

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2002  
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: 0-25985

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 50266  
(Address of principal executive offices)

(515) 221-0002  
(Telephone)

(Former name, former address and former fiscal year, if changed since last report)

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

APPLICABLE TO CORPORATE ISSUERS:

Shares of common stock outstanding at July 29, 2002: 14,442,202

PART I.—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

|  | June 30, 2002 | December 31, 2001 |
|--|---------------|-------------------|
| Assets   |               |                   |
| Cash and investments:  |               |                   |
| Fixed maturity securities:   |               |                   |
| Available for sale, at market (amortized cost: 2002—\$3,686,170; 2001—\$3,101,040) | \$ 3,619,298  | \$ 2,974,761      |

|   |                  |                  |
|---|------------------|------------------|
| Held for investment, at amortized cost (market: 2002—\$673,980; 2001—\$412,378)                             | 683,424          | 454,605          |
| Equity securities, at market (cost: 2002—\$21,666; 2001—\$18,609)   | 21,347           | 18,245           |
| Mortgage loans on real estate   | 182,784          | 108,181          |
| Derivative instruments  | 29,492           | 40,052           |
| Policy loans  | 304              | 291              |
| Cash and cash equivalents   | 146,369          | 184,130          |
|   | <u>4,683,018</u> | <u>3,780,265</u> |
| Total cash and investments  | 4,683,018        | 3,780,265        |
| Receivable from other insurance companies   | 16               | 83               |
| Premiums due and uncollected  | 1,428            | 1,386            |
| Accrued investment income   | 30,397           | 22,100           |
| Receivables from related parties  | 25,701           | 29,978           |
| Property, furniture, and equipment, less allowances for depreciation of \$3,591 in 2002 and \$3,150 in 2001 | 1,602            | 1,622            |
| Value of insurance in force acquired  | 363              | 415              |
| Deferred policy acquisition costs   | 540,221          | 492,757          |
| Intangibles, less accumulated amortization of \$1,047 in 2002 and \$987 in 2001                             | 2,088            | 2,148            |
| Deferred income tax asset   | 43,725           | 51,244           |
| Federal income taxes recoverable  | —                | 4,224            |
| Other assets  | 1,182            | 2,365            |
| Assets held in separate account   | 3,937            | 3,858            |
|   | <u>5,333,678</u> | <u>4,392,445</u> |
| Total assets  | \$ 5,333,678     | \$ 4,392,445     |

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## Liabilities and Stockholders' Equity

### Liabilities:

|  |                  |                  |
|--|------------------|------------------|
| Policy benefit reserves:   |                  |                  |
| Traditional life and accident and health insurance products                          | \$ 30,171        | \$ 25,490        |
| Annuity and single premium universal life products                                   | 4,734,091        | 3,968,455        |
| Other policy funds and contract claims   | 29,857           | 22,046           |
| Amounts due to related party under General Agency Commission and Servicing Agreement | 37,668           | 46,607           |
| Other amounts due to related parties   | 9,640            | 22,990           |
| Notes payable  | 40,000           | 46,667           |
| Amounts due to reinsurer   | 12,954           | 14,318           |
| Amounts due on securities purchased  | 238,957          | 66,504           |
| Federal income taxes payable   | 2,115            | —                |
| Other liabilities  | 29,443           | 32,788           |
| Liabilities related to separate account  | 3,937            | 3,858            |
|  | <u>5,168,833</u> | <u>4,249,723</u> |
| Total liabilities  | 5,168,833        | 4,249,723        |

### Minority interests in subsidiaries:

|   |               |               |
|---|---------------|---------------|
| Company-obligated mandatorily redeemable preferred securities of subsidiary trusts  |               |               |
| Stockholders' equity:   | 100,225       | 100,155       |
| Series Preferred Stock, par value \$1 per share, 2,000,000 shares authorized; 625,000 shares of 1998  |               |               |
| Series A Participating Preferred Stock issued and outstanding   | 625           | 625           |
| Common Stock, par value \$1 per share, 75,000,000 shares authorized; issued and outstanding: 2002—14,442,202 shares; 2001—14,516,974 shares | 14,442        | 14,517        |
| Additional paid-in capital  | 56,877        | 57,452        |
| Accumulated other comprehensive loss  | (18,337)      | (33,531)      |
| Retained earnings   | 11,013        | 3,504         |
|   | <u>64,620</u> | <u>42,567</u> |
| Total stockholders' equity  | 64,620        | 42,567        |
| Total liabilities and stockholders' equity  | \$ 5,333,678  | \$ 4,392,445  |

See accompanying notes.

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

Three Months Ended  
June 30,

Six Months Ended  
June 30,

|   | 2002     | 2001     | 2002     | 2001     |
|---|----------|----------|----------|----------|
| <b>Revenues:</b>  |          |          |          |          |
| Traditional life and accident and health insurance premiums   | \$ 4,383 | \$ 3,333 | \$ 7,320 | \$ 6,615 |
| Annuity and single premium universal life product charges   | 3,459    | 3,185    | 6,476    | 5,847    |
| Net investment income   | 76,592   | 50,725   | 144,178  | 92,355   |
| Realized gains (losses) on sales of investments   | 569      | 583      | (518)    | 739      |
| Change in fair value of derivatives   | (34,314) | (4,934)  | (43,986) | (30,782) |
| Total revenues  | 50,689   | 52,892   | 113,470  | 74,774   |
| <b>Benefits and expenses:</b>   |          |          |          |          |
| Insurance policy benefits and change in future policy benefits  | 2,703    | 2,395    | 5,024    | 4,592    |
| Interest credited to account balances   | 42,801   | 21,667   | 79,023   | 35,515   |
| Change in fair value of embedded derivatives  | (22,756) | 10,677   | (17,411) | 6,487    |
| Interest expense on notes payable   | 539      | 756      | 1,096    | 1,651    |
| Interest expense on General Agency Commission and Servicing Agreement                                       | 949      | 1,479    | 1,999    | 3,062    |
| Other interest expense  | 771      | —        | 888      | 951      |
| Amortization of deferred policy acquisition costs and value of insurance in force acquired                  | 10,756   | 5,437    | 17,942   | 5,876    |
| Other operating costs and expenses  | 6,661    | 3,705    | 9,914    | 7,568    |
| Total benefits and expenses   | 42,424   | 46,116   | 98,475   | 65,702   |
| Income before income taxes, minority interests and cumulative effect of change in accounting principle      | 8,265    | 6,776    | 14,995   | 9,072    |
| Income tax expense  | 2,152    | 1,663    | 3,762    | 1,780    |
| Income before minority interests and cumulative effect of change in accounting principle                    | 6,113    | 5,113    | 11,233   | 7,292    |
| Minority interests in subsidiaries:   |          |          |          |          |
| Earnings attributable to company-obligated mandatorily redeemable preferred securities of subsidiary trusts | (1,862)  | (1,862)  | (3,724)  | (3,724)  |
| Income before cumulative effect of change in accounting principle   | 4,251    | 3,251    | 7,509    | 3,568    |
| Cumulative effect of change in accounting for derivatives   | —        | —        | —        | (799)    |
| Net income  | \$ 4,251 | \$ 3,251 | \$ 7,509 | \$ 2,769 |
| Earnings per common share:  |          |          |          |          |
| Income before cumulative effect of change in accounting principle   | \$ 0.26  | \$ 0.19  | \$ 0.46  | \$ 0.22  |
| Cumulative effect of change in accounting for derivatives   | —        | —        | —        | (0.05)   |
| Earnings per common share   | \$ 0.26  | \$ 0.19  | \$ 0.46  | \$ 0.17  |
| Earnings per common share—assuming dilution:  |          |          |          |          |
| Income before cumulative effect of change in accounting principle   | \$ 0.23  | \$ 0.17  | \$ 0.41  | \$ 0.19  |
| Cumulative effect of change in accounting for derivatives   | —        | —        | —        | (0.04)   |
| Earnings per common share—assuming dilution   | \$ 0.23  | \$ 0.17  | \$ 0.41  | \$ 0.15  |

See accompanying notes.

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

|  | Preferred Stock | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Loss | Retained Earnings | Total Stockholders' Equity |
|--|-----------------|--------------|----------------------------|--------------------------------------|-------------------|----------------------------|
| Balance at January 1, 2001                       | \$ 625          | \$ 14,530    | \$ 57,577                  | \$ (16,876)                          | \$ 2,796          | \$ 58,652                  |
| Comprehensive income:                            |                 |              |                            |                                      |                   |                            |
| Net income for period                            | —               | —            | —                          | —                                    | 2,769             | 2,769                      |
| Change in net unrealized investment gains/losses | —               | —            | —                          | 9,099                                | —                 | 9,099                      |
| Total comprehensive income                       |                 |              |                            |                                      |                   | 11,868                     |

|  |        |           |           |             |           |           |
|--|--------|-----------|-----------|-------------|-----------|-----------|
| Issuance of 4,552 shares of common stock         | —      | 5         | 29        | —           | —         | 34        |
| Balance at June 30, 2001                         | \$ 625 | \$ 14,535 | \$ 57,606 | \$ (7,777)  | \$ 5,565  | \$ 70,554 |
| Balance at January 1, 2002                       | \$ 625 | \$ 14,517 | \$ 57,452 | \$ (33,531) | \$ 3,504  | \$ 42,567 |
| Comprehensive income:                            |        |           |           |             |           |           |
| Net income for period                            | —      | —         | —         | —           | 7,509     | 7,509     |
| Change in net unrealized investment gains/losses | —      | —         | —         | 15,194      | —         | 15,194    |
| Total comprehensive income                       |        |           |           |             |           | 22,703    |
| Net acquisition of 74,772 shares of common stock | —      | (75)      | (575)     | —           | —         | (650)     |
| Balance at June 30, 2002                         | \$ 625 | \$ 14,442 | \$ 56,877 | \$ (18,337) | \$ 11,013 | \$ 64,620 |

Total comprehensive income for the second quarter of 2002 was \$77,550 and was comprised of net income of \$4,251 and a decrease in net unrealized depreciation of available for sale fixed maturity securities and equity securities of \$73,299.

Total comprehensive income for the second quarter of 2001 was \$5,775 and was comprised of net income of \$3,251 and a decrease in net unrealized depreciation of available for sale fixed maturity securities and equity securities of \$2,524.

See accompanying notes.

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

|   | Six months ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2002                         | 2001      |
| <b>Operating activities</b>   |                              |           |
| Net income  | \$ 7,509                     | \$ 2,769  |
| Adjustments to reconcile net income to net cash used in operating activities:                     |                              |           |
| Adjustments related to interest sensitive products:   |                              |           |
| Interest credited to account balances   | 79,023                       | 35,515    |
| Annuity and single premium universal life product charges   | (6,476)                      | (5,847)   |
| Change in fair value of embedded derivatives  | (17,411)                     | 6,487     |
| Increase in traditional life insurance and accident and health reserves                           | 4,681                        | 3,077     |
| Policy acquisition costs deferred   | (87,870)                     | (74,244)  |
| Amortization of deferred policy acquisition costs   | 17,890                       | 5,718     |
| Provision for depreciation and other amortization   | 553                          | 615       |
| Amortization of discount and premiums on fixed maturity securities                                | (53,539)                     | (26,031)  |
| Realized losses (gains) on investments  | 518                          | (739)     |
| Change in fair value of derivatives   | 43,986                       | 30,782    |
| Deferred income taxes   | (662)                        | (4,260)   |
| Reduction of amounts due to related party under General Agency Commission and Servicing Agreement | (8,939)                      | (8,797)   |
| Changes in other operating assets and liabilities:  |                              |           |
| Accrued investment income   | (8,297)                      | (7,787)   |
| Receivables from related parties  | 4,277                        | 7,611     |
| Federal income taxes recoverable/payable  | 6,339                        | 491       |
| Other policy funds and contract claims  | 7,811                        | 2,165     |
| Other amounts due to related parties  | (3,469)                      | (4,000)   |
| Other liabilities   | (3,345)                      | 17,467    |
| Other   | 1,248                        | (2,689)   |
| Net cash used in operating activities   | (16,173)                     | (21,697)  |
| <b>Investing Activities</b>   |                              |           |
| Sales, maturities, or repayments of investments:  |                              |           |
| Fixed maturity securities—available for sale  | 455,737                      | 143,833   |
| Equity securities   | 1,175                        | 3,403     |
| Derivative instruments  | 4,626                        | 1,792     |
| Mortgage loans on real estate   | 1,037                        | —         |
| Acquisition of investments:   | 462,575                      | 149,028   |
| Fixed maturity securities—available for sale  | (828,983)                    | (975,893) |

|  |             |              |
|--|-------------|--------------|
| Fixed maturity securities—held for investment  | (215,161)   | —            |
| Equity securities  | (4,229)     | (14,334)     |
| Mortgage loans on real estate  | (75,640)    | (17,625)     |
| Derivative instruments   | (47,933)    | (41,141)     |
| Policy loans   | (13)        | (31)         |
|  | (1,171,959) | (1,049,024)  |
| Purchases of property, furniture and equipment   | (421)       | (739)        |
| Net cash used in investing activities  | (709,805)   | (900,735)    |
| <b>Financing activities</b>  |             |              |
| Receipts credited to annuity and single premium universal life policyholder account balances | \$ 841,996  | \$ 1,120,697 |
| Return of annuity and single premium universal life policyholder account balances            | (145,098)   | (102,213)    |
| Decrease in amounts due under repurchase agreements  | —           | (110,000)    |
| Repayments of notes payable  | (6,667)     | —            |
| Amounts due to reinsurer   | (1,364)     | 14,875       |
| Net proceeds (payments) from issuance/acquisition of common stock                            | (650)       | 34           |
| Net cash provided by financing activities  | 688,217     | 923,393      |
| Increase (decrease) in cash and cash equivalents   | (37,761)    | 961          |
| Cash and cash equivalents at beginning of period   | 184,130     | 175,724      |
| Cash and cash equivalents at end of period   | \$ 146,369  | \$ 176,685   |
| <b>Supplemental disclosures of cash flow information</b>                                     |             |              |
| Cash paid (received) during period for:  |             |              |
| Interest on notes payable and repurchase agreements  | \$ 2,109    | \$ 2,506     |
| Income taxes—life subsidiary   | (1,915)     | 5,550        |
| Non-cash financing and investing activities:   |             |              |
| Bonus interest deferred as policy acquisition costs  | 13,560      | 8,993        |

See accompanying notes.

**AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**June 30, 2002**  
**(Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements of American Equity Investment Life Holding Company (the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required by GAAP for complete financial statements. The unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring items, which are necessary to present fairly our financial position and results of operations on a basis consistent with the prior audited financial statements. Operating results for the three-month and six-month periods ended June 30, 2002, are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. For further information, refer to our consolidated financial statements and notes for the year ended December 31, 2001 included in our annual report on Form 10-K.

**2. Accounting Changes**

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, *Business Combinations* and SFAS No. 142, *Goodwill and other Intangible Assets*. Under the new Statements, goodwill and intangibles with indefinite lives will no longer be amortized but will be subject to impairment tests at least on an annual basis. Intangible assets with finite lives will continue to be amortized over their estimated useful lives. Value of insurance in force acquired will continue to be amortized over the expected future gross profits of the acquired block of business. The adoption of these Statements on January 1, 2002 did not have a material impact to the Company. The Company's intangible assets at June 30, 2002 consist of deferred debt and trust preferred security costs of \$1,755,000 and other intangible assets not subject to amortization of \$333,000 related to insurance licences acquired in connection with the purchase of an inactive life insurance company in 1996.

**3. Short-Term Bond Transaction**

During the second quarter of 2002, the Company entered into a transaction relating to the short-sale of \$150,000,000 of U.S. Treasury Securities. The transaction was intended to address interest rate exposure and generate capital gains that could be used to offset previously incurred capital losses. As a result of this transaction, the Company recorded short-term capital gains of \$2,406,000, interest income of \$372,000 and interest expense of \$3,191,000 during the second quarter. The net effect of \$413,000 is included in the consolidated statement of income as other interest expense. The Company has an obligation to repurchase, on or before November 14, 2002, \$150,000,000 of U.S. Treasury Securities that had a market value of \$155,532,000 at June 30, 2002. The Company has placed the proceeds of \$157,279,000 from the short sale into an interest-bearing collateral account to provide for the repurchase. At June 30, 2002, the net obligation on this transaction was \$415,000, which included net accrued interest payable of \$2,162,000. This net obligation is included in other liabilities.

**4. General Agency Commission and Servicing Agreement**

The Company has a General Agency Commission and Servicing Agreement with American Equity Investment Service Company (the Service Company), wholly-owned by the Company's chairman, whereby, the Service Company acts as a national supervisory agent with responsibility for paying

commissions to agents of the Company. This Agreement is more fully described in Note 8 to the Audited Financial Statements included in the Company's Form 10-K for December 31, 2001.

During the six months ended June 30, 2002 and 2001, the Company paid renewal commissions to the Service Company of \$10,938,000 and \$11,859,000, respectively, which were used to reduce the amount due under the General Agency Commission and Servicing Agreement, and amounts attributable to imputed interest.

During 1999, the Company agreed to loan to the Service Company up to \$50,000,000 pursuant to a promissory note bearing interest at the "reference rate" of the financial institution which is the Company's principal lender. The Company advanced \$27,000,000 and \$18,175,000 to the Service Company during the years ended December 31, 2000 and 1999, respectively. Principal and interest are payable quarterly over five years from the date of the advance. At June 30, 2002 and December 31, 2001, amounts receivable from the Service Company totaled \$24,946,000 and \$29,139,000, respectively.

## 5. Reclassifications

Certain amounts in the unaudited consolidated financial statements for the period ended June 30, 2001 have been reclassified to conform to the financial statement presentation for June 30, 2002 and December 31, 2001.

## 6. Earnings Per Share

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

|  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2002                           | 2001       | 2002                         | 2001       |
| (Dollars in thousands, except per share data)                        |                                |            |                              |            |
| <b>Numerator:</b>  |                                |            |                              |            |
| Income before cumulative effect of change in accounting principle    | \$ 4,251                       | \$ 3,251   | \$ 7,509                     | \$ 3,568   |
| Cumulative effect of change in accounting for derivative instruments | —                              | —          | —                            | (799)      |
| Net income   | \$ 4,251                       | \$ 3,251   | \$ 7,509                     | \$ 2,769   |
| <b>Denominator:</b>  |                                |            |                              |            |
| Weighted average shares outstanding                                  | 14,523,636                     | 14,534,745 | 14,518,555                   | 14,533,302 |
| Participating preferred stock  | 1,875,000                      | 1,875,000  | 1,875,000                    | 1,875,000  |
| Denominator for earnings per common shares                           | 16,398,636                     | 16,409,745 | 16,393,555                   | 16,408,302 |
| Effect of dilutive securities:                                       |                                |            |                              |            |
| Warrants   | 5,450                          | 20,004     | 9,266                        | 20,004     |
| Stock options and management subscription rights                     | 826,182                        | 1,681,049  | 826,182                      | 1,681,452  |
| Deferred compensation agreements                                     | 1,088,354                      | 753,364    | 1,088,354                    | 753,364    |
| Denominator for earnings per common share—assuming dilution          | 18,318,622                     | 18,864,162 | 18,317,357                   | 18,863,122 |
| Earnings per common share (as previously reported):                  |                                |            |                              |            |
| Income before cumulative effect of change in accounting principle    | N/A                            | N/A        | N/A                          | \$ 0.25    |
| Cumulative effect of change in accounting for derivatives            | N/A                            | N/A        | N/A                          | (0.06)     |
| Earnings per common share (as previously reported)                   | N/A                            | N/A        | N/A                          | \$ 0.19    |
| Earnings per common share (as restated):                             |                                |            |                              |            |
| Income before cumulative effect of change in accounting principle    | \$ 0.26                        | \$ 0.19    | \$ 0.46                      | \$ 0.22    |
| Cumulative effect of change in accounting for derivatives            | —                              | —          | —                            | (0.05)     |
| Earnings per common share (as restated)                              | \$ 0.26                        | \$ 0.19    | \$ 0.46                      | \$ 0.17    |
| Earnings per common share—assuming dilution:                         |                                |            |                              |            |
| Income before cumulative effect of change in accounting principle    | \$ 0.23                        | \$ 0.17    | \$ 0.41                      | \$ 0.19    |

|   |         |         |         |         |
|---|---------|---------|---------|---------|
|   | —       | —       | —       |         |
| Earnings per common share—assuming dilution | \$ 0.23 | \$ 0.17 | \$ 0.41 | \$ 0.15 |

Earnings per common share for the six months ended June 30, 2001 have been restated above on a comparable basis for the adoption of the FASB's Emerging Issues Task Force ("EITF") Issue No. D-95, *"Effect of Participating Convertible Securities on Computation of Basic Earnings Per Share."* EITF D-95 requires the inclusion of the Company's 1998 Series A Participating Preferred Stock, which converts into shares of the Company's common stock on December 31, 2003, in the calculation of earnings per common share. Earnings per share for the three months ended June 30, 2001 were previously restated as part of the Company's 2001 Form 10-K filing.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's discussion and analysis reviews our consolidated financial position at June 30, 2002, and the consolidated results of operations for the periods ended June 30, 2002 and 2001, and where appropriate, factors that may affect future financial performance. This analysis should be read in conjunction with the unaudited consolidated financial statements and notes thereto appearing elsewhere in this Form 10-Q, and the audited consolidated financial statements, notes thereto and selected consolidated financial data appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

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 under the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to known and unknown risks, uncertainties and other factors which may cause actual results to be materially different from those contemplated by the forward-looking statements. Such factors 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 policies
- customer response to new products and marketing initiatives
- mortality and other factors which may affect the profitability of our products
- changes in Federal income tax laws and regulations which may affect the relative income tax advantages of our products
- increasing competition in the sale of annuities
- regulatory changes or actions, including those relating to regulation of financial services affecting (among other things) bank sales and underwriting of insurance products and regulation of the sale, underwriting and pricing of products
- the risk factors or uncertainties listed from time to time in our private placement memorandums or filings with the Securities and Exchange Commission

### Results of Operations

#### *Three and Six Months Ended June 30, 2002 and 2001*

Our business has continued to grow rapidly, with reserves for annuities and single premium universal life policies increasing from \$3,968,455,000 at December 31, 2001 to \$4,734,091,000 at June 30, 2002. Deposits from sales of annuities and single premium universal life policies during the six months ended June 30, 2002, before reinsurance ceded, increased 13% to \$1,266,465,000 compared to \$1,120,697,000 for the same period in 2001. Deposits for the six months ended June 30, 2002 were reduced by \$424,469,000 for amounts ceded to an affiliate insurance company as part of a coinsurance agreement as described in Note 5 of the Notes to Consolidated Financial Statements found in the Annual Report on Form 10-K. The continued strong production is a direct result of the growth in our agency force which increased from 22,000 agents at December 31, 2000 to 34,000 agents at December 31, 2001 and 40,000 agents at June 30, 2002.

Our net income increased 31% to \$4,251,000 for the second quarter of 2002, and 110% to \$7,509,000 for the six months ended June 30, 2002, compared to income before cumulative effect of change in accounting principle of \$3,251,000 and \$3,568,000 for the same periods in 2001. These increases are primarily attributable to an increase in net investment income due to the growth in our invested assets from sales of annuities.

**Traditional life and accident and health insurance premiums** increased 32% to \$4,383,000 for the second quarter of 2002, and 11% to \$7,320,000 for the six months ended June 30, 2002 compared to \$3,333,000 and \$6,615,000 for the same periods in 2001. These changes are principally attributable to corresponding changes in direct sales of life products.

**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 9% to \$3,459,000 for the second quarter of 2002, and 11% to \$6,476,000



for the six months ended June 30, 2002 compared to \$3,185,000 and \$5,847,000 for the same periods in 2001. These increases are principally attributable to the growth in our annuity business and correspondingly, an increase in annuity policy withdrawals subject to surrender charges. Withdrawals from annuity and single premium universal life policies were \$145,098,000 for the six months ended June 30, 2002 compared to \$102,213,000 for the same period in 2001.

**Net investment income** increased 51% to \$76,592,000 in the second quarter of 2002, and 56% to \$144,178,000 for the six months ended June 30, 2002 compared to \$50,725,000 and \$92,355,000 for the same periods in 2001. Invested assets (amortized cost basis) increased 42% to \$4,574,348,000 at June 30, 2002 compared to \$3,205,734,000 at June 30, 2001, while the effective yield earned on invested assets (excluding cash and cash equivalents) was 7.11% for the six months ended June 30, 2002 compared to 7.46% for the same period in 2001.

**Realized gains (losses) on the sale of investments** consisted of net realized gains of \$569,000 in the second quarter of 2002 compared to net realized gains of \$583,000 for the same period in 2001. For the six months ended June 30, 2002, the Company had realized losses of \$518,000 compared to realized gains of \$739,000 for the same period in 2001. In the first six months of 2002, net realized losses of \$518,000 included: (i) net realized gains of \$1,482,000 on the sale of certain corporate fixed maturity and equity securities and (ii) the write down of \$2,000,000 in the fair value of a security in recognition of an "other than temporary" impairment.

**Change in fair value of derivatives** that we hold to fund the annual index credits on our equity index annuities was \$(34,314,000) in the second quarter of 2002, and \$(43,986,000) for the six months ended June 30, 2002 compared to \$(4,934,000) and \$(30,782,000) for the same periods in 2001. The difference between the change in fair value of derivatives between the periods is primarily due to the downward performance of the indexes during these periods upon which our call options are based. We mark to fair value the purchased call options we use to fund the annual index credits on our equity index annuities, and include changes in such fair value as a component of our revenues. See Critical Accounting Policies—Derivative Instruments—Equity Index Products found in the Annual Report on Form 10-K.

**Traditional life and accident and health insurance benefits** increased 13% to \$2,703,000 in the second quarter of 2002, and 9% to \$5,024,000 for the six months ended June 30, 2002 compared to \$2,395,000 and \$4,592,000 for the same periods in 2001. These increases are principally attributable to an increase in death benefits and surrenders.

**Interest credited to annuity policyholder account balances** increased 98% to \$42,801,000 in the second quarter of 2002, and 123% to \$79,023,000 for the six months ended June 30, 2002 compared to \$21,667,000 and \$35,515,000 for the same periods in 2001. These increases are principally attributable to the increase in annuity liabilities.

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The amounts are also impacted by changes in the weighted average crediting rates for our annuity liabilities, which are summarized as follows:

|               | Fixed Rate<br>(without bonuses) | Fixed Rate<br>(with bonuses) | Equity Index<br>Credits | Equity Index<br>Option Costs |
|---------------|---------------------------------|------------------------------|-------------------------|------------------------------|
| June 30, 2002 | 5.37%                           | 5.75%                        | 2.94%                   | 3.99%                        |
| June 30, 2001 | 5.65%                           | 6.19%                        | 1.39%                   | 4.87%                        |

The above crediting rates on our fixed rate annuities includes both multi-year rate guaranteed and annually adjustable rate products. Such rates are disclosed with and without the impact of first-year bonuses paid to policyholders. Generally such bonuses are deducted from the commissions paid to sales agents on such products and deferred as policy acquisition costs. With respect to our equity index annuities, the weighted average option costs represent the expenses we incur to fund the annual index credits on the equity index business. Gains realized on such options are recorded as part of the change in fair value of derivatives and are also reflected as an expense in interest credited to annuity policyholder account balances.

**Change in fair value of embedded derivatives** was \$(22,756,000) in the second quarter of 2002 and \$(17,411,000) for the six months ended June 30, 2002 compared to \$10,677,000 and \$6,487,000 for the same periods in 2001. The difference between the change in fair value of embedded derivatives between the periods is primarily due to the downward performance of the indexes during these periods upon which the liabilities are based. We mark to fair value our equity index annuity reserves, and include changes in such fair value as a component of our expenses. The annual crediting liabilities on our equity index annuities are treated as a "series of embedded derivatives" over the life of the applicable contracts. We estimate the fair value of these future liabilities by projecting the cost of the annual options we will purchase in the future to fund the index credits. See Note 1 of the Notes to Consolidated Financial Statements found in the Annual Report on Form 10-K.

**Interest expense on notes payable** decreased 29% to \$539,000 for the second quarter of 2002, and 34% to \$1,096,000 for the six months ended June 30, 2002 compared to \$756,000 and \$1,651,000 for the same periods in 2001. These decreases are attributable to a decrease in the average cost of funds borrowed and a decrease in the amounts of notes payable due.

**Interest expense on General Agency Commission and Servicing Agreement** decreased 36% to \$949,000 for the second quarter of 2002, and 35% to \$1,999,000 for the six months ended June 30, 2002 compared to \$1,479,000 and \$3,062,000 for the same periods in 2001. These decreases are principally attributable to a decrease in the amounts due under General Agency Commission and Servicing Agreement. See Note 8 of the Notes to Consolidated Financial Statements found in the Annual Report on Form 10-K.

**Other interest expense** totaled \$771,000 for the second quarter of 2002, and \$888,000 for the six months ended June 30, 2002 compared to \$0 and \$951,000 for the same periods in 2001. These amounts primarily consist of interest on amounts due under repurchase agreements and net interest expense on a short-bond transaction. We entered into a short sale of \$150,000,000 of U.S. Treasury Securities during the second quarter of 2002 and have recorded net interest expense of \$413,000 related to this transaction. See Note 3 of the Notes to Consolidated Financial Statements found in this Form 10-Q. Interest expense on amounts due under repurchase agreements decreased from \$951,000 to \$251,000 during the six months ended June 30, 2002 compared to the same period in 2001. This decrease is principally attributable to a decrease in the average balances outstanding. There was no interest expense on amounts due under repurchase agreements in the second quarter of 2001 as there were no borrowings under repurchase agreements during the second quarter of 2001.

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**Amortization of deferred policy acquisition costs and value of insurance in force acquired** increased 98% to \$10,756,000 in the second quarter of 2002, and 205% to \$17,942,000 for the six months ended June 30, 2002 compared to \$5,437,000 and \$5,876,000 for the same periods in 2001. These increases are primarily due to the (i) growth in our annuity business as discussed above; and (ii) the introduction of multi-year rate guaranteed products with shorter expected lives. See Note 1 of the Notes to Consolidated Financial Statements found in the Annual Report on Form 10-K.

**Other operating costs and expenses** increased 80% to \$6,661,000 in the second quarter of 2002, and 31% to \$9,914,000 for the six months ended June 30, 2002 compared to \$3,705,000 and \$7,568,000 for the same periods in 2001. These increases are principally attributable to increases in salary expense, related benefits, professional fees and certain marketing expenses.

**Income tax expense** increased 29% to \$2,152,000 in the second quarter of 2002, and 111% to \$3,762,000 for the six months ended June 30, 2002 compared to \$1,663,000 and \$1,780,000 for the same periods in 2001. These increases are principally due to an increase in pretax income. The effective income tax rate for the 2002 periods is less than the applicable statutory federal income tax rate of 35% because of (i) tax benefits for earnings attributable to redeemable preferred securities of subsidiary trusts and (ii) state income tax benefits on the parent company's non-life loss (life insurance subsidiary taxable income is taxed at the 35% federal income tax rate and not generally subject to state income taxes).

## Financial Condition

### Investments

Cash and investments increased 24% to \$4,683,018,000 at June 30, 2002 compared to \$3,780,265,000 at December 31, 2001 as a result of the growth in our annuity business discussed above offset by a decrease in the fair value of our available-for-sale fixed maturity and equity securities. At June 30, 2002, the fair value of our available-for-sale fixed maturity and equity securities was \$67,191,000 less than the amortized cost of those investments, compared to \$126,643,000 at December 31, 2001. At June 30, 2002, the amortized cost of our fixed maturity securities held for investment exceeded the market value by \$9,444,000, compared to \$42,227,000 at December 31, 2001. The decrease in the net unrealized investment losses at June 30, 2002 compared to December 31, 2001 is related to a decrease of approximately 27 basis points in market interest rates. Such unrealized losses are recognized in the accumulated other comprehensive loss component of stockholders' equity, net of related changes in the amortization patterns of deferred policy acquisition costs and deferred income taxes. The resulting deferred tax asset has been reviewed by management and no related valuation allowance was considered necessary at June 30, 2002. However, if management were to determine that an allowance was required in subsequent 2002 quarters, such amounts would increase the accumulated other comprehensive loss component of stockholders' equity.

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Our investment portfolio is summarized in the tables below:

|   | June 30, 2002   |         | December 31, 2001 |         |
|---|-----------------|---------|-------------------|---------|
|   | Carrying Amount | Percent | Carrying Amount   | Percent |
| (Dollars in thousands)                  |                 |         |                   |         |
| <b>Fixed maturities:</b>                |                 |         |                   |         |
| United States Government and agencies   | \$ 2,993,924    | 63.9%   | \$ 2,087,484      | 55.2%   |
| State, municipal, and other governments | 5,423           | 0.1%    | 5,099             | 0.1%    |
| Public utilities                        | 41,177          | 0.9%    | 38,472            | 1.0%    |
| Corporate securities                    | 478,971         | 10.2%   | 473,556           | 12.5%   |
| Redeemable preferred stocks             | 92,733          | 2.0%    | 92,649            | 2.5%    |
| Mortgage and asset-backed securities    |                 |         |                   |         |
| Government                              | 498,412         | 10.6%   | 528,325           | 14.0%   |
| Non-Government                          | 192,082         | 4.1%    | 203,781           | 5.4%    |
| Total fixed maturities                  | 4,302,722       | 91.8%   | 3,429,366         | 90.7%   |
| Equity securities                       | 21,347          | 0.5%    | 18,245            | 0.5%    |
| Mortgage loans                          | 182,784         | 3.9%    | 108,181           | 2.9%    |
| Derivative instruments                  | 29,492          | 0.6%    | 40,052            | 1.1%    |
| Policy loans                            | 304             | 0.0%    | 291               | 0.0%    |
| Cash and cash equivalents               | 146,369         | 3.2%    | 184,130           | 4.8%    |
| Total cash and investments              | \$ 4,683,018    | 100.0%  | \$ 3,780,265      | 100.0%  |

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At June 30, 2002 and December 31, 2001, the amortized cost and estimated fair value of fixed maturity securities and equity securities that were in an unrealized loss position were as follows:

| June 30, 2002  |                   |                      |
|----------------|-------------------|----------------------|
| Amortized Cost | Unrealized Losses | Estimated Fair Value |

(Dollars in thousands)

|  |                |                   |                           |
|--|----------------|-------------------|---------------------------|
| Fixed maturity securities:             |                |                   |                           |
| Available for sale:                    |                |                   |                           |
| United States Government and agencies  | \$             | 1,081,199         | \$ (12,845) \$ 1,068,354  |
| State, municipal and other governments |                | 5,424             | (1) 5,423                 |
| Public utilities                       |                | 21,209            | (1,539) 19,670            |
| Corporate securities                   |                | 239,268           | (26,734) 212,534          |
| Redeemable preferred stocks            |                | 1,500             | (98) 1,402                |
| Mortgage and asset-backed securities:  |                |                   |                           |
| Government                             |                | 471,647           | (24,492) 447,155          |
| Non-government                         |                | 136,222           | (19,403) 116,819          |
|  | \$             | 1,956,469         | \$ (85,112) \$ 1,871,357  |
| Held for investment:                   |                |                   |                           |
| United States Government and agencies  | \$             | 508,620           | \$ (14,838) \$ 493,782    |
|  | \$             | 508,620           | \$ (14,838) \$ 493,782    |
| Equity securities:                     |                |                   |                           |
| Non-redeemable preferred stocks        | \$             | 6,850             | \$ (130) \$ 6,720         |
| Common stocks                          |                | 2,550             | (273) 2,277               |
|  | \$             | 9,400             | \$ (403) \$ 8,997         |
| December 31, 2001                      |                |                   |                           |
|  | Amortized Cost | Unrealized Losses | Estimated Fair Value      |
| (Dollars in thousands)                 |                |                   |                           |
| Fixed maturity securities:             |                |                   |                           |
| Available for sale:                    |                |                   |                           |
| United States Government and agencies  | \$             | 1,334,060         | \$ (64,631) \$ 1,269,429  |
| State, municipal and other governments |                | 5,234             | (135) 5,099               |
| Public utilities                       |                | 29,364            | (1,368) 27,996            |
| Corporate securities                   |                | 320,703           | (27,228) 293,475          |
| Redeemable preferred stocks            |                | 3,528             | (188) 3,340               |
| Mortgage and asset-backed securities:  |                |                   |                           |
| Government                             |                | 493,295           | (23,854) 469,441          |
| Non-government                         |                | 168,321           | (21,366) 146,955          |
|  | \$             | 2,354,505         | \$ (138,770) \$ 2,215,735 |
| Held for investment:                   |                |                   |                           |
| United States Government and agencies  | \$             | 379,011           | \$ (45,210) \$ 333,801    |
|  | \$             | 379,011           | \$ (45,210) \$ 333,801    |
| Equity securities:                     |                |                   |                           |
| Non-redeemable preferred stocks        | \$             | 6,850             | \$ (130) \$ 6,720         |
| Common stocks                          |                | 2,992             | (252) 2,740               |
|  | \$             | 9,842             | \$ (382) \$ 9,460         |

The amortized cost and estimated fair value of fixed maturity securities at June 30, 2002 and December 31, 2001, 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-backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

| June 30, 2002      |                      |                     |                      |
|--------------------|----------------------|---------------------|----------------------|
| 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       | \$ 9,800            | \$ 7,910            | \$ —              | \$ —              |
| Due after five years through ten years      | 42,234              | 36,020              | —                 | —                 |
| Due after ten years through twenty years    | 188,286             | 180,401             | —                 | —                 |
| Due after twenty years                      | 1,108,280           | 1,083,052           | 508,620           | 493,782           |
|   | <u>1,348,600</u>    | <u>1,307,383</u>    | <u>508,620</u>    | <u>493,782</u>    |
| Mortgage-backed and asset-backed securities | 607,869             | 563,974             | —                 | —                 |
|   | <u>\$ 1,956,469</u> | <u>\$ 1,871,357</u> | <u>\$ 508,620</u> | <u>\$ 493,782</u> |

December 31, 2001

|   | 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       | \$ 4,718            | \$ 4,554             | \$ —                | \$ —                 |
| Due after five years through ten years      | 69,715              | 66,307               | —                   | —                    |
| Due after ten years through twenty years    | 377,480             | 351,674              | —                   | —                    |
| Due after twenty years                      | 1,240,976           | 1,176,804            | 379,011             | 333,801              |
|   | <u>1,692,889</u>    | <u>1,599,339</u>     | <u>379,011</u>      | <u>333,801</u>       |
| Mortgage-backed and asset-backed securities | 661,616             | 616,396              | —                   | —                    |
|   | <u>\$ 2,354,505</u> | <u>\$ 2,215,735</u>  | <u>\$ 379,011</u>   | <u>\$ 333,801</u>    |

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

|                        |                    | June 30, 2002 |         |
|------------------------|--------------------|---------------|---------|
| NAIC                   | Rating Agency      | Carrying      | Percent |
| (Dollars in thousands) |                    |               |         |
| 1                      | Aaa/Aa/A           | \$ 3,900,573  | 90.7%   |
| 2                      | Baa                | 332,888       | 7.7%    |
| 3                      | Ba                 | 53,324        | 1.2%    |
| 4                      | B                  | 15,937        | 0.4%    |
| 5                      | Caa and lower      | —             | —       |
| 6                      | In or near default | —             | —       |
| Total fixed maturities |                    | \$ 4,302,722  | 100.0%  |

Approximately 75% and 69% of our total invested assets were in United States Government and agency fixed maturity securities including government guaranteed mortgage-backed securities at June 30, 2002 and December 31, 2001, respectively. Corporate securities represented approximately

10% and 13% at June 30, 2002 and December 31, 2001 of our total invested assets, respectively. There are no other significant concentrations in the portfolio by type of security or by industry.

At June 30, 2002 and December 31, 2001, the fair value of investments we owned that were non-investment grade or non rated was \$72,583,000 and \$52,522,000, respectively. The unrealized losses on investments we owned that were non-investment grade or not rated at June 30, 2002 and December 31, 2001, was \$19,804,000 and \$7,156,000, respectively.

At June 30, 2002 and December 31, 2001, 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 which are listed below by length of time these invested assets have been in an unrealized loss position. We have excluded from this list securities with unrealized losses which are related to market movements in interest rates.

| June 30, 2002          |                   |            |
|------------------------|-------------------|------------|
| Amortized Cost         | Unrealized Losses | Fair Value |
| (Dollars in thousands) |                   |            |

|                                    |                       |                          |                   |
|------------------------------------|-----------------------|--------------------------|-------------------|
| 3 months or less                   | \$ —                  | \$ —                     | \$ —              |
| Greater than 3 months to 6 months  | 9,843                 | (4,243)                  | 5,600             |
| Greater than 6 months to 9 months  | 5,026                 | (1,170)                  | 3,856             |
| Greater than 9 months to 12 months | 16,186                | (2,986)                  | 13,200            |
| Greater than 12 months             | 42,083                | (13,198)                 | 28,885            |
|                                    | <u>\$ 73,138</u>      | <u>\$ (21,597)</u>       | <u>\$ 51,541</u>  |
| <b>December 31, 2001</b>           |                       |                          |                   |
|                                    | <u>Amortized Cost</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> |
| (Dollars in thousands)             |                       |                          |                   |
| 3 months or less                   | \$ 8,361              | \$ (1,075)               | \$ 7,286          |
| Greater than 3 months to 6 months  | 24,968                | (5,418)                  | 19,550            |
| Greater than 6 months to 9 months  | 9,547                 | (1,155)                  | 8,392             |
| Greater than 9 months to 12 months | 26,664                | (7,849)                  | 18,815            |
| Greater than 12 months             | —                     | —                        | —                 |
|                                    | <u>\$ 69,540</u>      | <u>\$ (15,497)</u>       | <u>\$ 54,043</u>  |

We have reviewed these investments and concluded that there was no other than temporary impairment on these investments at June 30, 2002 and December 31, 2001. The factors that we considered in making this determination included the financial condition and near-term prospects of the issuer, whether the issuer is current on all payments and all contractual payments have been made, our intent and ability to hold the investment to allow for any anticipated recovery and the length of time and extent to which the fair value has been less than cost.

During 2001, we began a commercial mortgage loan program. At June 30, 2002, we held \$182,784,000 of mortgage loans compared to \$108,181,000 at December 31, 2001. 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. At June 30, 2002, the

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

| <b>June 30, 2002</b>              |                   |                |
|-----------------------------------|-------------------|----------------|
|                                   | <b>Carrying</b>   | <b>Percent</b> |
| <b>(Dollars in thousands)</b>     |                   |                |
| <b>Geographic distribution</b>    |                   |                |
| East North Central                | \$ 25,746         | 14.1%          |
| East South Central                | 15,913            | 8.7%           |
| Middle Atlantic                   | 24,019            | 13.1%          |
| New England                       | 8,044             | 4.4%           |
| South Atlantic                    | 65,683            | 35.9%          |
| Mountain                          | 7,644             | 4.2%           |
| Pacific                           | 3,992             | 2.2%           |
| West North Central                | 31,743            | 17.4%          |
| Total                             | <u>\$ 182,784</u> | <u>100.0%</u>  |
| <b>June 30, 2002</b>              |                   |                |
|                                   | <b>Carrying</b>   | <b>Percent</b> |
| <b>(Dollars in thousands)</b>     |                   |                |
| <b>Property type distribution</b> |                   |                |
| Office                            | \$ 72,463         | 39.6%          |
| Retail                            | 47,940            | 26.2%          |
| Industrial                        | 43,157            | 23.6%          |
| Hotel                             | 13,037            | 7.1%           |
| Apartments                        | 974               | 0.5%           |
| Mixed use/other                   | 5,213             | 3.0%           |
| Total                             | <u>\$ 182,784</u> | <u>100.0%</u>  |

We did not issue any debt securities during the first six months of 2002, although certain restrictive covenants of our credit agreement related to the Company's notes payable have been amended during 2002. For information related to the Company's notes payable and requirements under the related credit agreement, see Note 7 of the Notes to Consolidated Financial Statements found in the Annual Report on Form 10-K.

The statutory capital and surplus of our life insurance subsidiaries at June 30, 2002 was \$174,359,000. The life insurance subsidiaries made surplus note interest payments to us of \$1,480,000 during the six months ended June 30, 2002. For the remainder of 2002, up to \$17,800,000 can be distributed by the life insurance subsidiaries as dividends without prior regulatory approval. Dividends may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. Our life insurance subsidiaries have \$5,551,000 of earned surplus at June 30, 2002.

The transfer of funds by our life insurance subsidiary, American Equity Investment Life Insurance Company ("American Equity Life"), is also restricted by certain covenants in our bank credit facility, which, among other things, requires American Equity Life to maintain statutory capital and surplus (including asset valuation and interest maintenance reserves) equal to a minimum of \$140,000,000 plus 25% of statutory net income and 75% of the capital contributions to life insurance subsidiary for periods subsequent to December 31, 2000. Under the most restrictive of these limitations,

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approximately \$8,393,000 of our earned surplus at June 30, 2002 would be available for distribution by American Equity Life to the parent company in the form of dividends or other distributions.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We seek to invest our available funds in a manner that will maximize shareholder value and fund future obligations to policyholders and debtors, subject to appropriate risk considerations. We seek to meet this objective through investments that: (i) consist predominately of investment grade fixed maturity securities of very high credit quality; (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 zero coupon 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 and the market value of our investments. 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 equity-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. At June 30, 2002, the effective duration of our cash and invested assets backing our insurance liabilities was approximately 7.78 years and the estimated duration of our insurance liabilities was approximately 6.84 years.

If interest rates were to increase 10% from levels at June 30, 2002, we estimate that the fair value of our fixed maturity securities, net of corresponding changes in the values of deferred policy acquisition costs and insurance in force acquired would decrease by approximately \$197,871,000. 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.

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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.

At June 30, 2002, 71.2% of our fixed income securities have call features and 28.1% are subject to current redemption. Another 28.3% will become subject to call redemption through December 31, 2002. During the six months ended June 30, 2002, we received \$138,000,000 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 credited income on our annuity liability reserves, we have the ability to reduce crediting rates on most of our annuity liabilities to maintain the spread at our targeted level. Approximately 73% of our annuity liabilities are subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates of 3% to 4%.

With respect to our equity index business, we purchase call options on the applicable equity indexes 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. Our risk associated with the current options we hold is limited to the cost of such options. Market value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for equity-indexed products. For the six months ended June 30, 2002, we realized gains of \$4,626,000 on our equity index options, and we credited \$4,495,000 to policy holders. On the respective anniversary dates of the equity 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 equity index business. This is a risk we manage through the terms of our equity index annuities, which permit us to change annual participation rates, asset fees, and/or caps, subject to guaranteed minimums. By reducing participation rates, asset fees or caps, we can limit option costs to budgeted amounts except in cases where the minimum guarantees would prevent further reductions. Based upon actuarial testing conducted as a part of the design of our equity index product, we believe the risk that minimum guarantees would prevent us from controlling option costs is negligible.

## PART II. OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

- (c) In May 2002, certain shareholders exercised warrants to purchase 34,125 shares of common stock at \$4.00 per share, resulting in proceeds of approximately \$136,500.

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

- (a) The Company's annual shareholders' meeting was held on June 6, 2002.
- (b) and (c) (i) Election of the following directors to the Company's Board of Directors:

|                  | FOR        | AGAINST OR<br>WITHHELD |
|------------------|------------|------------------------|
| James M. Gerlach | 11,993,002 | 1,959                  |
| Ben T. Morris    | 11,993,002 | 1,959                  |
| David S. Mulcahy | 11,993,002 | 1,959                  |

- (ii) Ratification of the appointment of Ernst & Young, LLP as Independent Auditors for 2002. There were 11,992,893 votes for the ratification; 0 cast against; and 2,068 abstentions.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) Exhibits:

None

- (b) No reports on Form 8-K were filed during the quarter ended June 30, 2002.

## SIGNATURES

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

Date: July 31, 2002

AMERICAN EQUITY INVESTMENT LIFE  
HOLDING COMPANY

By: /s/ DAVID J. NOBLE

David J. Noble,  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ WENDY L. CARLSON

Wendy L. Carlson,  
Chief Financial Officer  
(Principal Financial Officer)

Ted M. Johnson,  
Vice President—Accounting  
(Principal Accounting Officer)

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