rate annuities. The Company operates solely in the life insurance business.

Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: American Equity Investment Life Insurance Company ("American Equity Life"), American Equity Investment Life Insurance Company of New York, American Equity Investment Capital, Inc., and American Equity Investment Properties, L.C. All significant intercompany accounts and transactions have been eliminated.

The Company adopted the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants Statement of Position (SOP) 03-1, "*Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*" on January 1, 2004. As it applies to the Company, SOP 03-1 established guidance for the accounting and presentation of costs related to sales inducements (first year premium and interest bonuses credited to policyholder account balances). There was no change to the Company's method of accounting for sales inducements; however, the capitalized costs are now separately disclosed in the consolidated balance sheets and the related amortization expense is included in interest credited to account balances in the consolidated statements of income. Prior to 2004, the capitalized costs were included in deferred policy acquisition costs and the amortization expense was included in the amortization of deferred policy acquisition costs. The 2003 and 2002 amounts have been reclassified to conform with the 2004 presentation. The adoption of SOP 03-1 had no effect on net income or stockholders' equity.

The Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 46 ("FIN 46"), "*Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51*" on December 31, 2003, retroactive to January 1, 2003. Prior to the adoption of FIN 46, the Company's subsidiary trusts, American Equity Capital Trust I and American Equity Capital Trust II were included in the Company's consolidated financial statements. The subsidiary trusts are no longer consolidated upon adoption of FIN 46, and the effect of such deconsolidation is that the obligations of the trusts to the preferred security holders, previously reported as minority interests, have been replaced with the Company's subordinated debt obligations to the trusts and the Company's equity investments in the trusts. Interest payments on the subordinated debentures are no longer eliminated in consolidation but rather are reported as interest expense. The adoption of FIN 46 had no impact on net income, stockholders' equity or previously reported quarterly net income for 2003.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are utilized in the calculation of

deferred policy acquisition costs, deferred sales inducements, policyholder liabilities and accruals, valuation of embedded derivatives on index reserves and valuation allowances on deferred tax assets and investments. It is reasonably possible that actual experience could differ from the estimates and assumptions utilized.

Reclassifications

Certain items appearing in the 2003 and 2002 consolidated financial statements have been reclassified to conform with the current year presentation.

Investments

Fixed maturity securities (bonds and redeemable preferred stocks maturing more than one year after issuance) that may be sold prior to maturity are classified as available for sale. Available for sale securities are reported at estimated fair value and unrealized gains and losses, if any, on these securities are included directly in a separate component of stockholders' equity, net of income taxes and certain adjustments, for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements. Premiums and discounts are amortized/accrued using methods which result in a constant yield over the securities' expected lives. Amortization/accrual of premiums and discounts on mortgage and asset-backed securities incorporate prepayment assumptions to estimate the securities' expected lives.

Fixed maturity securities that the Company has the positive intent and ability to hold to maturity are classified as held for investment. Held for investment securities are reported at cost adjusted for amortization of premiums and discounts. Changes in the market value of these securities, except for declines that are other than temporary, are not reflected in the Company's financial statements. Premiums and discounts are amortized/accrued using methods which result in a constant yield over the securities' expected lives.

Equity securities, comprised of common and non-redeemable preferred stocks, are classified as available for sale and are reported at market value. Unrealized gains and losses are included directly in a separate component of stockholders' equity, net of income taxes.

Mortgage loans on real estate are reported at cost, adjusted for amortization of premiums and accrual of discounts. If the Company determines that the value of any 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.

Policy loans are reported at unpaid principal.

The carrying amounts of all the Company's investments are reviewed on an ongoing basis for credit deterioration. If this review indicates a decline in market value that is other than temporary, the Company's carrying amount in the investment is reduced to its estimated fair value and a specific writedown is taken. Such reductions in carrying amount are recognized as realized losses and charged to income. Realized gains and losses on sales are determined on the basis of specific identification of investments.

Market values, as reported herein, of fixed maturity and equity securities are based on the latest quoted market prices, or for those fixed maturity securities not readily marketable, at values which are representative of the market values of issues of comparable yield and quality.

Derivative Instruments

Pursuant to Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, all derivative instruments (including certain derivative instruments embedded in other contracts) are recognized in the balance sheet at their fair values and changes in fair value are recognized immediately in earnings, unless the derivatives qualify as hedges of future cash flows. For derivatives qualifying as hedges of future cash flows, the effective portion of the changes in fair value is recorded temporarily in equity, then recognized in earnings along with the related effects of the hedged items. Any "ineffective" portion of a hedge is reported in earnings as it occurs.

The Company has 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. A portion of the premium from each policyholder is invested in investment grade fixed income securities to cover the minimum guaranteed value due the policyholder at the end of the contract term. A portion of the premium is used to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to 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 market with the change in fair value included as a component of our revenues. On the respective anniversary dates of the index policies, the index used to compute the annual index credit is reset and the Company purchases new one-year call options to fund the next annual index credit. The Company manages the cost of these purchases through the terms of its index annuities, which permits the Company to change annual participation rates, asset fees, and/or caps, subject to guaranteed minimums. By reducing participation rates, asset fees or caps, the Company can limit option costs to budgeted amounts except in cases where the contractual features would prevent further modifications.

The Company's strategy attempts to mitigate any potential risk of loss under these agreements through a regular monitoring process which evaluates the program's effectiveness. The Company is exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, the Company purchases its option contracts from multiple counterparties and evaluates the creditworthiness of all counterparties prior to purchase of the contracts. At December 31, 2004, all of these options had been purchased from nationally recognized investment banking institutions with a Standard and Poor's credit rating of BBB+ or higher.

Under SFAS No. 133, the future annual index credits on the Company's index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. The Company does not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. The Company must value both the call options and the related forward embedded options in the policies at fair value. The change in fair value for the call options is included in change in fair value of derivatives and the change in fair value adjustment of the embedded options is included in change in fair value of embedded derivatives in the Consolidated Statements of Income.

Amortization of deferred policy acquisition costs and deferred sales inducements increased by \$6.4 million in 2004, decreased by \$1.7 million in 2003 and increased by \$1.4 million in 2002 as a result of the impact of SFAS No. 133.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Deferred Policy Acquisition Costs and Deferred Sales Inducements

To the extent recoverable from future policy revenues and gross profits, certain costs of producing new business, principally commissions, first-year premium and interest bonuses credited to policyholder account balances and certain costs of policy issuance (including policy issue costs of \$6.3 million, \$3.8 million and \$4.1 million in 2004, 2003 and 2002, respectively) have been deferred and capitalized as deferred policy acquisition costs or deferred sales inducements. For annuity and single premium universal life products, these capitalized costs are being amortized generally in proportion to expected gross profits from surrender charges and investment, mortality, and expense margins. That amortization is adjusted retrospectively when estimates of future gross profits/margins (including the impact of realized investment gains and losses) to be realized from a group of products are revised. Deferred policy acquisition costs and deferred sales inducements are also adjusted for the change in amortization that would have occurred if available-for-sale fixed maturity securities had been sold at their aggregate market value and the proceeds reinvested at current yields. The impact of this adjustment is included in accumulated other comprehensive income (loss) within stockholders' equity.

For traditional life and accident and health insurance, deferred policy acquisition costs are being amortized over the premium-paying period of the related policies in proportion to premium revenues recognized, principally using the same assumptions for interest, mortality and withdrawals that are used for computing liabilities for future policy benefits subject to traditional "lock-in" concepts.

Future Policy Benefits

Future policy benefit reserves for annuity and single premium universal life products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. Policy benefits and claims that are charged to expense include benefit claims incurred in the period in excess of related policy account balances. Interest crediting rates (including first year interest bonuses capitalized as deferred sales inducements) for these products ranged from 3.0% to 11.5% in 2004 and 2003 and from 3.0% to 12.0% in 2002. These rates include first-year interest bonuses capitalized as deferred sales inducements.

The liability for future policy benefits for traditional life insurance is based on net level premium reserves, including assumptions as to interest, mortality, and other assumptions underlying the guaranteed policy cash values. Reserve interest assumptions are level and range from 3.0% to 6.0%. The liabilities for future policy benefits for accident and health insurance are computed using a net level premium method, including assumptions as to morbidity and other assumptions based on the Company's experience, modified as necessary to give effect to anticipated trends and to include provisions for possible unfavorable deviations. Policy benefit claims are charged to expense in the period that the claims are incurred.

Unpaid claims include amounts for losses and related adjustment expenses and are determined using individual claim evaluations and statistical analysis. Unpaid claims represent estimates of the ultimate net costs of all losses, reported and unreported, which remain unpaid at December 31 of each year. These estimates are necessarily subject to the impact of future changes in claim severity, frequency and other factors. In spite of the variability inherent in such situations, management believes that the unpaid claim amounts are adequate. The estimates are continuously reviewed and as adjustments to these amounts become necessary, such adjustments are reflected in current operations.

Certain group policies include provisions for annual experience refunds of premiums equal to net premiums received less a 16% administrative fee and less claims incurred. Such amounts (2004 \$0.0 million; 2003 \$0.1 million; and 2002 \$0.3 million) are reported as a reduction of traditional life and accident and health insurance premiums in the consolidated statements of income.

Deferred Income Taxes

Deferred income tax assets or liabilities are computed based on the temporary differences between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period. Deferred income tax assets are subject to ongoing evaluation of whether such assets will be realized. The ultimate realization of deferred income tax assets depends on generating future taxable income during the periods in which temporary differences become deductible. If future income is not generated as expected, deferred income tax assets may need to be written off.

Stockholders' Equity

On December 9, 2003, the Company completed an initial public offering of 18,700,000 shares of its common stock at a price of \$9.00 per share. Pursuant to the over-allotment option granted to the underwriters in the offering, the underwriters purchased an additional 2,000,000 shares on December 29, 2003 and an additional 805,000 shares on January 7, 2004, which fully exercised the over-allotment option. The proceeds from the initial public offering (including proceeds from shares issued pursuant to the over-allotment option), net of the underwriting discount and expenses, were approximately \$178.0 million.

The Company issued 625,000 shares of 1998 Series A Participating Preferred Stock (aggregate liquidation preference of \$10.0 million). During 2004, all of these shares converted into 1,875,000 shares of the Company's common stock. Prior to conversion, these preferred shares had participating dividend rights with shares of the Company's common stock, when and as such dividends were declared.

Recognition of Premium Revenues and Costs

Revenues for annuity and single premium universal life products include surrender charges assessed against policyholder account balances and mortality and expense charges (single premium universal life products only) during the period. Expenses related to these products include interest credited to policyholder account balances and benefit claims incurred in excess of policyholder account balances (single premium universal life products only).

Traditional life and accident and health insurance premiums are recognized as revenues over the premium-paying period. Future policy benefits are recognized as expenses over the life of the policy by means of the provision for future policy benefits.

All insurance-related revenues, benefits, losses and expenses are reported net of reinsurance ceded.

Premiums and Deposits by Product Type

The Company markets index annuities, fixed rate annuities, a variable annuity and life insurance. In connection with its reinsured group life business, the Company also collects renewal premiums on

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certain accident and health insurance policies. Premiums and deposits (net of coinsurance) collected in 2004, 2003 and 2002, by product category were as follows:

| Product Type | Year ended December 31, | | |
|-------------------------|-------------------------|--------------|--------------|
| | 2004 | 2003 | 2002 |
| (Dollars in thousands) | | | |
| Index Annuities: | | | |
| Index Strategies | \$ 1,008,801 | \$ 468,716 | \$ 523,224 |
| Fixed Strategy | 491,721 | 201,702 | 370,496 |
| | 1,500,522 | 670,418 | 893,720 |
| Fixed Rate Annuities | 271,385 | 407,156 | 703,628 |
| Life Insurance | 14,566 | 13,001 | 12,958 |
| Accident and Health | 549 | 685 | 706 |
| Variable Annuities | 279 | 26 | 83 |
| | \$ 1,787,301 | \$ 1,091,286 | \$ 1,611,095 |

Two national marketing organizations through which the Company markets its products each accounted for more than 10% of the annuity deposits and insurance premium collections during 2004 and 2003. One national marketing organization accounted for more than 10% of the annuity deposits and insurance premium collections during 2002.

Stock-Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related Interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of the company's employee stock options equals the fair value of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net income is required by SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, and has been determined as if the Company had accounted for its employee stock options and subscription rights under the fair value method of these statements. The fair value for these options was estimated at the date of grant using a Black-Scholes option valuation model (which is primarily used for public companies) for 2004 and 2003 and a minimum value option pricing model (which is used for non-public companies) for 2002 with the following weighted-average assumptions:

| | Year Ended December 31, | | |
|--------------------------------|-------------------------|----------|---------|
| | 2004 | 2003 | 2002 |
| Risk-free interest rate | 3.10% | 1.46% | 1.45% |
| Dividend yield | 0% | 0% | 0% |
| Weighted-average expected life | 10 years | 10 years | 3 years |
| Expected volatility | 24.5% | 3.2% | N/A |

The minimum value option pricing model is similar to the Black-Scholes option valuation model (which is primarily used for public companies) except that it excludes an assumption for the expected volatility of market price.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

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The Company's pro forma net earnings and earnings per common share were as follows:

| | Year ended December 31, | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|-----------|-----------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands, except per share data) | | |
| Net income, as reported numerator for earnings per common share | \$ 45,284 | \$ 25,440 | \$ 14,207 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect | (1,125) | (242) | (491) |
| Net income, pro forma numerator for earnings per common share, pro forma | 44,159 | 25,198 | 13,716 |
| Interest (dividends in 2002 related to convertible trust preferred securities) related to convertible subordinated debentures (net of income tax benefit) | 1,255 | 1,347 | 1,348 |
| Numerator for earnings per common share assuming dilution, pro forma | \$ 45,414 | \$ 26,545 | \$ 15,064 |
| Earnings per common share, as reported | \$ 1.19 | \$ 1.45 | \$ 0.87 |
| Earnings per common share, pro forma | \$ 1.16 | \$ 1.43 | \$ 0.84 |
| Earnings per common share assuming dilution, as reported | \$ 1.08 | \$ 1.21 | \$ 0.76 |
| Earnings per common share assuming dilution, pro forma | \$ 1.05 | \$ 1.20 | \$ 0.74 |

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in stockholders' equity during a period except those resulting from investments by and distributions to stockholders. Other comprehensive income (loss) excludes net realized investment gains (losses) included in net income which merely represent transfers from unrealized to realized gains and losses. These amounts totaled \$0.9 million, \$6.9 million and \$(0.1) million in 2004, 2003 and 2002, respectively. Such amounts, which have been measured through the date of sale, are net of adjustments to deferred policy acquisition costs, deferred sales inducements and income taxes totaling \$0.5 million in 2004, \$3.6 million in 2003 and \$(0.1) million in 2002.

Pending Accounting Changes

In March 2004, the FASB's Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (EITF 03-1). EITF 03-1 provides guidance regarding the meaning of other-than-temporary impairment and its application to investments classified as either available for sale or held to maturity under FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and to equity securities accounted for under the cost method. Included in EITF 03-1 is guidance on how to account for impairments that are solely due to interest rate changes, including changes resulting from increases in sector credit spreads. This guidance was to become effective for reporting periods beginning after June 15, 2004. However, on September 30, 2004, the FASB issued a Staff Position that delays the effective date for the recognition and measurement guidance of EITF 03-1 until additional clarifying guidance is issued. The issuance of this guidance was delayed during the fourth quarter of 2004, with additional discussion of this issue by the FASB planned

for 2005. We are not able to assess the impact of the adoption of EITF 03-1 until final guidance is issued.

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R"). This standard requires expensing stock options and other share-based payments and supersedes SFAS No. 123, which had allowed companies to choose between expensing stock options or showing proforma disclosure only. This standard is effective for the Company as of July 1, 2005 and will apply to all awards granted, modified, cancelled or purchased after that date as well as the unvested portion of prior awards. The Company will adopt the standard as of the effective date and does not believe it will have a material effect on the financial statements.

2. Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating the fair values of financial instruments:

Fixed maturity securities: Quoted market prices, when available, or price matrices for securities which are not actively traded, developed using yield data and other factors relating to instruments or securities with similar characteristics.

Equity securities: Quoted market prices.

Mortgage loans on real estate: Discounted expected cash flows using interest rates currently being offered for similar loans.

Derivative instruments: Quoted market prices from related counterparties.

Policy loans: The Company has not attempted to determine the fair values associated with its policy loans, as management believes any differences between the Company's carrying value and the fair values afforded these instruments are immaterial to the Company's financial position and, accordingly, the cost to provide such disclosure is not worth the benefit to be derived.

Cash and cash equivalents: Amounts reported in the consolidated balance sheets for these instruments approximate their fair values.

Annuity and single premium universal life policy benefit reserves and coinsurance deposits related party: Fair values of the Company's liabilities under contracts not involving significant mortality or morbidity risks (principally deferred annuities), are stated at the cost the Company would incur to extinguish the liability (i.e., the cash surrender value) adjusted as required under SFAS No. 133. The coinsurance deposits related to the annuity benefit reserves have fair values determined in a similar fashion. The Company is not required to and has not estimated the fair value of its liabilities under other contracts.

Notes payable and amounts due under repurchase agreements: The fair value of the contingent convertible senior notes is based upon quoted market prices. The amounts reported in the consolidated balance sheets for other notes payable and short term indebtedness under repurchase agreements with variable interest rates approximate their fair values.

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

Amounts due to related party under General Agency Commission and Servicing Agreement: Fair values are estimated by discounting expected cash flows using interest rates currently being offered for similar instruments.

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

| | December 31, | | | |
|--------------------------------------------------------------------------------------|-----------------|----------------------|-----------------|----------------------|
| | 2004 | | 2003 | |
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| (Dollars in thousands) | | | | |
| Assets | | | | |
| Fixed maturity securities: | | | | |
| Available for sale | \$ 2,705,323 | \$ 2,705,323 | \$ 3,618,025 | \$ 3,618,025 |
| Held for investment | 4,098,493 | 4,005,775 | 1,827,289 | 1,717,224 |
| Equity securities, available for sale | 38,303 | 38,303 | 21,409 | 21,409 |
| Mortgage loans on real estate | 959,779 | 999,380 | 608,715 | 667,341 |
| Derivative instruments | 148,006 | 148,006 | 119,833 | 119,833 |
| Policy loans | 362 | 362 | 324 | 324 |
| Cash and cash equivalents | 62,664 | 62,664 | 32,598 | 32,598 |
| Coinsurance deposits related party | 2,068,700 | 1,780,862 | 1,926,603 | 1,640,639 |
| Liabilities | | | | |
| Annuity and single premium universal life policy benefit reserves | 9,745,896 | 8,573,784 | 8,271,377 | 7,278,813 |
| Amounts due to related party under General Agency Commission and Servicing Agreement | 35,812 | 35,812 | 40,601 | 40,601 |
| Notes payable | 260,000 | 287,625 | 31,833 | 31,833 |
| Subordinated debentures | 173,576 | 148,833 | 116,425 | 87,761 |
| Amounts due under repurchase agreements | 264,875 | 264,875 | 108,790 | 108,790 |

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3. Investments

At December 31, 2004 and 2003, the amortized cost and estimated fair value of fixed maturity securities and equity securities were as follows:

| December 31, 2004 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|-----------------------------------------------|---------------------|------------------------------|-------------------------------|-------------------------|
| (Dollars in thousands) | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government and agencies | \$ 1,766,796 | \$ 211 | \$ (58,759) | \$ 1,708,248 |
| Public utilities | 43,297 | 1,552 | | 44,849 |
| Corporate securities | 262,253 | 7,223 | (6,916) | 262,560 |
| Redeemable preferred stocks | 34,848 | 1,105 | (584) | 35,369 |
| Mortgage and asset-backed securities: | | | | |
| United States Government and agencies | 254,640 | 2,436 | (72) | 257,004 |
| Non-government | 407,970 | 4,602 | (15,279) | 397,293 |
| | <u>\$ 2,769,804</u> | <u>\$ 17,129</u> | <u>\$ (81,610)</u> | <u>\$ 2,705,323</u> |
| Held for investment: | | | | |
| United States Government and agencies | \$ 4,022,646 | \$ 2,240 | \$ (94,958) | \$ 3,929,928 |
| Corporate securities | 75,847 | | | 75,847 |
| | <u>\$ 4,098,493</u> | <u>\$ 2,240</u> | <u>\$ (94,958)</u> | <u>\$ 4,005,775</u> |
| Equity securities, available for sale: | | | | |
| Non-redeemable preferred stocks | \$ 30,472 | \$ 331 | \$ (294) | \$ 30,509 |
| Common stocks | 8,366 | | (572) | 7,794 |
| | <u>\$ 38,838</u> | <u>\$ 331</u> | <u>\$ (866)</u> | <u>\$ 38,303</u> |
| December 31, 2003 | | | | |
| Fixed maturity securities: | | | | |
| Available for sale: | | | | |
| United States Government and agencies | \$ 2,594,861 | \$ 1,150 | \$ (57,686) | \$ 2,538,325 |
| Public utilities | 51,300 | 724 | (189) | 51,835 |
| Corporate securities | 330,993 | 13,485 | (10,753) | 333,725 |
| Redeemable preferred stocks | 8,923 | 1,156 | | 10,079 |
| Mortgage and asset-backed securities: | | | | |
| United State Government and agencies | 263,040 | 2,320 | (1,258) | 264,102 |
| Non-government | 454,639 | 3,045 | (37,725) | 419,959 |
| | <u>\$ 3,703,756</u> | <u>\$ 21,880</u> | <u>\$ (107,611)</u> | <u>\$ 3,618,025</u> |
| Held for investment: | | | | |
| United States Government and agencies | \$ 1,751,532 | \$ | \$ (110,065) | \$ 1,641,467 |
| Corporate securities | 75,757 | | | 75,757 |
| | <u>\$ 1,827,289</u> | <u>\$</u> | <u>\$ (110,065)</u> | <u>\$ 1,717,224</u> |

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| December 31, 2004 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|----------------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| Equity securities, available for sale: | | | | |
| Non-redeemable preferred stocks | \$ 16,182 | \$ 41 | \$ (132) | \$ 16,091 |
| Common stocks | 5,612 | | (294) | 5,318 |
| | <u>\$ 21,794</u> | <u>\$ 41</u> | <u>\$ (426)</u> | <u>\$ 21,409</u> |

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The amortized cost and estimated fair value of fixed maturity securities at December 31, 2004, 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 the Company's mortgage-backed and asset-backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

| | Available for sale | | Held for investment | |
|---------------------------------------------|--------------------|-------------------------|---------------------|-------------------------|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| (Dollars in thousands) | | | | |
| Due after one year through five years | \$ 12,969 | \$ 13,833 | \$ | \$ |
| Due after five years through ten years | 271,365 | 262,760 | | |
| Due after ten years through twenty years | 837,916 | 812,259 | 815,914 | 810,652 |
| Due after twenty years | 984,944 | 962,174 | 3,282,579 | 3,195,123 |
| | 2,107,194 | 2,051,026 | 4,098,493 | 4,005,775 |
| Mortgage-backed and asset-backed securities | 662,610 | 654,297 | | |
| | \$ 2,769,804 | \$ 2,705,323 | \$ 4,098,493 | \$ 4,005,775 |

Net unrealized losses on available for sale fixed maturity securities and equity securities reported as a separate component of stockholders' equity were comprised of the following at December 31, 2004 and 2003:

| | December 31, | |
|------------------------------------------------------------------------------------------------------------------------------|--------------|-------------|
| | 2004 | 2003 |
| (Dollars in thousands) | | |
| Net unrealized losses on available for sale fixed maturity securities and equity securities | \$ (65,016) | \$ (86,116) |
| Adjustments for assumed changes in amortization of deferred policy acquisition costs and deferred sales inducements | 35,041 | 51,128 |
| Net unrealized gain and amortization on fixed maturity securities transferred from available for sale to held for investment | 330 | |
| Deferred income tax benefit | 10,376 | 12,246 |
| | \$ (19,269) | \$ (22,742) |

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(Dollars in thousands)

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2004:

| | Less than 12 months | | 12 months or more | | Total | |
|----------------------------------------|----------------------|--------------------|----------------------|--------------------|----------------------|--------------------|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| Fixed maturity securities: | | | | | | |
| Available for sale: | | | | | | |
| United States Government and agencies | \$ 1,206,169 | \$ (39,591) | \$ 440,809 | \$ (19,168) | \$ 1,646,978 | \$ (58,759) |
| Corporate securities | 53,367 | (4,042) | 5,205 | (2,874) | 58,572 | (6,916) |
| Redeemable preferred stocks | 19,416 | (584) | | | 19,416 | (584) |
| Mortgage and asset-backed securities | 51,593 | (2,032) | 217,322 | (13,319) | 268,915 | (15,351) |
| | <u>\$ 1,330,545</u> | <u>\$ (46,249)</u> | <u>\$ 663,336</u> | <u>\$ (35,361)</u> | <u>\$ 1,993,881</u> | <u>\$ (81,610)</u> |
| Held for investment: | | | | | | |
| United States Government and agencies | \$ 1,781,894 | \$ (34,576) | \$ 1,336,616 | \$ (60,382) | \$ 3,118,510 | \$ (94,958) |
| | <u>\$ 1,781,894</u> | <u>\$ (34,576)</u> | <u>\$ 1,336,616</u> | <u>\$ (60,382)</u> | <u>\$ 3,118,510</u> | <u>\$ (94,958)</u> |
| Equity securities, available for sale: | | | | | | |
| Non-redeemable preferred stocks | \$ 8,424 | \$ (178) | \$ 6,066 | \$ (116) | \$ 14,490 | \$ (294) |
| Common stocks | | | 2,373 | (572) | 2,373 | (572) |
| | <u>\$ 8,424</u> | <u>\$ (178)</u> | <u>\$ 8,439</u> | <u>\$ (688)</u> | <u>\$ 16,863</u> | <u>\$ (866)</u> |

Approximately 93% of the unrealized losses on fixed maturity securities shown in the above table are on securities that are rated investment grade. These unrealized losses are primarily from the Company's investments in United States Government agencies and United States Government agency mortgage-backed securities. These securities are relatively long in duration and are callable, making the value of such securities very sensitive to changes in market interest rates. Approximately 7% of the unrealized losses on fixed maturity securities shown in the above table are on securities rated below investment grade. The Company reviews all investments on an ongoing basis for credit deterioration. Factors considered in evaluating whether a decline in value is other than temporary include:

the length of time and the extent to which the fair value has been less than cost;

the financial condition and near-term prospects of the issuer;

whether the investment is rated investment grade;

whether the issuer is current on all payments and all contractual payments have been made as agreed;

the Company's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery;

consideration of rating agency actions;

changes in cash flows of asset-backed and mortgage-backed securities.

The securities in an unrealized loss position are current in respect to payments of interest and principal and the Company has the ability to hold these securities until they recover in fair value.

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Components of net investment income are as follows:

| | Year ended December 31, | | |
|-------------------------------|-------------------------|-------------------|-------------------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Fixed maturity securities | \$ 376,319 | \$ 322,247 | \$ 288,087 |
| Equity securities | 1,668 | 1,951 | 1,194 |
| Mortgage loans on real estate | 52,697 | 33,241 | 15,025 |
| Policy loans | 26 | 25 | 19 |
| Cash and cash equivalents | 580 | 1,327 | 3,500 |
| Other | 2,187 | 2,429 | 2,892 |
| | 433,477 | 361,220 | 310,717 |
| Less investment expenses | (3,551) | (2,691) | (2,169) |
| Net investment income | \$ 429,926 | \$ 358,529 | \$ 308,548 |

Proceeds from sales of available for sale fixed maturity securities for the years ended December 31, 2004, 2003 and 2002 were \$272.7 million, \$507.3 million and \$1,821.1 million, respectively. Scheduled principal repayments, calls and tenders for available for sale fixed maturity securities for the years ended December 31, 2004, 2003 and 2002 were \$1.1 billion, \$1.7 billion and \$1.7 billion, respectively. Calls of held for investment fixed maturity securities for the years ended December 31, 2004 and 2003 were \$1,157.4 million and \$869.2 million, respectively. There were no calls of held for investment fixed maturity securities for the years ended December 31, 2002.

Net realized gains (losses) included in revenues for the years ended December 31, 2004, 2003 and 2002 are as follows:

| | Year ended December 31, | | |
|-----------------------------------------------|-------------------------|-----------------|-----------------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Available for sale fixed maturity securities: | | | |
| Gross realized gains | \$ 13,720 | \$ 19,922 | \$ 19,943 |
| Gross realized losses | (220) | (4,216) | (6,773) |
| Writedowns (other than temporary impairments) | (12,828) | (9,821) | (13,030) |
| | 672 | 5,885 | 140 |
| Equity securities | 271 | 1,061 | (262) |
| | \$ 943 | \$ 6,946 | \$ (122) |

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Changes in unrealized appreciation (depreciation) on investments for the years ended December 31, 2004, 2003 and 2002 are as follows:

| | Year ended December 31, | | |
|-----------------------------------------------------------------------------------------------------------------------------|-------------------------|--------------|-----------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Fixed maturity securities held for investment carried at amortized cost | \$ 17,347 | \$ (111,892) | \$ 44,054 |
| Investments carried at estimated fair value: | | | |
| Fixed maturity securities, available for sale | \$ 21,250 | \$ (41,961) | \$ 82,509 |
| Equity securities, available for sale | (150) | 660 | (681) |
| | 21,100 | (41,301) | 81,828 |
| Adjustment for effect on other balance sheet accounts: | | | |
| Deferred policy acquisition costs and deferred sales inducements | (16,087) | 25,541 | (49,470) |
| Deferred income tax asset | (1,870) | 5,815 | (11,624) |
| Net unrealized gain and amortization on fixed maturity securities transferred from available to sale to held for investment | 330 | (853) | 853 |
| | (17,627) | 30,503 | (60,241) |
| Change is unrealized appreciation (depreciation) on investments carried at estimated fair value | \$ 3,473 | \$ (10,798) | \$ 21,587 |

The Company transferred fixed maturity securities at fair value of \$1.2 billion during 2004 and \$436.7 million during 2002 from available for sale to held for investment to match its investment objectives, which are to hold these investments to maturity. The unrealized gain on these securities on the date of transfer is included as a separate component of accumulated other comprehensive loss and is being amortized over the lives of the securities. The unrealized gains on the securities transferred during 2004 and 2002 were \$1.7 million and \$1.0 million, respectively, at the date of transfer. A portion of the securities transferred during 2004 were called for redemption subsequent to the transfer, and all of the securities transferred during 2002 were called for redemption during 2003.

The Company's mortgage loan portfolio totaled \$959.8 million and \$608.7 million at December 31, 2004 and 2003, respectively, with commitments outstanding of \$58.8 million at December 31, 2004. The portfolio consists of commercial mortgage loans diversified as to property type, location and loan size. The loans are collateralized by the related properties.

The Company's mortgage lending policies establish limits on the amount that can be loaned to one borrower and require diversification by geographic location and collateral type. The commercial

mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows:

| | December 31, | | | |
|-----------------------------------|--------------------|---------------|--------------------|---------------|
| | 2004 | | 2003 | |
| | Carrying Amount | Percent | Carrying Amount | Percent |
| (Dollars in thousands) | | | | |
| Geographic distribution | | | | |
| East | \$ 196,805 | 20.5% | \$ 115,817 | 19.0% |
| Middle Atlantic | 80,098 | 8.3% | 56,563 | 9.3% |
| Mountain | 148,608 | 15.5% | 79,777 | 13.1% |
| New England | 50,624 | 5.3% | 38,539 | 6.3% |
| Pacific | 84,860 | 8.8% | 42,327 | 7.0% |
| South Atlantic | 166,606 | 17.4% | 105,635 | 17.4% |
| West North Central | 165,041 | 17.2% | 125,163 | 20.5% |
| West South Central | 67,137 | 7.0% | 44,894 | 7.4% |
| | 959,779 | 100.0% | 608,715 | 100.0% |
| Total | \$ 959,779 | 100.0% | \$ 608,715 | 100.0% |
| Property type distribution | | | | |
| Office | \$ 296,995 | 30.9% | \$ 145,490 | 23.9% |
| Medical Office | 65,396 | 6.8% | 55,314 | 9.1% |
| Retail | 218,133 | 22.7% | 163,434 | 26.8% |
| Industrial/Warehouse | 236,835 | 24.7% | 162,943 | 26.8% |
| Hotel | 25,652 | 2.7% | 20,819 | 3.4% |
| Apartment | 44,984 | 4.7% | 29,565 | 4.9% |
| Mixed use/other | 71,784 | 7.5% | 31,150 | 5.1% |
| | 959,779 | 100.0% | 608,715 | 100.0% |
| Total | \$ 959,779 | 100.0% | \$ 608,715 | 100.0% |

At December 31, 2004, fixed maturity securities and short-term investments with an amortized cost of \$2.0 million were on deposit with state agencies to meet regulatory requirements. There are no restrictions on these assets.

At December 31, 2004, the only investment in any person or its affiliates (other than bonds issued by agencies of the United States Government) that exceeded 10% of stockholders' equity was FBL Capital Trust I with an estimated fair value and amortized cost of \$75.8 million.

4. Deferred Policy Acquisition Costs and Deferred Sales Inducements

An analysis of deferred policy acquisition costs is presented below for the years ended December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|--------------------------------------|-----------------------------|-----------------------------|
| | (Dollars in thousands) | |
| Balance at beginning of year | \$ 608,197 | \$ 532,656 |
| Costs deferred during the year | 188,248 | 104,408 |
| Amortized to expense during the year | (67,867) | (47,450) |
| Effect of net unrealized losses | (15,557) | 18,583 |
| | <u> </u> | <u> </u> |
| Balance at end of year | \$ 713,021 | \$ 608,197 |
| | <u> </u> | <u> </u> |

An analysis of deferred sales inducements is presented below for the years ended December 31, 2004 and 2003:

| | <u>2004</u> | <u>2003</u> |
|--------------------------------------|-----------------------------|-----------------------------|
| | (Dollars in thousands) | |
| Balance at beginning of year | \$ 95,467 | \$ 62,794 |
| Costs deferred during the year | 75,162 | 31,249 |
| Amortized to expense during the year | (10,632) | (5,532) |
| Effect of net unrealized losses | (530) | 6,956 |
| | <u> </u> | <u> </u> |
| Balance at end of year | \$ 159,467 | \$ 95,467 |
| | <u> </u> | <u> </u> |

5. Reinsurance and Policy Provisions*Coinsurance*

The Company has entered into two coinsurance agreements with EquiTrust Life Insurance Company ("EquiTrust"), an affiliate of Farm Bureau Life Insurance Company ("Farm Bureau") covering 70% of certain of the Company's fixed rate and index annuities issued from August 1, 2001 through December 31, 2001, 40% of those contracts issued during 2002 and 2003 and 20% of those contracts issued from January 1, 2004 to July 31, 2004, when the agreement was suspended by mutual consent of the parties. As a result of the suspension, new business will no longer be ceded to EquiTrust until the parties mutually agree to resume the coinsurance of new business. The business reinsured under these agreements is not eligible for recapture before the expiration of 10 years. As of December 31, 2004, Farm Bureau beneficially owned 14.4% of the Company's common stock.

Total annuity deposits ceded were \$202.1 million, \$649.4 million and \$837.9 million for the years ended December 31, 2004, 2003 and 2002, respectively. Expense allowances received were \$22.6 million, \$65.6 million and \$99.4 million for the years ended December 31, 2004, 2003 and 2002, respectively. Coinsurance deposits (aggregate policy benefit reserves transferred to EquiTrust under these agreements) with EquiTrust were \$2.1 billion and \$1.9 billion at December 31, 2004 and 2003, respectively. The Company remains liable with respect to the policy liabilities ceded to EquiTrust should EquiTrust fail to meet the obligations it has assumed. None of the coinsurance deposits with EquiTrust are deemed by management to be uncollectible. The balance due under these agreements to EquiTrust was \$32.0 million at December 31, 2004 and \$22.6 million at December 31, 2003, and

represents the market value of the call options related to the ceded business held by the Company to fund the index credits and cash due to or from EquiTrust related to the transfer of annuity deposits.

During 1998, the Company entered into a modified coinsurance agreement to cede 70% of its variable annuity business to EquiTrust. Under this agreement, the Company paid EquiTrust \$0.2 million for each of the years ended December 31, 2004, 2003 and 2002. The modified coinsurance agreement will continue until termination by written notice at the election of either party. Any such termination will apply to the submission or acceptance of new policies, and business reinsured under the agreement prior to any such termination is not eligible for recapture before the expiration of 10 years. EquiTrust (or one of its affiliates) provides the administrative support necessary to manage this business.

Financial Reinsurance

The Company has entered into two reinsurance transactions with Hannover Life Reassurance Company of America ("Hannover"), which are treated as reinsurance under statutory accounting practices and as financial reinsurance under accounting principles generally accepted in the United States ("GAAP"). The first transaction became effective November 1, 2002 (the "2002 Hannover Transaction") and the second transaction became effective September 30, 2003 (the "2003 Hannover Transaction"). The agreements for these transactions include a coinsurance segment and a yearly renewable term segment reinsuring a portion of death benefits payable on certain annuities issued from January 1, 2002 to December 31, 2002 (2002 Hannover Transaction) and issued from January 1, 2003 to September 30, 2003 (2003 Hannover Transaction). The coinsurance segments provide reinsurance to the extent of 6.88% (2002 Hannover Transaction) and 13.41% (2003 Hannover Transaction) of all risks associated with the Company's annuity policies covered by these reinsurance agreements. The 2002 Hannover Transaction provided \$29.8 million in net statutory surplus benefit during 2002 and the 2003 Hannover Transaction provided \$29.7 million in net statutory surplus benefit during 2003. The statutory surplus benefits provided by these agreements were reduced by \$13.1 million in 2004 and \$6.8 million in 2003. The remaining statutory surplus benefit under these agreements will be reduced in the following years as follows: 2005 \$11.6 million; 2006 \$12.4 million; 2007 \$13.2 million; 2008 \$6.2 million. Risk charges attributable to the 2003 and 2002 Hannover Transactions of \$2.2 million, \$1.6 million and \$0.2 million were incurred during 2004, 2003 and 2002, respectively.

The statutory surplus benefit provided by the 2003 Hannover Transaction replaced the statutory surplus benefit previously provided by a financial reinsurance agreement entered into during 2001 with a subsidiary of Swiss Reinsurance Company ("Swiss Re"). The Company terminated this agreement and recaptured all reserves subject to this agreement effective September 30, 2003. The Swiss Re agreement was treated as reinsurance under statutory accounting requirements and as financial reinsurance under GAAP. An amount due to reinsurer (\$10.9 million at December 31, 2002) was recorded under GAAP equal to the amount of the expense allowance received and was being repaid ratably over a five-year period. The termination of this agreement resulted in the full repayment of the amount due to reinsurer. The agreement bore interest at the ninety day London Interbank Offered Rate ("LIBOR") plus 140 basis points. Risk charges and interest expense incurred on the cash portion of the surplus benefit provided by the agreement were \$0.2 million and \$0.6 million for the years ended December 31, 2003 and 2002, respectively. This agreement provided an initial statutory surplus benefit of \$35.0 million in 2001. The statutory surplus benefit remaining at January 1, 2003 was \$30.9 million, all of which was eliminated upon termination of the agreement.

Indemnity Reinsurance

In the normal course of business, the Company seeks to limit its exposure to loss on any single insured and to recover a portion of benefits paid under its life and accident and health insurance products by ceding reinsurance to other insurance enterprises or reinsurers. Reinsurance coverages for life insurance vary according to the age and risk classification of the insured. Reinsurance contracts do not relieve the Company of its obligations to its policyholders. To the extent that reinsuring companies are later unable to meet obligations under reinsurance agreements, the Company's life insurance subsidiaries would be liable for these obligations, and payment of these obligations could result in losses to the Company. To limit the possibility of such losses, the Company evaluates the financial condition of its reinsurers, and monitors concentrations of credit risk. No allowance for uncollectible amounts has been established against the Company's asset for amounts receivable from other insurance companies since none of the receivables are deemed by management to be uncollectible.

6. Income Taxes

The Company files a consolidated federal income tax return with all its subsidiaries.

The Company's income tax expense is as follows:

| | Year ended December 31, | | |
|--------------------------------------------------------------------------------|-------------------------|-----------|-----------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Consolidated statement of income | | | |
| Current income taxes | \$ 37,857 | \$ 15,812 | \$ 18,390 |
| Deferred income taxes | (13,600) | (2,307) | (11,091) |
| Total income tax expense included in consolidated statement of income | 24,257 | 13,505 | 7,299 |
| Stockholders equity | | | |
| Expense (benefit) relating to change in net unrealized investment gains/losses | 1,870 | (5,815) | 11,624 |
| Total income tax expense included in consolidated financial statements | \$ 26,127 | \$ 7,690 | \$ 18,923 |

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Income tax expense in the consolidated statements of income differed from the amount computed at the applicable statutory federal income tax rate (35%) as follows:

| | Year ended December 31, | | |
|--------------------------------------------------------------------------------------------------------------------------|-------------------------|-----------|-----------|
| | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | |
| Income before income taxes and minority interests | \$ 69,541 | \$ 38,945 | \$ 28,951 |
| Income tax expense on income before income taxes and minority interests | \$ 24,339 | \$ 13,631 | \$ 10,133 |
| Tax effect of: | | | |
| Earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts (see note 9) | | | (2,606) |
| State income taxes, net of federal benefit or expense | 120 | (67) | (233) |
| Dividends received deduction | (23) | (11) | (41) |
| Other | (179) | (48) | 46 |
| Income tax expense | \$ 24,257 | \$ 13,505 | \$ 7,299 |
| Effective tax rate | 34.9% | 34.7% | 25.2% |

Deferred income tax assets or liabilities are established for temporary differences between the financial reporting amounts and tax bases of assets and liabilities that will result in deductible or taxable amounts, respectfully, in future years.

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The tax effects of temporary differences that give rise to the deferred tax assets and liabilities at December 31, 2004 and 2003, is as follows:

| | December 31, | |
|-----------------------------------------------------------------------------------------------|------------------------|------------------|
| | 2004 | 2003 |
| | (Dollars in thousands) | |
| Deferred income tax assets: | | |
| Policy benefit reserves | \$ 325,285 | \$ 252,950 |
| Unrealized depreciation on available for sale fixed maturity securities and equity securities | 10,376 | 12,246 |
| Deferred compensation | 2,428 | 859 |
| Net operating loss carryforwards | 4,919 | 5,769 |
| Other | 194 | 951 |
| | 343,202 | 272,775 |
| Deferred income tax liabilities: | | |
| Accrued discount on fixed maturity securities | (7,418) | (15,645) |
| Deferred policy acquisition costs | (259,303) | (195,986) |
| Value of insurance in force acquired | (36) | (73) |
| Amounts due to reinsurers | (5,303) | (1,907) |
| Other | (580) | (331) |
| | (272,640) | (213,942) |
| Net deferred income tax asset | \$ 70,562 | \$ 58,833 |

In the opinion of the Company's management, realization of its deferred income tax assets is more likely than not based on expectations as to the Company's future taxable income and considering all other available evidence, both positive and negative. Therefore, no valuation allowance against deferred tax assets has been established.

At December 31, 2004, the Company has non-life net operating loss carryforwards for Federal tax purposes of \$11.3 million which expire in 2012 through 2023.

7. Notes Payable and Amounts Due Under Repurchase Agreements

In December 2004, the Company issued \$260.0 million of contingent convertible senior notes due December 6, 2024 through a private placement under Rule 144A of the Securities Act of 1933. The notes are unsecured and bear interest at a fixed rate of 5.25% per annum. Interest is payable semi-annually in arrears on June 6 and December 6 of each year, beginning June 6, 2005. In addition to regular interest on the notes, beginning with the six-month interest period ending June 6, 2012, the Company will also pay contingent interest under certain conditions at a rate of 0.5% per annum based on the average trading price of the notes during a specified period.

The notes are convertible at the holders' option prior to the maturity date into cash and shares of the Company's common stock under the following conditions:

during any fiscal quarter, if the closing sale price of the Company's common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the

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fiscal quarter preceding the quarter in which the conversion occurs is more than 120% of the conversion price of the notes in effect on that 30th trading day;

the Company has called the notes for redemption and the redemption has not yet occurred; or

upon the occurrence of specified corporate transactions.

Holders may convert any outstanding notes into cash and shares of the Company's common stock at an initial conversion price per share of \$14.47. This represents a conversion rate of approximately 69.1085 shares of common stock per \$1,000 in principal amount of notes (the "Conversion Rate"). Subject to certain exceptions described in the indenture covering these notes, at the time the notes are tendered for conversion, the value (the "Conversion Value") of the cash and shares of the Company's common stock, if any, to be received by a holder converting \$1,000 principal amount of the notes will be determined by multiplying the Conversion Rate by the "Ten Day Average Closing Stock Price", which equals the average of the closing per share prices of the Company's common stock on the New York Stock Exchange on the ten consecutive trading days beginning on the second trading day following the day the notes are submitted for conversion. The Company will deliver the Conversion Value to holders as follows: (1) an amount in cash (the "Principal Return") equal to the lesser of (a) the aggregate Conversion Value of the notes to be converted and (b) the aggregate principal amount of the notes to be converted, and (2) if the aggregate Conversion Value of the notes to be converted is greater than the Principal Return, an amount in shares (the "Net Shares") equal to such aggregate Conversion Value less the Principal Return (the "Net Share Amount") and (3) an amount in cash in lieu of fractional shares of common stock. The number of Net Shares to be paid will be determined by dividing the Net Share Amount by the Ten Day Average Closing Stock Price.

The Company may redeem some or all of the notes at any time on or after December 15, 2011. In addition, the holders may require the Company to repurchase all or a portion of their notes on December 15, 2011, 2014, and 2019 and upon a change in control, as defined in the indenture governing the notes, holders may require the Company to repurchase all or a portion of their notes for a period of time after the change in control. The redemption price or repurchase price shall be payable in cash and equal to 100% of the principal amount of the notes plus accrued and unpaid interest (contingent interest and liquidated damages, if any) up to but not including the date of redemption or repurchase.

The notes are senior unsecured obligations and rank equally in right of payment with all existing and future senior indebtedness and senior to any existing and future subordinated indebtedness. The notes effectively rank junior in right of payment to any existing and future secured indebtedness to the extent of the value of the assets securing such secured indebtedness. The notes are structurally subordinated to all liabilities of the Company's subsidiaries.

Pursuant to EITF Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings Per Share", the Company will be required to include the dilutive effect of the contingent convertible senior notes in its diluted earnings per share calculation, regardless of whether the market price trigger has been met. Because the notes include a mandatory cash settlement feature for the principal amount, incremental dilutive shares will only exist when the average fair value of the Company's common stock for a reporting period exceeds the initial conversion price per share of \$14.47.

The Company has agreed to file a registration statement pursuant to which it will register the resale of the notes and the shares issuable upon conversion of the notes. If such registration statement

is not filed or declared effective within certain time periods specified in a registration rights agreement between the Company and the initial purchasers of the notes, the Company will be required to pay liquidated damages to the holders of the notes.

On September 22, 2004, the Company entered into a \$50 million revolving line of credit agreement with three banks. The revolving period of the facility will be three years followed by a two-year term out option. The applicable interest rate will be floating at LIBOR plus 1.75% or prime rate, as elected by the Company. There is no amount outstanding under the revolving line of credit at December 31, 2004. Under this agreement, without obtaining a waiver from the lenders, the Company is required to maintain a minimum risk-based capital ratio at American Equity Investment Life Insurance Company, a maximum ratio of senior debt to total capital, and is prohibited from paying dividends on its capital stock in excess of 33% of consolidated net income for the prior year.

At December 31, 2003, the Company had \$31.8 million outstanding under a credit agreement with principal and interest payments paid quarterly. The notes bore interest at (3.57% at December 31, 2003) prime or LIBOR plus a specified margin of up to 2.25%. The Company repaid all outstanding amounts under this agreement during 2004.

As part of its investment strategy, the Company enters into securities repurchase agreements (short-term collateralized borrowings). These borrowings are collateralized by investment securities with fair market values approximately equal to the amount due. Such borrowings averaged \$196.3 million, \$84.6 million, \$46.0 million for the years ended December 31, 2004, 2003 and 2002, respectively. The weighted average interest rate on amounts due under repurchase agreements was 1.60%, 1.35% and 1.59% for the years ended December 31, 2004, 2003 and 2002, respectively.

8. General Agency Commission and Servicing Agreement

The Company has a General Agency Commission and Servicing Agreement ("Servicing Agreement") with American Equity Investment Service Company (the Service Company), wholly-owned by David J. Noble, Chairman, Chief Executive Officer and President of the Company, whereby the Service Company acts as a national supervisory agent with responsibility for paying commissions to agents of the Company. Under the terms of the Servicing Agreement, as amended, the Service Company has paid a portion (ranging from 13.5% to 100%) of the agents' commissions for certain annuity policies issued during 1997-1999 and 2002-2004. In return, the Company has paid and agreed to pay quarterly renewal commissions to the Service Company ranging from .0975% to .375% based upon the account values of the applicable annuity policies issued during those years. No renewal commission is paid unless the underlying policy is in force on the date renewal commissions are calculated pursuant to the terms of the Servicing Agreement.

The Company records a liability to the Service Company for the amounts paid by the Service Company to the Company's agents and capitalizes such amounts as deferred policy acquisition costs. For all years except 2004, renewal commissions are capped and interest expense computed at a 9% imputed interest rate. The liability to the Service Company for policies issued during 2004 was created on December 31, 2004 and quarterly renewal commissions are payable for five years. The effective interest rate based upon the estimated future renewal commissions for these policies as of December 31, 2004 is 14.8%. Actual renewal commission payments may vary from expected based upon the persistency and account value growth of the covered policies.

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During the years ended December 31, 2004, 2003 and 2002, the Service Company paid \$20.0 million, \$14.4 million and \$11.8 million, respectively, to agents of the Company and the Company paid renewal commissions to the Service Company of \$28.1 million, \$22.1 million and \$21.7 million, respectively. Estimated future payments under the Servicing Agreement at December 31, 2004 are as follows (Dollars in thousands):

| | |
|-------------------------------|------------------|
| Year ending December 31: | |
| 2005 | \$ 22,732 |
| 2006 | 5,891 |
| 2007 | 5,659 |
| 2008 | 5,436 |
| 2009 | 5,221 |
| | <u>44,939</u> |
| Amounts representing interest | (9,127) |
| | <u>35,812</u> |
| Net amount | <u>\$ 35,812</u> |

As a source of funding its portion of producing agents' commission payments, the Service Company borrowed funds from Mr. Noble and a third party. The amount payable to Mr. Noble by the Service Company at December 31, 2004 and 2003 was \$3.0 million and \$14.3 million, respectively. As an alternate source of funds for such first year commissions, the Service Company borrowed funds from the Company. Notes receivable from the Service Company under this arrangement are summarized as follows (Dollars in thousands):

| | December 31, | |
|-------------------|------------------|------------------|
| | 2004 | 2003 |
| Interest at 8.75% | \$ 419 | \$ 3,619 |
| Interest at 9.00% | 3,444 | 2,003 |
| Interest at 9.50% | 12,325 | 7,799 |
| Interest at Prime | 16,188 | 14,500 |
| | <u>\$ 16,188</u> | <u>\$ 27,921</u> |

Principal and interest on all loans to the Service Company are payable quarterly over five years from the date of the advance. The Service Company repays the above described indebtedness from the renewal commissions paid to it under the General Agency Commission and Servicing Agreement.

9. Subordinated Debentures

The Company's wholly-owned subsidiary trusts (not consolidated under FIN 46) have issued fixed rate and floating rate trust preferred securities and have used the proceeds from these offerings to purchase subordinated debentures from the Company. The Company also issued subordinated debentures to the trusts in exchange for all of the common securities of each trust. The sole assets of the trusts are the subordinated debentures and any interest accrued thereon. The interest payment dates on the subordinated debentures correspond to the distribution dates on the trust preferred securities issued by the trusts. The trust preferred securities mature simultaneously with the subordinated debentures. The Company's obligations under the subordinated debentures and related agreements provide a full and unconditional guarantee of payments due under the trust preferred

securities. Following is a summary of subordinated debt obligations to the trusts at December 31, 2004 and 2003:

| | December 31, | | Interest Rate | Due Date |
|------------------------------------|-------------------|-------------------|------------------|--------------------|
| | 2004 | 2003 | | |
| (Dollars in thousands) | | | | |
| American Equity Capital Trust I | \$ 24,073 | \$ 26,713 | 8% | September 30, 2029 |
| American Equity Capital Trust II | 77,861 | 77,340 | 5% | June 1, 2047 |
| American Equity Capital Trust III | 27,840 | | Floating | April 29, 2034 |
| American Equity Capital Trust IV | 12,372 | 12,372 | Floating | January 8, 2034 |
| American Equity Capital Trust VII | 10,830 | | Floating | September 14, 2034 |
| American Equity Capital Trust VIII | 20,600 | | Floating | December 22, 2034 |
| | <u>\$ 173,576</u> | <u>\$ 116,425</u> | | |

The interest rate for the floating rate subordinated debentures are based upon the three month London Interbank Offered rate plus 4.00% for Trust III and IV and 3.75% for Trust VII and VIII.

American Equity Capital Trust I issued 865,671 shares of trust preferred securities, of which 2,000 shares are held by one of the Company's subsidiaries. During 2004, 88,000 shares of these trust preferred securities converted into 325,923 shares of the Company's common stock. The remaining 777,761 shares of these trust preferred securities are convertible into 2,872,794 shares of the Company's common stock.

The principal amount of the subordinated debentures issued by the Company to American Equity Capital Trust II ("Trust II") is \$100.0 million. These debentures were assigned a fair value of \$74.7 million at the date of issue (based upon an effective yield-to-maturity of 7%). The difference between the fair value at the date of issue and the principal amount is being accreted over the life of the debentures. The trust preferred securities issued by Trust II were issued to Iowa Farm Bureau Federation, which owns more than 50% of the voting capital stock of FBL Financial Group, Inc. ("FBL"), parent company of Farm Bureau. The consideration received by Trust II in connection with the issuance of its trust preferred securities consisted of fixed income securities of equal value which were issued by FBL.

10. Retirement and Stock Compensation Plans

The Company has adopted a contributory defined contribution plan which is qualified under Section 401(k) of the Internal Revenue Code. The plan covers substantially all full-time employees of the Company, subject to minimum eligibility requirements. Employees can contribute up to 15% of their annual salary (with a maximum contribution of \$13,000 in 2004, \$12,000 in 2003 and \$11,000 in 2002) to the plan. The Company contributes an additional amount, subject to limitations, based on the voluntary contribution of the employee. Further, the plan provides for additional employer contributions based on the discretion of the Board of Directors. Plan contributions charged to expense were \$0.2 million for the year ended December 31, 2004 and \$0.1 million for each of the years ended December 31, 2003 and 2002.

The Company has entered into deferred compensation arrangements with certain officers, directors, and consultants, whereby these individuals agreed to take common stock of the Company at a future date in lieu of cash payments at the time of service. The common stock is to be issued in

conjunction with a "trigger event", as that term is defined in the individual agreements. At December 31, 2004 and 2003, these individuals have earned, and the Company has reserved for future issuance, 377,853 and 345,829 shares of common stock, respectively, pursuant to these arrangements. The Company has accrued liabilities of \$1.9 million and \$1.5 million at December 31, 2004 and 2003, respectively, representing the value associated with the shares earned.

During 1997, the Company established the American Equity Investment NMO Deferred Compensation Plan ("NMO Deferred Compensation Plan") whereby agents can earn common stock in addition to their normal commissions. Awards are calculated using formulas determined annually by the Company's Board of Directors and are generally based upon new annuity deposits. For the years ended December 31, 2004, 2003 and 2002, agents earned the right to receive 414,117 shares, 325,370 shares, and 692,439 shares, respectively. These shares will be distributed at the end of the vesting and deferral period of 9 years. A portion of the awards may be subject to forfeiture if certain production levels are not met over the remaining vesting period. The Company recognizes commission expense as the awards vest. For the years ended December 31, 2004, 2003 and 2002, agents vested in 449,869 shares, 405,796 shares and 476,918 shares of common stock, respectively, and the Company recorded commission expense (which was subsequently capitalized as deferred policy acquisition costs) of \$4.9 million, \$2.6 million and \$2.6 million, respectively, under these plans. Amounts accrued are reported as other liabilities until the shares have been issued. At December 31, 2004, the Company has reserved 2,411,445 shares for future issuance under the plans.

During 2003, the Company created a Rabbi Trust, the NMO Deferred Compensation Trust (the "Trust") and issued 1,591,083 shares of its common stock to the Trust to fund the vested share liability established under the NMO Deferred Compensation Plan. In accordance with FASB's Emerging Issues Task Force Issue No. 97-14, *"Accounting for Deferred Compensation Arrangements where Amounts Earned are Held in a Rabbi Trust and Invested"*, the stock held in the Trust is included as part of common stock issued and outstanding. In the December 31, 2004 consolidated balance sheet, the common shares held in the Rabbi Trust and the related Trust obligation funded by such shares are included in the common stock and additional paid-in-capital components as a respective deduction and addition, with no impact on the reported amount of total stockholders' equity, as the Plan does not permit diversification and must be settled by the delivery of a fixed number of shares of the Company's stock.

Prior to the Company's initial public offering, the Company performed an internal valuation which involved estimates by management to determine a market value as there was no publicly quoted market value for the Company's stock. Those estimates were based upon various factors including past stock transactions with third parties, growth in the Company's revenues, comparison of the Company's growth pattern to other companies and annual valuations completed by investment bankers familiar with the operations of the Company. The results of the internal valuation affected the amount of commission expense recognized (which was capitalized as deferred policy acquisition costs) in connection with the NMO Deferred Compensation Plan as described in the preceding paragraph. The results of the internal valuation of the Company's stock also affected the calculation of earnings per common share assuming dilution by affecting the number of dilutive securities used in the calculation (see Note 13).

The Company has a Stock Option and Warrant Agreement with Mr. Noble (owner of 4% of its outstanding common stock at December 31, 2004) which allows the purchase of 1,200,000 shares of the Company's common stock. Included in this amount are warrants to purchase 240,000 shares of common

stock at \$3.33 per share that were exercised in 2000 and options expiring in 2007 to purchase 600,000 shares of common stock at \$3.33 per share and 360,000 shares of common stock at \$7.33 per share.

During 2000, as a separate deferred compensation agreement, the Company loaned Mr. Noble \$0.8 million pursuant to a forgivable loan agreement. The forgivable loan agreement is with full recourse, and although the proceeds of the loan were used for the exercise of warrants described in the preceding paragraph, the loan is not collateralized by the shares issued in connection with the exercise of these warrants. This loan is repayable in five equal annual installments of principal and interest, each of which may be forgiven if Mr. Noble remains continuously employed by the Company in his present capacity, subject to specified exceptions.

The Company's 1996 Stock Option Plan authorized grants of options to officers, directors and employees for up to 1,200,000 shares of the Company's common stock. In 2000, the Company adopted the 2000 Employee Stock Option Plan which authorizes grants of options to officers and employees on up to 1,800,000 shares of the Company's common stock and the Company adopted the 2000 Directors Stock Option Plan which authorizes grants of options to directors on up to 225,000 shares. All options granted under the 2000 plans have 10 year terms and a six month vesting period after which they become fully exercisable immediately. All options granted under the 1996 plan have 10 year terms and are vested and exercisable.

Changes in the number of stock options outstanding during the years ended December 31, 2004, 2003 and 2002 are as follows:

| | Number of Shares | Weighted- Average Exercise Price per Share | Total Exercise Price |
|-----------------------------------------------|---------------------|--------------------------------------------------------|----------------------------|
| (Dollars in thousands, except per share data) | | | |
| Outstanding at January 1, 2002 | 2,644,952 | \$ 5.66 | \$ 14,978 |
| Granted | | | |
| Cancelled | (15,547) | 9.13 | (142) |
| Exercised | (103) | 9.68 | (1) |
| Outstanding at December 31, 2002 | 2,629,302 | 5.65 | 14,835 |
| Granted | 300,000 | 9.00 | 2,700 |
| Cancelled | (21,640) | 6.69 | (145) |
| Exercised | | | |
| Outstanding at December 31, 2003 | 2,907,662 | 5.98 | 17,390 |
| Granted | 570,000 | 10.80 | 6,156 |
| Cancelled | (17,500) | 9.71 | (170) |
| Exercised | | | |
| Outstanding at December 31, 2004 | 3,460,162 | 6.76 | \$ 23,376 |

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Stock options outstanding at December 31, 2004 (all of which are currently exercisable except for options on 288,000 shares granted in December 2004) are as follows:

| | Number of Shares | Weighted- Average Remaining Life |
|------------------------|---------------------|----------------------------------------|
| Exercise price: | | |
| \$3.33 | 1,060,500 | 2.19 |
| \$4.00 | 346,350 | 2.56 |
| \$5.33 | 114,000 | 3.64 |
| \$7.33 | 568,770 | 3.16 |
| \$8.67 | 18,000 | 4.92 |
| \$9.00 | 291,000 | 8.94 |
| \$9.16 | 22,500 | 9.67 |
| \$9.49 | 4,500 | 9.75 |
| \$9.67 | 495,042 | 6.14 |
| \$9.95 | 3,500 | 9.50 |
| \$10.77 | 288,000 | 10.00 |
| \$11.00 | 245,500 | 9.44 |
| \$12.85 | 2,500 | 9.25 |
| | 3,460,162 | |

At December 31, 2004, the Company had no shares of common stock available for future grant under the 1996 Stock Option Plan, 613,708 shares of common stock available for future grant under the 2000 Employee Stock Option Plan, and 213,000 shares of common stock available for future grant under the 2000 Directors Stock Option Plan.

On December 1, 1997, in connection with a rights offering of shares of the Company's common stock, the Company issued subscription rights to purchase an aggregate of 2,157,375 shares of the Company's common stock to certain officers and directors. The subscription rights have an exercise price of \$5.33 per share, were exercisable immediately, and expire on December 1, 2005. During 2002, the expiration date was extended from December 1, 2002 to December 1, 2005 and the Company recognized compensation expense of \$0.2 million. During 2004, rights with respect to 6,000 shares of the Company's common stock were exercised.

11. Life Insurance Subsidiaries

Prior approval of regulatory authorities is required for the payment of dividends to the Company by its life insurance subsidiaries which exceed an annual limitation. During 2005, American Equity Life could pay dividends to its parent of \$60.9 million, without prior approval from regulatory authorities.

Statutory accounting practices prescribed or permitted by regulatory authorities for the Company's life insurance subsidiaries differ from generally accepted accounting principles. Combined net income for the Company's life insurance subsidiaries as determined in accordance with statutory accounting practices was \$47.7 million, \$25.4 million and \$26.0 million in 2004, 2003 and 2002, respectively, and total statutory capital and surplus of the Company's life insurance subsidiaries was \$608.9 million and \$374.6 million at December 31, 2004 and 2003, respectively.

12. Commitments and Contingencies

The Company leases its home office space and certain equipment under operating leases which expire through December 2008. During the years ended December 31, 2004, 2003 and 2002, rent expense totaled \$1.0 million in each of these years. At December 31, 2004, minimum rental payments due under all noncancellable operating leases with initial terms of one year or more are (dollars in thousands):

| | | |
|--------------------------|----|--------------|
| Year ending December 31: | | |
| 2005 | \$ | 1,030 |
| 2006 | | 577 |
| 2007 | | 126 |
| 2008 | | 68 |
| 2009 | | 5 |
| | \$ | <u>1,806</u> |

Assessments are, from time to time, levied on the Company by life and health guaranty associations in most states in which the Company is licensed to cover losses to policyholders of insolvent or rehabilitated companies. During 2004, the Company paid \$0.6 million in assessments related to the insolvency of London Pacific Life and Annuity Company and established a reserve for future assessments related to this insolvency of \$1.2 million. The Company believes the reserve for guaranty fund assessments is sufficient to provide for future assessments based upon known insolvencies.

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. The Company is currently a defendant in several purported class action lawsuits filed in state courts alleging improper sales practices. In these lawsuits, the plaintiffs are seeking returns of premiums and other compensatory and punitive damages. We have reached a final settlement in one of these cases, the impact of which is expected to be immaterial. The class was certified as such incident to the settlement in that case. No class has been certified in any of the other pending cases as this time. Although the Company has denied all allegations in these lawsuits and intends to vigorously defend against them, the lawsuits are in the early stages of litigation and neither their outcomes nor a range of possible outcomes can be determined at this time. However, the Company does not believe that these lawsuits will have a material adverse effect on its business, financial condition or results of operations.

In addition, the Company is from time to time subject to other legal proceedings and claims in the ordinary course of business, none of which management believe are likely to have a material adverse effect on our financial position, results of operations or cash flows. There can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on the Company's financial position, results of operations or cash flows.

13. Earnings Per Share

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

| | Year ended December 31, | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|------------|------------|
| | 2004 | 2003 | 2002 |
| (Dollars in thousands, except per share data) | | | |
| Numerator: | | | |
| Net income numerator for earnings per common share | \$ 45,284 | \$ 25,440 | \$ 14,207 |
| Interest (dividends in 2002 related to convertible rust preferred securities) on convertible subordinated debentures (net of income tax benefit) | 1,255 | 1,347 | 1,348 |
| Numerator for earnings per common share assuming dilution | \$ 46,539 | \$ 26,787 | \$ 15,555 |
| Denominator: | | | |
| Weighted average common shares outstanding | 37,518,141 | 15,684,932 | 14,528,387 |
| Participating preferred stock | 640,369 | 1,875,000 | 1,875,000 |
| Denominator for earnings per common share | 38,158,510 | 17,559,932 | 16,403,387 |
| Effect of dilutive securities: | | | |
| Convertible subordinated debentures (convertible trust preferred securities in 2002) | 3,005,902 | 3,198,717 | 2,592,514 |
| Stock options and management subscription rights | 1,500,158 | 683,548 | 381,024 |
| Deferred compensation agreements | 431,575 | 727,653 | 1,015,924 |
| Denominator for earnings per common share assuming dilution | 43,096,145 | 22,169,850 | 20,392,849 |
| Earnings per common share | \$ 1.19 | \$ 1.45 | \$ 0.87 |
| Earnings per common share assuming dilution | \$ 1.08 | \$ 1.21 | \$ 0.76 |

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14. Quarterly Financial Information (Unaudited)

Unaudited quarterly results of operations are summarized below.

| Quarter ended | March 31 | June 30 | September 30 | December 31 |
|-----------------------------------------------|----------|----------|--------------|-------------|
| (Dollars in thousands, except per share data) | | | | |
| 2004 | | | | |
| Premiums and product charges | \$ 9,357 | \$ 9,058 | \$ 8,936 | \$ 10,226 |
| Net investment income | 99,361 | 106,586 | 109,783 | 114,196 |
| Realized gains on investments | 379 | 10 | 422 | 132 |
| Change in fair value of derivatives | 5,815 | (4,934) | (19,696) | 47,511 |
| Total revenues | 114,912 | 110,720 | 99,445 | 172,065 |
| Net income | 10,437 | 10,378 | 10,689 | 13,780 |
| Earnings per common share | \$ 0.28 | \$ 0.27 | \$ 0.28 | \$ 0.36 |
| Earnings per common share assuming dilution | \$ 0.25 | \$ 0.25 | \$ 0.26 | \$ 0.33 |
| 2003 | | | | |
| Premiums and product charges | \$ 9,333 | \$ 8,750 | \$ 8,509 | \$ 7,546 |
| Net investment income | 90,696 | 84,235 | 89,299 | 94,299 |
| Realized gains (losses) on investments | 196 | 7,592 | (907) | 65 |
| Change in fair value of derivatives | (13,962) | 33,053 | 6,050 | 27,384 |
| Total revenues | 86,263 | 133,630 | 102,951 | 129,294 |
| Net income | 4,477 | 6,383 | 6,368 | 8,212 |
| Earnings per common share | \$ 0.27 | \$ 0.39 | \$ 0.39 | \$ 0.39 |
| Earnings per common share assuming dilution | \$ 0.23 | \$ 0.34 | \$ 0.34 | \$ 0.32 |

The differences between the change in fair value of derivatives by quarter primarily corresponds to the performance of the indices upon which the Company's call options are based. Earnings per common share for each quarter is computed independently of earnings per common share for the year. As a result, the sum of the quarterly earnings per common share amounts may not equal the earnings per common share for the year.

Schedule I Summary of Investments Other

Than Investments in Related Parties

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

December 31, 2004

| Column A | Column B | Column C | Column D |
|----------------------------------------|----------------------|---------------------|-----------------------------------------------------|
| Type of Investment | Amortized Cost(1) | Fair Value | Amount at which shown in the balance sheet(2) |
| (Dollars in thousands) | | | |
| Fixed maturity securities: | | | |
| Available for sale | | | |
| United States Government and agencies | \$ 1,766,796 | \$ 1,708,249 | \$ 1,708,249 |
| Public utilities | 43,297 | 44,849 | 44,849 |
| Corporate securities | 262,253 | 262,560 | 262,560 |
| Redeemable preferred stocks | 34,848 | 35,368 | 35,368 |
| Mortgage and asset-backed securities | 662,610 | 654,297 | 654,297 |
| | <u>2,769,804</u> | <u>2,705,323</u> | <u>2,705,323</u> |
| Held for investment | | | |
| United States Government and agencies | 4,022,646 | 3,929,928 | 4,022,646 |
| Corporate securities | 75,847 | 75,847 | 75,847 |
| | <u>4,098,493</u> | <u>4,005,775</u> | <u>4,098,493</u> |
| Total fixed maturity securities | 6,868,297 | \$ 6,711,098 | 6,803,816 |
| Equity securities, available for sale: | | | |
| Non-redeemable preferred stocks | 30,472 | \$ 30,509 | 30,509 |
| Common stocks | 8,366 | 7,794 | 7,794 |
| Total equity securities | 38,838 | \$ 38,303 | 38,303 |
| Mortgage loans on real estate | 959,779 | | 959,779 |
| Derivative instruments | 148,006 | | 148,006 |
| Policy loans | 362 | | 362 |
| Cash and cash equivalents | 62,664 | | 62,664 |
| Total investments | \$ 8,077,946 | | \$ 8,012,930 |

(1) On the basis of cost adjusted for repayments and amortization of premiums and accrual of discounts for fixed maturity securities, derivative instruments, and short-term investments, and unpaid principal balance for mortgage loans.

(2) Derivative instruments are carried at estimated fair value.

Schedule II Condensed Financial Information of Registrant

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY (PARENT COMPANY)

Condensed Balance Sheets

(Dollars in thousands)

| | December 31, | |
|----------------------------------------------------------------------------------------------------------|----------------|----------------|
| | 2004 | 2003 |
| Assets | | |
| Cash and cash equivalents | \$ 49,366 | \$ 1,947 |
| Fixed maturity securities, available for sale, at market (amortized cost: 2004 \$100,000; 2003 \$40,000) | 99,617 | 40,024 |
| Equity securities of subsidiary trusts (not eliminated in consolidation) | 5,220 | 3,417 |
| Receivable from subsidiary (eliminated in consolidation) | 345 | 1,420 |
| Receivables from related party | 16,468 | 27,921 |
| Federal income tax recoverable | 1,319 | 1,020 |
| Deferred income tax asset | 5,404 | 6,175 |
| Other assets | 12,372 | 3,149 |
| | <u>190,111</u> | <u>85,073</u> |
| Investment in and advances to subsidiaries | 568,769 | 329,481 |
| | <u>758,880</u> | <u>414,554</u> |
| Total assets | \$ 758,880 | \$ 414,554 |
| Liabilities and Stockholders' Equity | | |
| Liabilities: | | |
| Notes payable | \$ 260,000 | \$ 31,833 |
| Subordinated debentures payable to subsidiary trusts | 173,636 | 116,485 |
| Other liabilities | 3,740 | 2,520 |
| | <u>437,376</u> | <u>150,838</u> |
| Total liabilities | 437,376 | 150,838 |
| Stockholders' equity: | | |
| Series preferred stock | | 625 |
| Common stock | 38,360 | 35,294 |
| Additional paid-in capital | 215,793 | 208,436 |
| Accumulated other comprehensive loss | (19,269) | (22,742) |
| Retained earnings | 86,620 | 42,103 |
| | <u>321,504</u> | <u>263,716</u> |
| Total stockholders' equity | 321,504 | 263,716 |
| | <u>758,880</u> | <u>414,554</u> |
| Total liabilities and stockholders' equity | \$ 758,880 | \$ 414,554 |

See accompanying note to condensed financial statements.

Schedule II Condensed Financial Information of Registrant (Continued)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY (PARENT COMPANY)

Condensed Statements of Income

(Dollars in thousands)

| | Year ended December 31, | | |
|---------------------------------------------------------------------------------------------------------------------|-------------------------|------------------|------------------|
| | 2004 | 2003 | 2002 |
| Revenues: | | | |
| Net investment income | \$ 2,198 | \$ 31 | \$ 20 |
| Dividends from subsidiary (eliminated in consolidation) | | 4,000 | 5,000 |
| Dividends from subsidiary trusts (eliminated in consolidation prior to 2003) | 307 | 214 | 214 |
| Investment advisory fees (eliminated in consolidation) | 10,096 | 5,246 | 1,994 |
| Surplus note interest from subsidiary (eliminated in consolidation) | 4,080 | 4,080 | 2,780 |
| Interest on notes receivable from related party | 1,597 | 1,291 | 2,379 |
| Change in fair value of derivatives | 60 | | |
| Total revenues | 18,338 | 14,862 | 12,387 |
| Expenses: | | | |
| Interest expense on notes payable | 1,749 | 1,486 | 1,901 |
| Interest expense on subordinated debentures issued to subsidiary trusts (eliminated in consolidation prior to 2003) | 9,609 | 7,661 | 7,660 |
| Other operating costs and expenses | 4,504 | 3,013 | 2,453 |
| Total expenses | 15,862 | 12,160 | 12,014 |
| Income before income tax (expense) benefit, equity in undistributed income of subsidiaries and minority interests | 2,476 | 2,702 | 373 |
| Income tax (expense) benefit | (615) | 703 | 1,912 |
| Income before equity in undistributed income of subsidiaries and minority interests | 1,861 | 3,405 | 2,285 |
| Equity in undistributed income of subsidiaries (eliminated in consolidation) | 43,423 | 22,035 | 19,367 |
| Income before minority interests in subsidiaries | 45,284 | 25,440 | 21,652 |
| Minority interests in subsidiaries: | | | |
| Earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts | | | (7,445) |
| Net income | \$ 45,284 | \$ 25,440 | \$ 14,207 |

See accompanying note to condensed financial statements.

Schedule II Condensed Financial Information of Registrant (Continued)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY (PARENT COMPANY)

Condensed Statements of Cash Flows

(Dollars in thousands)

| | Year ended December 31, | | |
|------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|-----------|-----------|
| | 2004 | 2003 | 2002 |
| Operating activities | | | |
| Net income | \$ 45,284 | \$ 25,440 | \$ 14,207 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | | |
| Provision for depreciation and amortization | 247 | 285 | 159 |
| Accrual of discount on equity security | (33) | | |
| Equity in undistributed income of subsidiaries | (43,423) | (22,035) | (19,367) |
| Minority interests in subsidiaries earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts | | | 7,445 |
| Accrual of discount on debenture issued to subsidiary trust | 522 | 522 | 521 |
| Deferred income tax benefit | 912 | (241) | (1,353) |
| Changes in operating assets and liabilities: | | | |
| Receivable from subsidiary | 1,075 | (940) | 20 |
| Receivable from related party | 11,453 | (7,459) | 8,677 |
| Federal income tax recoverable | (299) | (462) | (558) |
| Other assets | (28) | (433) | 343 |
| Amounts due to related parties | (21) | (73) | 100 |
| Other liabilities | 1,240 | 793 | 352 |
| Net cash provided by (used in) operating activities | 16,929 | (4,603) | 10,546 |
| Investing activities | | | |
| Capital contributions to subsidiaries | (152,125) | (125,025) | (50) |
| Acquisition of fixed maturity securities available for sale | (100,000) | (40,000) | |
| Purchases of property, plant and equipment | | (19) | |
| Purchase of surplus notes from subsidiary | | | (10,000) |
| Net cash used in investing activities | (252,125) | (165,044) | (10,050) |

See accompanying note to condensed financial statements.

Schedule II Condensed Financial Information of Registrant (Continued)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY (PARENT COMPANY)

Condensed Statements of Cash Flows (Continued)

(Dollars in thousands)

| | Year ended December 31, | | |
|-----------------------------------------------------|-------------------------|----------------|----------------|
| | 2004 | 2003 | 2002 |
| Financing activities | | | |
| Financing fees incurred and deferred | \$ (9,598) | \$ (610) | \$ (100) |
| Proceeds from notes payable | 260,000 | | 10,000 |
| Repayments of notes payable | (31,833) | (11,500) | (13,334) |
| Proceeds from issuance of subordinated debentures | 57,500 | 12,000 | |
| Net proceeds from issuance of common stock | 7,313 | 171,265 | 137 |
| Dividends paid | (767) | (352) | (163) |
| | <u>282,615</u> | <u>170,803</u> | <u>(3,460)</u> |
| Net cash provided by (used in) financing activities | | | |
| Increase (decrease) in cash and cash equivalents | 47,419 | 1,156 | (2,964) |
| Cash and cash equivalents at beginning of year | 1,947 | 791 | 3,755 |
| | <u>49,366</u> | <u>1,947</u> | <u>791</u> |
| Cash and cash equivalents at end of year | | | |

Supplemental disclosures of cash flow information

Cash paid during the year for interest:

| | | | |
|-------------------------|----------|----------|----------|
| Notes payable | \$ 6,922 | \$ 2,629 | \$ 1,763 |
| Subordinated debentures | 8,518 | 7,139 | 7,139 |

Non-cash investing and financing activities:

| | | | |
|---------------------------------------------------------------------------------------------------------|--------|-----|--|
| Fixed maturity security contributed to subsidiary | 39,562 | | |
| Subordinated debentures issued to subsidiary trust for common equity securities of the subsidiary trust | 1,770 | 372 | |

See accompanying note to condensed financial statements.

Schedule II Condensed Financial Information of Registrant (Continued)

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY (PARENT COMPANY)

Note to Condensed Financial Statements

December 31, 2004

1. Basis of Presentation

The accompanying condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto of American Equity Investment Life Holding Company.

In the parent company financial statements, the Company's investment in and advances to subsidiaries (which includes surplus notes issued by American Equity Life) are stated at cost plus equity in undistributed income (losses) of subsidiaries since the date of acquisition and net unrealized gains/losses on the subsidiaries' fixed maturity securities classified as "available for sale" and equity securities in accordance with SFAS 115, Accounting for Certain Investments in Debt and Equity Securities.

See note 7 to the consolidated financial statements for a description of the parent company's notes payable.

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Schedule IV Reinsurance

AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY

| Column A | Column B | Column C | Column D | Column E | Column F |
|-------------------------------------------------------------|--------------|--------------------------|------------------------------|--------------|----------------------------------|
| | Gross amount | Ceded to other companies | Assumed from other companies | Net amount | Percent of amount assumed to net |
| (Dollars in thousands) | | | | | |
| Year ended December 31, 2004: | | | | | |
| Life insurance in force, at end of year | \$ 2,500,878 | \$ 1,258 | \$ 125,443 | \$ 2,625,063 | 4.78% |
| Insurance premiums and other considerations: | | | | | |
| Annuity and single premium universal life product charges | \$ 29,929 | \$ 7,467 | \$ | \$ 22,462 | % |
| Traditional life and accident and health insurance premiums | 13,399 | 52 | 1,768 | 15,115 | 11.70% |
| | \$ 43,328 | \$ 7,519 | \$ 1,768 | \$ 37,577 | 4.71% |
| Year ended December 31, 2003: | | | | | |
| Life insurance in force, at end of year | \$ 2,580,812 | \$ 1,034 | \$ 141,817 | \$ 2,721,595 | 5.21% |
| Insurance premiums and other considerations: | | | | | |
| Annuity and single premium universal life product charges | \$ 26,025 | \$ 5,573 | \$ | \$ 20,452 | % |
| Traditional life and accident and health insurance premiums | 11,941 | 156 | 1,901 | 13,686 | 13.89% |
| | \$ 37,966 | \$ 5,729 | \$ 1,901 | \$ 34,138 | 5.57% |
| Year ended December 31, 2002: | | | | | |
| Life insurance in force, at end of year | \$ 2,084,417 | \$ 807 | \$ 133,745 | \$ 2,217,355 | 6.03% |
| Insurance premiums and other considerations: | | | | | |
| Annuity and single premium universal life product charges | \$ 17,091 | \$ 1,715 | \$ | \$ 15,376 | % |
| Traditional life and accident and health insurance premiums | 10,421 | 362 | 3,605 | 13,664 | 26.38% |
| | \$ 27,512 | \$ 2,077 | \$ 3,605 | \$ 29,040 | 12.41% |

Item 15. Exhibits and Financial Statement Schedules.**(a) Exhibits:**

| Exhibit No. | Description |
|-------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 | Articles of Incorporation, including Articles of Amendment**++ |
| 3.2 | Articles of Amendment to Articles of Incorporation filed on September 23, 2003# |
| 3.3 | Amended and Restated Bylaws |
| 4.1 | Agreement dated December 4, 1997 between American Equity Investment Life Holding Company and Farm Bureau Life Insurance Company re Right of First Refusal* |
| 4.2 | Stockholders' Agreement dated April 30, 1997 among American Equity Investment Life Holding Company and stockholders* |
| 4.3 | Registration Rights Agreement dated April 30, 1997 between American Equity Investment Life Holding Company and stockholders* |
| 4.4 | Amended and Restated Declaration of Trust of American Equity Capital Trust I dated September 7, 1999 |
| 4.5 | Indenture dated September 7, 1999 between American Equity Investment Life Holding Company and West Des Moines State Bank, as trustee# |
| 4.6 | Trust Preferred Securities Guarantee Agreement dated September 7, 1999 between American Equity Investment Life Holding Company and West Des Moines State Bank, as trustee# |
| 4.7 | Trust Common Securities Guarantee Agreement dated September 7, 1999 between American Equity Investment Life Holding Company and West Des Moines State Bank, as trustee# |
| 4.8 | Indenture dated October 29, 1999 between American Equity Investment Life Holding Company and West Des Moines State Bank, as trustee)# |
| 4.9 | Trust Preferred Securities Guarantee Agreement dated October 29, 1999 between American Equity Investment Life Holding Company and West Des Moines, State Bank, as trustee# |
| 4.10 | Trust Common Securities Guarantee Agreement dated October 29, 1999 between American Equity Investment Life Holding Company and West Des Moines State Bank, as trustee# |
| 4.11 | Indenture dated December 16, 2003, between American Equity Investment Life Holding Company and Wilmington Trust Company, as trustee |
| 4.12 | Guarantee Agreement dated December 16, 2003, between American Equity Investment Life Holding Company and Wilmington Trust Company, as trustee |
| 4.13 | Indenture dated April 29, 2004, between American Equity Investment Life Holding Company and JP Morgan Chase Bank, as trustee |
| 4.14 | Guarantee Agreement dated April 29, 2004, between American Equity Investment Life Holding Company and JP Morgan Chase Bank, as trustee |
| 4.15 | Indenture dated September 14, 2004, between American Equity Investment Life Holding Company and JP Morgan Chase Bank, as trustee |
| 4.16 | Guarantee Agreement dated September 14, 2004, between American Equity Investment Life Holding Company and JP Morgan chase Bank, as trustee |

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- 4.17 Indenture dated December 22, 2004, between American Equity Investment Life Holding Company and JP Morgan Chase Bank, as trustee##
- 4.18 Guarantee Agreement dated December 22, 2004, between American Equity Investment Life Holding Company and JP Morgan Chase Bank, as trustee##
- 4.19 Indenture dated December 6, 2004 between American Equity Investment Life Holding Company and US Bank, as trustee.##
- 4.20 Registration Rights Agreement dated as of December 6, 2004 by and among American Equity Investment Life Holding Company, Deutsche Bank Securities Inc., Raymond James & Associates, Inc., and Advest, Inc.##
- 4.21 First Supplemental Indenture dated December 30, 2004 between American Equity Investment Life Holding Company and US Bank, as trustee.##
- 4.22 Registration Rights Agreement dated as of December 30, 2004 between American Equity Investment Life Holding Company and Deutsche Bank Securities Inc.##
- 9 Voting Trust Agreement dated December 30, 1997 among Farm Bureau Life Insurance Company, American Equity Investment Life Holding Company and David J. Noble, David S. Mulcahy and Debra J. Richardson (Voting Trustees)*
- 10.1 Restated and Amended General Agency Commission and Servicing Agreement dated June 30, 1997 between American Equity Investment Life Insurance Company and American Equity Investment Service Company*
- 10.1-A 1999 General Agency Commission and Servicing Agreement dated as of June 30, 1999 between American Equity Investment Life Insurance Company and American Equity Investment Service Company
- 10.1-B Second Restated and Amended General Agency Commission and Servicing Agreement dated as of October 1, 2002 between American Equity Investment Life Insurance Company and American Equity Investment Service Company
- 10.1-C First Amendment to the 1999 General Agency Commission and Servicing Agreement effective July 1, 2003 between American Equity Investment Life Insurance Company and American Equity Investment Service Company
- 10.1-D First Amendment to Second Restated and Amended General Agency Commission and Servicing Agreement effective December 29, 2004 between American Equity Investment Life Insurance Company and American Equity Investment Service Company##
- 10.2 1996 Stock Option Plan*
- 10.3 Restated and Amended Stock Option and Warrant Agreement dated April 30, 1997 between American Equity Investment Life Holding Company and D.J. Noble*
- 10.4 Warrant to Purchase Common Stock dated May 12, 1997 issued to Sanders Morris Mundy Inc.*
- 10.5 Deferred Compensation Agreements between American Equity Investment Life Holding Company and
 - (a) James M. Gerlach dated June 6, 1996*
 - (b) Terry A. Reimer dated November 11, 1996*
 - (c) David S. Mulcahy dated December 31, 1997*
- 10.6 Forgivable Loan Agreement dated April 30, 2000 between American Equity Investment Life Holding Company and D.J. Noble

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- 10.7 2000 Employee Stock Option Plan
 - 10.8 2000 Director Stock Option Plan
 - 10.9 Coinsurance and Yearly Renewable Term Reinsurance Agreement dated January 1, 2001 between American Equity Investment Life Holding Company and Atlantic International Reinsurance Company LTD.
 - 10.10 Coinsurance Agreement dated December 19, 2001 between American Equity Investment Life Holding Company and EquiTrust Life Insurance Company
 - 10.10-A Coinsurance Agreement dated December 29, 2003 between American Equity Investment Life Holding Company and EquiTrust Life Insurance Company
 - 10.10-B First Amendment to Coinsurance Agreement dated December 29, 2003 between American Equity Investment Life Holding Company and EquiTrust Life Insurance Company
 - 10.11 Amended and Restated Credit Agreement dated December 30, 2002 among American Equity Investment Life Holding Company, West Des Moines State Bank, as co-agent, Fleet National Bank, as documentation agent and U.S. Bank National Association, as agent
 - 10.12 2002 Coinsurance and Yearly Renewable Term Reinsurance Agreement dated November 1, 2002 between American Equity Investment Life Holding Company and Hannover Life Reassurance Company of America
 - 10.13 2003 Coinsurance and yearly Renewable Term Reinsurance Agreement dated September 30, 2003 between American Equity Investment Life Holding Company and Hannover Life Reassurance Company of America#
 - 10.13-A First Amendment to 2003 Coinsurance and yearly Renewable Term Reinsurance Agreement dated September 30, 2003 between American Equity Investment Life Holding Company and Hannover Life Reassurance Company of America
 - 10.14 Form of Change in Control Agreement between American Equity Investment Life Holding Company and each of John M. Matovina, Kevin R. Wingert, Debra J. Richardson and Wendy L. Carlson#
 - 10.15 Form of Change in Control Agreement between American Equity Investment Life Holding Company and each James M. Gerlach and Terry A. Reimer#
 - 10.16 First Amendment dated August 14, 2003 to Amended and Restated Credit Agreement dated December 30, 2002 among American Equity Investment Life Holding Company, West Des Moines State Bank, as co-agent, Fleet National Bank, documentation agent and U.S. National Association, as agent#
 - 10.17 Second Amendment dated October 24, 2003 to Amended and Restated Credit Agreement dated December 30, 2002 among American Equity Investment Life Holding Company, West Des Moines State Bank, as co-agent, Fleet National Bank, as documentation agent and U.S. Bank National Association, as agent#
 - 10.18 Third Amendment dated December 31, 2003, to Amended and Restated Credit Agreement dated December 30, 2002 among American Equity Investment Life Holding Company, West Des Moines State Bank, as co-agent, Fleet National Bank, as documentation agent and U.S. Bank National Association, as agent
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- 10.19 Fourth Amendment dated June 30, 2004 to Amended and Restated Credit Agreement dated December 30, 2002 among American Equity Investment Life Holding Company, West Des Moines State Bank, as co-agent, Fleet National Bank, as documentation agent and U.S. Bank National Association, as agent
- 10.20 Amended and Restated Credit Agreement dated September 22, 2004 among American Equity Investment Life Holding Company, West Des Moines State Bank, LaSalle Bank and U.S. Bank National Association
- 21.1 Subsidiaries of American Equity Investment Life Holding Company
- 23 Consent of Independent Registered Public Accounting Firm
- 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
-

*

Incorporated by reference to American Equity Investment Life Holding Company's Registration Statement on Form 10 dated April 29, 1999

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Incorporated by reference to the Registration Statement on Form 10 dated April 29, 1999 and Post-Effective Amendment No. 1 to the Registration Statement on Form 10 dated July 20, 1999

Incorporated by reference to Form 10-K for the period ended December 31, 1999

Incorporated by reference to Form 10-Q for the period ended June 30, 2000

Incorporated by reference to Form 10-K for the period ended December 31, 2000

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Incorporated by reference to Form 10-K for the period ended December 31, 2001

Incorporated by reference to Form 10-K for the period ended December 31, 2002

Incorporated by reference to Form 10-Q for the period ended June 30, 2003

Incorporated by reference to Form 10-K for the period ended December 31, 2003

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Incorporated by reference to Form 10-Q for the period ended June 30, 2004

Incorporated by reference to Form 10-Q for the period ended September 30, 2004

#

Incorporated by reference to the Registration Statement on Form S-1 dated September 15, 2003, including all pre-effective amendments thereto

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Previously filed with the original Form 10-K for the period ended December 31, 2004

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